

# City and County of San Francisco

## Fixed Assets

### *Definitions and Guidelines*



## Contents

|  |    |
|--|----|
| ABOUT FIXED ASSETS .....   | 3  |
| Introduction .....   | 3  |
| Fixed Asset Definitions .....  | 3  |
| Capitalization Thresholds .....  | 4  |
| Land and Land Improvements .....   | 4  |
| Land Definition .....  | 4  |
| Land Improvement Definition .....  | 4  |
| Buildings and Building Improvements .....  | 5  |
| Building Definition .....  | 5  |
| Building Improvement Definition .....  | 5  |
| Maintenance Expense (DO NOT CAPITALIZE) .....  | 6  |
| Contributed Assets .....   | 7  |
| Construction-in-Progress .....   | 7  |
| Construction-in-Progress Definition .....  | 7  |
| Accumulating and Tracking Construction Costs .....                                   | 7  |
| Reporting Construction-in-Progress on Government-wide Financial Statements .....     | 8  |
| Placing Constructed Assets into Service .....  | 8  |
| Capitalization of Interest .....   | 9  |
| Intangible Assets .....  | 11 |
| Recognition Criteria .....   | 11 |
| Internally Generated Intangible Assets .....   | 11 |
| Internally Generated Intangible Assets Criteria .....                                | 11 |
| Internally Generated Computer Software .....   | 12 |
| Amortization of Intangible Assets .....  | 13 |
| DISPOSING FIXED ASSETS .....   | 13 |
| Disposal of Assets .....   | 13 |
| Disposing Federal/Grant-Funded Assets .....  | 14 |
| CAPITAL ASSETS IMPAIRMENT .....  | 14 |
| Definition of Impairment .....   | 14 |
| TRANSFERRING FIXED ASSETS .....  | 15 |
| Transfers of Assets .....  | 15 |
| Definition of Transfers .....  | 15 |
| Transfer Policy .....  | 15 |
| Intra-Department Transfer .....  | 15 |
| Inter-Department Transfer .....  | 15 |
| CALCULATING ASSET COST AND DEPRECIATION .....  | 16 |
| Depreciation Definition .....  | 16 |
| Asset Cost or Acquisition Value .....  | 16 |
| Asset Salvage Value .....  | 16 |
| Asset Estimated Useful Life .....  | 16 |
| Depreciation Method to Calculate an Asset's Depreciation .....                       | 17 |
| Depreciating an Asset that was not Purchased at the Beginning of a Fiscal Year ..... | 17 |
| DEPARTMENT'S MONITORING RESPONSIBILITIES .....                                       | 18 |
| Monitoring Depreciation Expense .....  | 18 |
| Maintaining Inventory Controls .....   | 18 |
| Department's Responsibility for Inventory .....                                      | 18 |
| REPORTING DEPRECIATION AND FIXED ASSETS .....  | 19 |
| Reporting Depreciation Expense in the Financial Statements .....                     | 19 |
| Reporting Fixed Assets in the Financial Statements .....                             | 19 |
| APPENDIX A .....   | 21 |
| Suggested Useful Lives for Non-Infrastructure Fixed Assets .....                     | 21 |

|  |    |
|--|----|
| APPENDIX B .....   | 23 |
| Suggested Useful Lives for Infrastructure Fixed Assets.....                                  | 23 |
| APPENDIX C .....   | 24 |
| FAACS Input Form .....   | 24 |
| APPENDIX D .....   | 26 |
| FAACS Retired/Disposed Assets Form.....  | 26 |
| APPENDIX E .....   | 28 |
| FAACS CIP Transfer Form .....  | 28 |
| APPENDIX F .....   | 30 |
| Conducting the Physical Inventory.....   | 30 |
| APPENDIX G .....   | 33 |
| Excerpts from the Financial Accounting Standards Board (FASB) Statement Nos. 34 and 62 ..... | 33 |
| APPENDIX H .....   | 36 |
| Summary of the Governmental Accounting Standards Board (GASB) Statement No. 42 .....         | 36 |
| APPENDIX I.....  | 37 |
| Summary of the Governmental Accounting Standards Board (GASB) Statement No. 51 .....         | 37 |

# CITY AND COUNTY OF SAN FRANCISCO FIXED ASSET DEFINITIONS AND GUIDELINES

## ABOUT FIXED ASSETS

### *Introduction*

This document describes the policies and guidelines for fixed assets acquired or constructed in the City and County of San Francisco. Detailed processing procedures for entering fixed assets into the Fixed Assets Accounting and Control System (FAACS) are provided in the FAACS manual entitled "FAACS 4.2 Hold File Fundamentals for Fixed Assets Accounting".

Fixed Assets are required to be reported in the City's Comprehensive Annual Financial Report (CAFR) for both the primary government and the business-type activities. Fixed assets are reported by major classes such as Land, Construction-in-Progress, Facilities and Improvements, Machinery and Equipment, Easements, and Infrastructure. Fixed assets that are not being depreciated are disclosed separately from those that are being depreciated. Fixed assets are disclosed in the Statement of Net Assets and details are provided in notes to the basic financial statements.

The following sections describe definitions and guidelines to be followed in determining the various categories of fixed assets as well as reporting requirements

### *Fixed Asset Definitions*

Fixed assets are real or personal property that have a value equal to or greater than the capitalization threshold for the particular classification of the asset (generally greater than \$5,000) and have an estimated life of greater than one year. The City has invested in a broad range of fixed assets that are used in the City's operations, which include:

- Land and land improvements
- Buildings and building improvements
- Facilities and other improvements
- Infrastructure
- Personal property
- Furniture and equipment
- Vehicles and boats
- Software developed for internal use
- Other assets
- Construction in progress
- Leasehold improvements

Works of art, historical treasures, library books, and zoological animals held for public exhibition, education, or research in furtherance of public service, rather than financial gain, are not capitalized. These items are protected, kept unencumbered, cared for and preserved by the City. It is the City's policy to utilize proceeds from the sale of these items for the acquisition of other items for collection and display.

## **Capitalization Thresholds**

Standard capitalization thresholds for capitalizing assets have been established for each major class of assets. All City departments are required to use these thresholds.

| <b>Class of Asset</b>                  | <b>Threshold</b> |
|--|------------------|
| Land and land improvements             | Capitalize all   |
| Infrastructure                         | \$100,000        |
| Buildings and building improvements    | \$100,000        |
| Leasehold improvements                 | \$100,000        |
| Construction-In-Progress               | \$100,000        |
| Equipment                              | \$ 5,000         |
| Intangible (Software, easements, etc.) | \$100,000        |

Justification for any deviation from these thresholds shall be documented on the fixed asset change form that is to be maintained on file by the departmental property managers. For purposes of determining whether the value of a potential asset exceeds the above capitalization thresholds, departments shall consider all costs associated with the acquisition or construction of the item, and group individual components of an item such as a desktop computer into a single unit. Items of similar nature such as chairs, desks, etc., should be viewed individually for purposes of determining whether to capitalize the cost of acquiring the item.

## **Land and Land Improvements**

### **Land Definition**

Land is the surface or crust of the earth, which can be used to support structures, and may be used to grow grass, shrubs, and trees. Land is characterized as having an unlimited life (indefinite).

### **Land Improvement Definition**

Land improvements consist of betterments, site preparation, and site improvements (other than buildings) that ready land for its intended use. The costs associated with improvements to land are added to the cost of the land.

Land improvements include items such as excavation, non-infrastructure utility installation, driveways, sidewalks, parking lots, flagpoles, retaining walls, fencing, outdoor lighting, and other non-building improvements intended to make the land ready for its intended purpose. Land improvements can be further categorized as non-exhaustible and exhaustible.

**Non-Exhaustible** – Expenditures for improvements that do not require maintenance or replacement; expenditures to bring land into condition to commence erection of structures; expenditures for improvements not identified with structures; and expenditures for land improvements that do not deteriorate with use or passage of time are additions to the cost of land, are generally not exhaustible, and therefore, not depreciable.

**Exhaustible** – Other improvements that are part of a site, such as parking lots, landscaping, and fencing, are usually exhaustible and are therefore depreciable. Depreciation of site improvements is necessary if the improvement is exhaustible.

Capitalization Threshold: All acquisitions of land and land improvements will be capitalized.

### **Examples of expenditures to be capitalized as Land and Land Improvements**

- Purchase price or fair market value at time of gift
- Commissions
- Professional fees (title searches, architect, legal, engineering, appraisal, surveying, environmental assessments, etc.)
- Land excavation, fill, grading, drainage
- Demolition costs of existing buildings and improvements (less salvage) on land purchased with the intent to demolish and rebuild will be included in the cost of the land. (Please note that demolition costs related to assets already placed in service should be expensed).
- Removal, relocation, or reconstruction of property of others (railroad, telephone, and power lines)
- Interest on mortgages accrued at date of purchase
- Accrued and unpaid taxes at date of purchase
- Other costs incurred in acquiring the land
- Water wells (includes initial cost for drilling, the pump and its casing)

## **Buildings and Building Improvements**

### **Building Definition**

A building is a structure that is permanently attached to the land, has a roof, is partially or completely enclosed by walls, and is not intended to be transportable or moveable. Buildings should be recorded at either their acquisition cost or construction cost. The cost of new construction should be carefully evaluated. Usually projects consist of major components such as land, land improvements, building construction (including professional fees and permits), furniture, fixtures, and equipment. In addition, buildings include components (e.g., roof, air conditioner system, etc.) that should be recorded separately when significant because these building components have different useful lives. The value of each component needs to be determined and placed within its own category.

### **Building Improvement Definition**

Building improvements are capital events that materially extend the useful life of a building or increase the value of a building, or both. A building improvement should be capitalized as a betterment and recorded as an addition of value to an existing building if the expenditure for the improvement is at the capitalization threshold, or the expenditure increases the life or value of the building by 25 percent of the original life period or cost.

For a replacement to be capitalized, it must be a part of a major repair or rehabilitation project, which increases the value, and/or useful life of the building, such as the renovation of a health center. A replacement may also be capitalized if the new item/part is of significantly improved quality and higher value compared to the old item/part such as replacement of an old shingle roof with a new fireproof tile roof. Replacement or restoration to original utility level would not qualify. Determinations must be made on a case-by-case basis.

### **Examples of Building Improvements**

- Roofing projects
- Major energy conservation projects
- Remodeling or replacing major building components
- Conversion of attics, basements, etc., to usable office, clinic, or research space
- Structures attached to the building such as covered garages, enclosed stairwells, etc.
- Installation or upgrade of heating and cooling systems, including ceiling fans and attic vents
- Original installation/upgrade of wall or ceiling covering such as carpeting, tiles, paneling, or parquet
- Structural changes such as reinforcement of floors or walls, installation or replacement of beams, rafters, joists, steel grids, or other interior framing
- Installation or upgrade of window or door frame, upgrading of windows, built-in closets and cabinets
- Interior renovation associated with casings, baseboards, light fixtures, ceiling trim, etc.
- Exterior renovation such as installation or replacement of siding, roofing, masonry, etc.
- Installation or upgrade of plumbing and electrical wiring
- Installation or upgrade of phone or closed circuit television systems, networks, fiber optic cable, wiring required in the installation of equipment (that will remain in the building)
- Other costs associated with the above improvements
- Fencing and gates,
- Landscaping
- Parking lots/driveways/parking barriers
- Outside sprinkler systems
- Recreation areas and athletic fields (including bleachers)
- Golf courses
- Paths and trails
- Septic systems
- Stadiums
- Swimming pools, tennis courts, basketball courts
- Fountains
- Plazas and pavilions
- Retaining walls

Depreciation Methodology: The straight-line depreciation method (historical cost-residual value)/useful life will be used for buildings, building improvements and their components. Subsequent improvements that change the use or function of the building shall be depreciated.

### **Maintenance Expense (DO NOT CAPITALIZE)**

The following are examples of expenditures NOT to capitalize as improvements to buildings. Instead, these items should be recorded as maintenance expense.

- Adding, removing and/or moving walls relating to renovation projects that are not considered major rehabilitation projects and do not increase the value of the building

- Improvement projects of minimal or no added life expectancy and/or value to the building
- Plumbing or electrical repairs
- Cleaning, pest extermination, or other periodic maintenance
- Interior decorations such as draperies, blinds, curtain rods, wallpaper, etc.
- Exterior decoration such as detachable awnings, uncovered porches, decorative fences
- Maintenance-type interior renovation such as repainting, touch-up plastering, replacement of carpet, tile, or panel sections; sink and fixture refinishing, etc.
- Maintenance-type exterior renovation such as repainting, replacement of deteriorated siding, roof, or masonry sections
- Replacement of a part or component of a building with a new part of the same type and performance capabilities, such as replacement of an old boiler with a new one of the same type and performance capabilities
- Any other maintenance-related expenditure which does not increase the value of the building

### ***Contributed Assets***

Contributed assets are defined as voluntary contributions of resources to a governmental entity by an unrelated person or entity. All contributed assets are to be valued at the fair market value of the asset at the time of donation, plus ancillary charges, if any.

According to GASB 33, recipients of contributed (donated) fixed assets must recognize fixed asset contributions as revenues and not as contributed capital. The contributed asset and related revenue are to be recognized when the assets are received. To qualify as a fixed asset, the fair market value of the contributed asset must exceed the City's capitalization thresholds.

#### **Example of Contributed Assets**

The donation of land to the City will be valued at its fair market value based on a current appraisal. This land will be recognized when the City takes possession of the land.

### ***Construction-in-Progress***

#### **Construction-in-Progress Definition**

Construction-in-progress is defined as an asset that represents an accumulation of all costs incurred on uncompleted buildings, infrastructure, land improvements, or other capital construction projects. It includes all applicable charges such as:

- Direct labor costs
- Overhead allocations
- Legal and architect's fees
- Installation charges
- Environmental impact or feasibility studies
- Interest on borrowings (proprietary funds only) and
- Any other costs incurred in preparing the structure or project for its intended use

#### **Accumulating and Tracking Construction Costs**

Construction projects are identified in FAMIS as "C" capital project types. FAMIS tracks all project costs on a monthly, quarterly, year-to-date, and all-years basis. It also displays budgeted costs versus actual costs to date. Project managers should review costs charged to a project on at least a monthly basis to insure that the charges are appropriate and capital in nature. They



should monitor the actual costs for their projects against budgets to control project costs by phase and gauge the progress of the project against set timelines.

Project managers are typically aware of a project's completion status and prepare a project status report that lists projects and the estimated start and completion dates of each project phase. A copy of the project status report is provided to the accounting/finance personnel so that they may summarize the total costs charges to each project. See "Placing Constructed Assets in Service" below for completed projects.

Note: If the CIP project is financed by the Finance Corporation, the bank pays the vendor separately for the Finance Corp. Therefore, the Office of Finance, on behalf of the Finance Corp., provides the payment information to the Controller's Office to book the CIP entry into FAACS. A separate funding source and index code are used for the Finance Corp.

In some cases, the department may have purchased the asset and was reimbursed by the Finance Corp. The corresponding voucher that purchased the asset should not be posted by the department into FAACS. The Finance Corp. and/or the department should notify the Controller's Office to post an alternate entry into FAACS.

## **Reporting Construction-in-Progress on Government-wide Financial Statements**

Construction-in-progress should be capitalized and not depreciated. It should be reported with land and other non-depreciating assets at the government-wide level. Unspent debt proceeds from fixed assets related debt should be reported in the net assets section of the statement of net assets as "restricted for capital projects".

## **Placing Constructed Assets into Service**

Once the work under the project is **substantially completed** for its intended purpose and **transferred into active service**, the project manager will certify the project as substantially complete and obtain sign-offs from various regulatory commissions such as the EEOC and prepare a governing board agenda for approval of the project closeout.

*Example of a CIP transferred to active service* would be a new art museum or a new swimming pool that has been opened to the public.

*Example of a CIP in active service but not substantially completed:* Third Street Bridge Retrofit Project is on going even though the bridge is in use. Once the retrofit project is substantially completed, then the CIP project costs would be capitalized.

The Administrative Code Section 6.22(k) – *Inspection and Acceptance of Completed Work; Final Payment* specifies the requirements to close a project. It states that the department authorized to perform public works or improvements must have its department head approve the projects. "The department head authorized to execute any contract for public works or improvements shall be responsible for the inspection and acceptance of such work on completion. Such acceptance shall be in writing and shall include the certificate of the department head concerned that the work covered by the contract has been fully and satisfactorily completed in accordance with the plans and specifications therefore. Receipt of copy of such acceptance in writing shall constitute the Controller's authority to complete any payments due the contractor under the contract; provided that the Controller may make such additional investigation or inspection as is provided by Administrative Code Section 10.07". (It does not require the department's commissions or boards to approve but some departments like the SFPUC may submit the matter to their commission.)

Upon receipt of the above approval, project managers should provide a memorandum to accounting/finance personnel officially notifying them that the substantially completed projects have been put into active service. An asset is moved out of construction-in-progress when a project is substantially completed and the department has beneficial use of the assets. (The criteria for DPW to record the capital asset are those projects that receive a "Substantial Completion Certificate" and/or a "Notice of Temporary Occupancy Certificate" from the project managers.) Once a construction project is substantially completed and placed into service, the construction-in-progress asset should be transferred out by the accounting/finance personnel to the appropriate fixed assets category using the FAACS CIP Transfer Form (see Appendix E). (Any encumbrance and/or available balance in the appropriation budget will remain with the existing project as available for construction –in-progress and future expenditures that may be required for final completion. Upon final completion of DPW capital projects, DPW project managers will issue a "Final Completion Certificate". Any additional costs for final completion within the year will be added to the asset in FAACS from the Hold File. If it is beyond one year, another asset with the additional costs will be created that points to the original asset.)

A DPW Final Completion Certificate or Notice of Completion is used by the DPW Bureau of Construction Management in the project close-out process for City and County of San Francisco (or other counties where the asset is located) County Clerk recordation of the new asset.

A major capital asset may have many projects with multiple funding sources through different departments. This asset would be captured in FAACS as one asset based on a summary of all the capital projects and funding associated with that asset. The Controller's Office FAACS Administrator reviews the FAACS CIP Transfer Forms received from the departments for the projects substantially completed for that major capital asset to assure that the asset is properly recorded.

## **Capitalization of Interest**

### **Accounting Standards**

The following accounting standards provide the authoritative guidance on the capitalization of interest on constructed assets accounted for in *proprietary funds*:

- Financial Accounting Standards Board (FASB) Statement No. 34 – *Capitalization of Interest Cost*
- FASB Statement No. 62 – *Capitalization of Interest Cost in Situations Involving Certain Tax-Exempt Borrowings and Certain Gift and Grants (an amendment of FASB Statement No. 34)*

#### **FASB Statement No. 34**

This Statement establishes standards for capitalizing interest cost as part of the historical cost of acquiring certain assets. To qualify for interest capitalization, assets must require a period of time to get them ready for their intended use. Examples are assets that an enterprise constructs for its own use (such as facilities) and assets intended for sale or lease that are constructed as discrete projects (such as real estate projects). Interest capitalization is required for those assets if its effect, compared with the effect of expensing interest, is material. If the net effect is not material, interest capitalization is not required.

The interest cost eligible for capitalization shall be the interest cost recognized on borrowings and other obligations. The amount capitalized is to be an allocation of the interest cost incurred during the period required to complete the asset. The interest rate for capitalization purposes is to be based on the rates on the enterprise's outstanding borrowings. If the enterprise associates a specific new borrowing with the asset, it may apply the rate on that borrowing to the appropriate portion of the expenditures for the asset. A weighted average of the rates on other borrowings is to be applied to expenditures not covered by specific new

borrowings. Judgment is required in identifying the borrowings on which the average rate is based.

**FASB Statement No. 62**

This Statement amends FASB Statement No. 34, *Capitalization of Interest Cost*, (a) to require capitalization of interest cost of restricted tax-exempt borrowings less any interest earned on temporary investment of the proceeds of those borrowings from the date of borrowing until the specified qualifying assets acquired with those borrowings are ready for their intended use and (b) to proscribe capitalization of interest cost on qualifying assets acquired using gifts or grants that are restricted by the donor or grantor to acquisition of those assets.

**Determining Which Accounting Standard to Apply**

Departments shall capitalize interest on all constructed assets meeting the City's capitalization criteria that are accounted for in proprietary funds in accordance with either FASB Statement No. 34 or 62. Apply the provisions of FASB Statement No. 62 in situations involving the acquisition of qualifying assets financed with the proceeds of tax-exempt borrowings if those funds are externally restricted to finance acquisition of specified qualifying assets or to service the related debt. Otherwise, apply the provisions of FASB Statement No. 34 (Paragraph 6 of FASB Statement No. 62 – *Refer to Appendix G*).

**Identifying Assets Qualifying for Interest Capitalization**

Identify assets that qualify for interest capitalization in accordance with paragraphs 9-11 of FASB Statement No. 34 and if applicable, paragraph 5 of FASB Statement No. 62. (*Refer to Appendix G for individual paragraphs.*)

**Determine the Capitalization Period**

Determine the period in which to capitalize interest on qualifying assets in accordance with paragraphs 17-19 of FASB Statement No. 34 and (if applicable) paragraph 7 of FASB Statement No. 62. (*Refer to Appendix G for the paragraphs above in FASB Statement No. 34 and 62.*)

**Compute the Amount of Interest to Capitalize**

Compute the amount of interest to capitalize on qualifying assets during the capitalization period in accordance with paragraphs 12-16 of FASB Statement No. 34 and (if applicable) paragraphs 3,4, and 6 of FASB Statement No. 62. (*Refer to Appendix G for the paragraphs above in FASB Statement No. 34 and 62.*)

**Enter Capitalized Interest in FAACS**

When the amounts of interest to capitalize on qualifying assets have been determined, enter the amounts as positive adjustments to the corresponding assets in FAACS (Fixed Assets and Accounting Control System).

## ***Intangible Assets***

The Governmental Accounting Standards Board (GASB) has issued Statement No. 51, "Accounting and Financial Reporting for Intangible Assets". The Statement is effective for fiscal year 2010 and must be in place at the beginning of the fiscal year (July 1, 2009) to properly report and account for intangible assets.

GASB Statement No. 34 provided some guidance regarding intangible assets. Statement No. 51 established additional requirements for intangible assets to reduce inconsistencies and enhance comparability with other local governments.

An Intangible asset is an asset that possesses all of the following characteristics:

- Lacks physical substance - An asset that may be contained IN or ON an item with physical substance, such as computer software on a compact disc, a right-of-way easement on top of land.
- Nonfinancial in nature - Cannot be receivables or prepayment of goods, an asset that is not in monetary form or represents neither a claim or right to.
- Initial useful life that extends beyond a single reporting period.

Examples of intangible assets include easements, land use rights (water rights, timber rights etc.), patents, trademarks, computer software, etc.

Exceptions are Intangible assets acquired or created primarily for directly obtaining income or profit, assets resulting from capital lease transactions reported by lessees, and goodwill created through the combination of a government or other entity.

## **Recognition Criteria**

An intangible asset should be recognized ONLY IF it is "identifiable":

- The asset is separable, i.e. capable of being separated and sold, transferred, licensed, etc.
- OR-
- The asset arises from contractual or other legal rights, regardless of whether rights are transferable or separable

## **Internally Generated Intangible Assets**

Internally generated intangible assets are assets that are:

- Created or produced by the government or an entity contracted by the government;
- OR-
- Acquired from a third party but require more than minimal incremental effort to achieve expected level of service capacity

## **Internally Generated Intangible Assets Criteria**

Outlays incurred related to the Internally Generated Intangible Assets that are considered identifiable should be capitalized ONLY upon the occurrence of ALL of the following:

- Determination of the specific objective of the project and the nature of the service capacity that is expected to be provided by the intangible asset upon completion of the project; (Planning stage is to decide what needs to be created and what it is created to do.)

- Demonstration of the technical or technological feasibility for completing the project so that the intangible asset will provide its expected service capacity; (Is it possible to create this asset under current technology?)
- Demonstration of the current intention, ability, and presence of effort to complete or, in the case of a multiyear project, continue development of the intangible asset. (Are funds, personnel, etc. being allocated by management to see project through to completion.)

Outlays incurred prior to meeting criteria should be expensed as incurred. Outlays incurred after meeting criteria should be capitalized.

## **Internally Generated Computer Software**

Computer software is a common type of intangible asset that is often internally generated. Computer software should be considered internally generated if:

- It is developed in-house by the government's personnel OR
- It is developed by a third-party contractor on behalf of the government OR
- It is commercially available software that is purchased or licensed by the government and modified using more than incremental effort before being put into operation (i.e., licensed financial accounting software that the government modifies to add special reporting capabilities).

Activities involved in developing and installing internal generated computer software can be grouped into the following steps:

- *Preliminary Project Stage*
  - Activities in this stage include the conceptual formulation and evaluation of alternatives, the determination of the existence of needed technology, and the final selection of alternatives for the development of the software. The outlays incurred in this stage should be expensed as incurred.
- *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, including the parallel processing phase. The outlays incurred in this stage should be capitalized.
- *Post-Implementation/Operation Stage*
  - Activities in this stage include application training and software maintenance. The outlays incurred in this stage should be expensed as incurred.

Data conversion should be considered an activity of the application development stage only to the extent it is determined to be necessary to make the computer software operational. Otherwise, data conversion should be considered an activity of the post-implementation/operation stage, and should be expensed.

The criteria to be capitalized should be considered met only when both of the following occur:

- a) The activities noted in the preliminary project stage are completed
- b) Management implicitly or explicitly authorizes and commits to funding, at least currently in the case of a multiyear project, the software project.

For commercially available software that will be modified to the point that it is considered "internally generated", (a) and (b) above generally would be considered to have occurred upon the government's commitment to purchase or license the computer software.

Outlays associated with an internally generated modification of computer software that is already in operation should be capitalized if the modification results in ANY of the following:

- An increase in the functionality of the computer software,
- An increase in the efficiency of the computer software,
- An extension of the estimated useful life of the software.

Note - If the modification does not result in any of the above outcomes, the modification should be considered maintenance, and the associated outlays should be expensed as incurred.

## **Amortization of Intangible Assets**

Existing guidance for depreciation of capital assets generally applies to amortizing intangible assets. Exception for intangible assets with indefinite useful lives:

- No factors currently exist that limit the useful life of the asset
- Intangible assets with indefinite useful lives should not be amortized

## **DISPOSING FIXED ASSETS**

### ***Disposal of Assets***

Any item that is sold, traded-in, scrapped, abandoned, or otherwise removed from service during any given reporting period is classified as a disposal. Dispositions are not budgeted, however, replacement equipment for equipment that has been disposed is budgeted and marked with an "R" for replacement equipment on the budget documents.

When an asset is sold to another entity, a gain or loss must be recognized when the proceeds do not equal the net book value of the asset. This gain or loss is classified as other income for financial reporting purposes.

When an asset is exchanged or traded-in for like equipment, the difference between the cost and the accumulated depreciation (net book value) should be added to the cash outlay of the new asset.

For assets that are listed as missing (lost/stolen), the accounting personnel responsible for fixed assets will prepare a fixed asset report listing the missing items. The personnel will document all efforts made to locate the missing assets. This missing fixed asset report listing will be reviewed by the department head on a periodic basis. Items will remain on the listing for a period of one year.

All assets that are retired/disposed of in any way require a FAACS Retired/ Disposed Assets Form (Appendix D) that provides justification of the change indicated; e.g., sold, donated, stolen, lost, destroyed/damaged, traded in, or written off. Approval from a department head is required in instances of an asset being lost, stolen, destroyed/damaged.

FAACS (Fixed Assets and Accounting Control System) shall be updated on a regular basis to reflect all asset disposals that occurred. Various methods include the following:

- *Cannibalized:* Where parts of an asset to be disposed are used in rehabilitating another fixed asset.
- *Donated:* Where an item is donated usually to charity (this is typically performed by the purchasing department).
- *Recycled:* Where an item is delivered to a recycling facility.
- *Traded-in:* Where an asset is exchanged for an asset of similar nature with a manufacturer. This usually occurs when the asset is under warranty.
- *Junked:* Where an asset is literally discarded because it has no remaining life.

- *Reverse acquired:* Where an asset is reversed from FAACS and then subsequently re-input. This could be due to errors in the initial input of the asset. This is only permitted in the first year of acquisition of an asset.
  - *Sold:* When an asset is to be sold, the purchasing department signs a “Surplus Turn-in” equipment form indicating receipt of the fixed asset to be sold. This form is to be kept together with the asset transfer form as support.
  - *Lost/Stolen:* Items that simply cannot be located. If any fixed asset item is identified as stolen, the employee discovering the theft must report the theft to his/her supervisor as soon as possible.
  - *Destroyed:* This usually applies to items destroyed due to such occurrences as fires, floods, or earthquakes.
- (Refer to FAACS manual for detailed procedures.)

## Disposing Federal/Grant-Funded Assets

For all dispositions involving federally funded assets, the project grants finance personnel must first ascertain if there are peculiar grant requirements surrounding the disposition of fixed assets. Typically, in the event that an asset to be disposed of has a fair market value in excess of \$5,000, the department must report the disposal to the federal agency that provided the initial funding.

In some instances, departments may be required to remit some or all of the cash proceeds received from the disposition of assets acquired with federal funding to the federal agency involved. Refer to the individual grant agreements for specific guidance on federal requirements governing the disposition of federally funded assets.

## CAPITAL ASSETS IMPAIRMENT

### Definition of Impairment

A capital asset is considered impaired when its service utility has declined significantly and unexpectedly. Prominent events or changes in circumstances affecting capital assets include evidence of physical damage, enactment or approval of laws or regulations or other changes in environmental factors, technological changes or evidence of obsolescence, changes in the manner or duration of use of a capital asset, and construction stoppage.

Impairment losses should be reported in accordance with the guidance in paragraphs 41 through 46, 55, 56, 101, and 102 of Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, and paragraphs 19 through 24 of Accounting Principles Board Opinion No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*. If not otherwise apparent from the face of the financial statements, the description, amount, and financial statement classification of impairment losses should be disclosed in the notes to the financial statements. If evidence is available to demonstrate that the impairment will be temporary, the capital asset should not be written down.

Impaired capital assets that are idle should be disclosed, regardless of whether the impairment is considered permanent or temporary.

An insurance recovery associated with events or changes in circumstances resulting in impairment of a capital asset should be netted with the impairment loss. Restoration or replacement of the capital asset using the insurance recovery should be reported as a separate transaction. Insurance recoveries should be disclosed if not apparent from the face of the financial statements. Insurance recoveries for circumstances other than impairment of capital

assets should be reported in the same manner. (Refers to Appendix H for a Summary on GASB Statement No. 42)

## **TRANSFERRING FIXED ASSETS**

### ***Transfers of Assets***

#### **Definition of Transfers**

Transfers are defined as the physical relocation of a fixed asset, either by account, department, building, floor, or room. A transfer may be a complete transfer or a partial transfer of an item. This is particularly useful for those pieces of equipment that have multiple parts such as computers, where only certain pieces are changed frequently.

#### **Transfer Policy**

Desktop computer equipment shall be treated as a single unit (e.g., monitor, keyboard, tower, and any other peripheral equipment such as external disk drives). As such, the mere act of exchanging one keyboard for another does not constitute a transfer of an asset. Only in those cases in which the complete desktop computer (meeting the equipment threshold definition) is physically relocated, shall an asset transfer form be completed, and an entry made in the fixed asset system.

#### **Intra-Department Transfer**

An intra-department transfer is a change in physical location of an asset while remaining within the same department. Individual City departments are responsible for tracking their fixed assets and ensuring that the FAACS location codes accurately reflect the location of each asset. All transfers of fixed assets are required to be documented. The FAACS Input Form (Appendix C) can be used for this purpose with the explanation of the transfer. The completed form must be approved by the department head or designee. A copy of the approved form is kept by the property manager. An example of an intra-departmental transfer would be moving a bus from one MUNI facility to another. Advise the Controller's Office FAACS Administrator of any intra-department transfers.

#### **Inter-Department Transfer**

An inter-department transfer is the movement of an asset between departments. Transferring an asset between departments requires that both the location and department code be updated in FAACS. All inter-department transfers should be documented using the FAACS Input Form with a complete explanation of the transfer. The form must be approved by the department heads or their designees for both the transferring and receiving departments. Advise the Controller's Office FAACS Administrator of any inter-department transfers



## **CALCULATING ASSET COST AND DEPRECIATION**

### ***Depreciation Definition***

In accounting terms, depreciation is the process of allocating the cost of tangible property over a period of time, rather than deducting the cost as an expense in the year of acquisition. Generally, at the end of an asset's life, the sum of the amounts charged for depreciation in each accounting period (accumulated depreciation) will equal original cost less salvage value. Good accounting and financial management practices require that a government entity take both the cost expiration and the declining value of an asset into consideration. The cost expiration of a government entity's assets must be recognized if the cost of providing services is to be realistically reported. Also, the decline in the value of those assets must be considered if the government entity's net assets are to be stated correctly.

#### **Information needed to Calculate Depreciation**

To calculate depreciation on a fixed asset, the following five factors must be known:

- The date the asset was placed in service
- The asset's cost or acquisition value
- The asset's salvage value
- The asset's estimated useful life
- The depreciation method

### ***Asset Cost or Acquisition Value***

Fixed assets should be reported at historical cost and should include the cost of freight, site preparation, architect and engineering fees, etc. If something other than cash is used to pay for the asset, then the fair-market value of the non-cash payment or consideration determines the asset's cost or acquisition value. When the value of the consideration paid can't be determined, the asset's fair-market value determines its cost.

With few exceptions, an asset's cost should also include necessary costs incurred to place the asset in service. Costs include the invoice price plus incidental costs (insurance during transit, freight, capitalized interest, duties, title search, registration fees, and installation costs). Exceptions to this rule include interest expenses associated with deferred payments and real estate taxes paid, if any, in the acquisition of property.

### ***Asset Salvage Value***

The salvage value of an asset is the value it is expected to have when it is no longer useful for its intended purpose. In other words, the salvage value is the amount for which an asset could be sold at the end of its useful life. This value can be based on (1) general guidelines from some professional organizations such as the Government Finance Officers Association, (2) information from other governmental entities, (3) internal experience, or (4) professionals such as engineers, architects, etc.

### ***Asset Estimated Useful Life***

Estimated useful life means the estimated number of months or years that an asset will be able to be used for the purpose for which it was purchased. The estimated useful life should be greater than two years. Fixed assets should be depreciated over their estimated useful lives based on

the Suggested Useful Lives Table in Appendix A and B or refer to FAACS Screen 5105 – Class Code Table for specific useful lives by class code.

## Depreciation Method to Calculate an Asset's Depreciation

### Straight-line Method

The straight-line method is the method used in the City and County of San Francisco. It can be used for any depreciable property. Under the straight-line depreciation method, the basis of the asset is written off evenly over the useful life of the asset. The same amount of depreciation is taken each year. In general, the amount of annual depreciation is determined by dividing an asset's depreciable cost by its estimated life.

The total amount depreciated can never exceed the asset's historical cost less salvage value. At the end of the asset's estimated life, the salvage value will remain.

For example, a \$12,000 copier is placed in service on March 16, 2002. It has an estimated life of five years and a salvage value of \$2,000. The depreciation calculation for the straight-line method would be:

|                       |              |
|-----------------------|--------------|
| Original cost         | \$12,000     |
| Salvage value         | <u>2,000</u> |
| Adjusted basis        | \$10,000     |
| Estimated life        | 5            |
| Depreciation per year | \$ 2,000     |

## Depreciating an Asset that was not Purchased at the Beginning of a Fiscal Year

To avoid the complications of depreciating each asset from the specific date on which it was placed in service, GAAP supports guidelines that assume various assets are placed in service or disposed of at designated dates throughout the year

There are three methods of calculating straight-line depreciation for fixed assets within FAACS:

1. The recording of no depreciation in the first year of operation in the asset;
2. The recording of depreciation excluding the first month of acquisition;
3. The half-year convention where half a year's worth of depreciation is taken in the first year that the asset is placed in service.

Departments are responsible for entering the appropriate depreciation indicator code in FAACS when a fixed asset is initially recorded. The Water Department, Hetch Hetchy Water and Power, and Clean Water Program have adopted the first convention in which no depreciation is recorded in the year of acquisition and a full year of depreciation is recorded in the year of disposition.

The Laguna Honda Hospital has adopted the third convention in which six months of depreciation is recorded in the year of acquisition and six months of depreciation is recorded in the year of disposition.

For all other departments, depreciation is recorded from the month after the date in which the asset is placed in service.

## **DEPARTMENT'S MONITORING RESPONSIBILITIES**

### ***Monitoring Depreciation Expense***

Departments are responsible for reviewing their respective depreciation entries for accuracy and reasonableness on a quarterly basis. Significant fluctuations in depreciation expense from period to period should be investigated to ascertain their nature and determine the reasonableness of the amount recorded. If changes have to be made to the fixed asset variables (such as life of the asset or acquisition costs), the departments are responsible for updating FAACS on a timely basis to reflect these changes and maintaining supporting documentation for those changes. If the changes are significant, a copy of the support and effects of the changes should be provided to the Controller's Office.

Refer to the FAACS Manual for procedures on adjustments made in the initial year of acquisition. If the adjustments are detected subsequent to the year of acquisition, documentation of the change should be provided to the Controller's Office because the impact of the adjustment on depreciation expense recognized in previous years should be manually computed and a journal entry should be recorded to reflect the appropriate amount of accumulated depreciation.

### ***Maintaining Inventory Controls***

#### **Department's Responsibility for Inventory**

Departments are also responsible for maintaining a system of control over their fixed assets and ensuring that the physical location code of each asset is accurately recorded in FAACS.

A physical inventory of all non-federally funded property and equipment should be taken and reconciled to the property and equipment records at least once every three years. For artifacts and library resources, a perpetual inventory shall be maintained through a recognized cataloging system.

Physical inventories should be conducted by personnel having no direct responsibility (custody and receipt/issue authority) for assets subject to the inventory count. Refer to Appendix D for procedures in conducting a physical inventory.

#### **Inventory Control over Federally-Funded Assets**

A physical inventory of equipment acquired with federal funding shall be taken and reconciled to the equipment records at least once every two years in accordance with OMB Circulars A-102 and A-110 by the department.

#### **Reconciliation of Inventory Results and Actions**

During a physical inventory, discrepancies might arise. Reconciliation is the process of identifying, explaining, and correcting the differences occurring between the physical count and the inventory records. If inventory listed is unrecorded, it should be recorded into the inventory system as soon as possible. If a significant number of unrecorded assets are discovered, the inventory officer should determine why this problem is occurring. For assets not located, a search should be conducted in an effort to locate the missing assets. The search should include research on transfers to other divisions, scrapping, etc. When an asset is deemed lost, it shall be removed from the inventory and accounting records. Records of this loss shall be maintained in accordance with record retention rules of the City.

After the inventory is reconciled, the inventory officer is to certify the reconciliation with a statement and signature indicating his inventory is complete. A copy of this is to be forwarded to the department head as well as the Controller's Office within 30 days of the physical inventory. The department will then have 60 days to respond to the results of the inventory (if discrepancies are noted) and document a corrective action plan with the Controller's Office.

## **REPORTING DEPRECIATION AND FIXED ASSETS**

### ***Reporting Depreciation Expense in the Financial Statements***

For general fixed assets, depreciation is reported only on government-wide financial statements. Depreciation expense is reported on the Statement of Activities. When fixed assets that are to be used in governmental activities are purchased or constructed, the resources expended for those assets are reported as expenditures in governmental funds, i.e., public protection; public works, transportation and commerce, etc. However, in the Statement of Activities, the cost of those assets identified with specific functions is allocated over their estimated useful lives and reported as depreciation expense of those functions. As a result, fund balance decreases by the amount of financial resources expended, whereas net assets decrease by the amount of depreciation expense charged for the year and any loss on disposal of fixed assets.

### ***Reporting Fixed Assets in the Financial Statements***

When fixed assets (land, facilities and improvement, machinery and equipment, and infrastructure assets) that are to be used in governmental activities are purchased or constructed, the costs of those assets are reported as capital outlay expenditures in governmental funds. However, the Statement of Net Assets includes those fixed assets, net of depreciation, among the assets of the City as a whole under governmental activities. If the fixed assets are to be used in business-type activities, then those assets are included in the business-type activity columns in the government-wide financial statements.

Fixed assets are defined as assets with an initial individual cost of more than \$5,000 and an estimated useful life in excess of two years. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated fixed assets are recorded at estimated fair market value at the date of donation. Interest during the construction phase of the fixed assets of business-type activities is reflected in the capitalized value of the asset constructed, net of interest earned on the invested proceeds over the same period. Amortization of assets acquired under capital lease is included in depreciation and amortization. Facilities and improvements, infrastructure, and machinery and equipment of the primary government, as well as the component units, are depreciated using the straight-line method over the following estimated useful lives:

| <u>Assets</u>               | <u>Years</u>     |
|-----------------------------|------------------|
| Facilities and improvements | 15 to 50         |
| Infrastructure              | 15 to 70         |
| Machinery and Equipment     | 3 to 40          |
| Easements                   | varies with type |

Facilities and improvements are generally estimated to have useful lives from 15 to 50 years, except for utility type assets of the Water Department, Hetch Hetchy Water and Power, and the Clean Water Program, the San Francisco Municipal Railway, Laguna Honda Hospital, and the Port of San Francisco that have estimated useful lives from 51 to 100 years. These long-lived assets include reservoirs, aqueducts, pumping stations of Hetch Hetchy Water and Power, Cable

Car Barn facilities and structures of the San Francisco Municipal Railway, building and structures of Laguna Honda Hospital, and pier substructures of the Port of San Francisco. In addition, the Hetch Hetchy Water and Power has utility type assets with useful lives over 100 years. Equipment is generally estimated to have useful lives of 3 to 40 years, except for certain equipment of the Water Department that has an estimated useful life of up to 75 years.

Works of art, historical treasures and zoological animals held for public exhibition, education, or research in furtherance of public service, rather than financial gain, are not capitalized. These items are protected, kept unencumbered, cared for and preserved by the City. It is the City's policy to utilize proceeds from the sale of these items for the acquisition of other items for collection and display.

Fixed assets that are not being depreciated, such as land or infrastructure assets using the modified approach should be reported as part of a network or subsystem of a network. When this modified approach is used for infrastructure reporting, the following items should be included in the Management Discussion and Analysis section of the financial report:

- Significant changes in the condition levels of infrastructure assets
- How current condition levels compare with target condition levels established by the government
- Significant differences between the amount estimated to be necessary for maintaining and preserving infrastructure assets at target condition levels and the actual amounts of expense incurred for that purpose during the current fiscal period.

Note: For governmental activities, no major net infrastructure assets were reported at the beginning of fiscal year 2002 because the historical costs did not meet the threshold established in GASB 34 (Government Accounting Standards Board Statement No. 34 – *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*). In fiscal year 2002, newly completed projects are capitalized and ongoing infrastructure projects are accounted for in construction-in-progress.

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<sup>1</sup> Guidance provided in this document regarding fixed assets definitions and guidelines is taken from the Capital Asset Guide from the Texas Comptroller of Public Accounts, Carole Keeton Rylander and a May 10, 2001 Draft Report for CCSF Fixed Assets Policies & Procedures Manual – City-wide prepared by KPMG, LLC.

## APPENDIX A

### *Suggested Useful Lives for Non-Infrastructure Fixed Assets*

| Asset Type                                   | Examples  | Depreciable Life in Years |
|--|---|---------------------------|
| <b>Non-Infrastructure</b>                    |   |                           |
| Furniture, office equipment                  | Desks, tables, chairs, fax machines, photocopiers   | 5-7                       |
| Computer hardware                            | Monitors, CPU, printer  | 5                         |
| Telephone equipment                          |   | 10                        |
| Motor vehicles:                              |   |                           |
| Cars and light trucks                        |   | 5                         |
| Buses  | City  | 8-10                      |
| Patrol vehicles                              |   | 5                         |
| Fire trucks                                  |   | 5-10                      |
| LRV's, streetcars, cable cars                |   | 25                        |
| Intangible                                   |   | Varies with type          |
| Buildings                                    | Airports, convention center, healthcare facilities, jails, libraries, maintenance facilities, museums, office/administration, parking garages, recreation centers | 50                        |
| Buildings – Temporary                        | Trailer offices   | 20                        |
| Building and structure improvements:         |   | 20                        |
| HVAC systems                                 | Air-conditioners, heating, ventilation systems  | 15                        |
| Building signage                             |   | 15                        |
| Environmental, health and safety             |   | 15                        |
| Food service equipment                       |   | 5-20                      |
| Heavy construction equipment                 | Backhoes, trucks, dozers, front-end loaders, large tractors   | 5-10                      |
| Shop, bldg., and field maintenance equipment | Compressors, forklifts, generators, pumps, carpentry equipment, automotive equipment, painting equipment  | 3-15                      |
| Engineering, scientific equipment            | Lab equipment   | 5-15                      |
| Firefighting equipment                       | Ladder, hoses   | 5                         |
| Police special equipment                     |   | 10                        |
| Medical equipment                            |   | 5                         |
| Traffic control equipment                    | Stoplights  | 5                         |
| Radio, communications equipment              | Mobile, portable radios   | 5                         |
| Recreational/athletic equipment              | Fitness equipment, golf equipment, marine equipment   | 5                         |
| Outdoor equipment                            | Playground equipment, scoreboards, bleachers, radio towers  | 5                         |
| Custodial equipment                          | Floor scrubbers, vacuums, other   | 5                         |
| Grounds equipment                            | Mowers, tractors and attachments  | 15                        |
| Land improvements                            | Parking lots, sidewalks, bus ramp, fencing, running track, flagpole   | 15                        |
| Land improvements-ground work                | Golf course, ball field, park landscaping   | 15                        |
| Landfill disposal systems                    |   | 25                        |
| Land   |   | No deprec'n               |
| Sewerage treatment plants                    |   | 25                        |
| Water treatment system                       |   | 15                        |
| Power plant                                  |   | 20                        |
| Pumping plant                                |   | 20                        |

Refer to FAACS Screen 5105 – Class Code Table for specific useful lives by class code. The Class Code Table is more extensive than the suggested list above. Please refer to Screen 5105 if you cannot find the item you are looking for in the table above.

## APPENDIX B

### *Suggested Useful Lives for Infrastructure Fixed Assets*

| <b>Infrastructure</b>                 |  |                  |
|---------------------------------------|--|------------------|
| Easements                             |  | Varies with type |
| Roadway structures                    |  | 30               |
| Overhead lines and poles              |  | 40               |
| Rails, tracks, and roadways           |  | 40               |
| Substations, switches, and rectifiers |  | 50               |
| Stations, passenger                   |  | 30               |
| Tunnels                               |  | 40               |

Refer to FAACS Screen 5105 – Class Code Table for specific useful lives by class code.



## **APPENDIX C**

### **FAACS Input Form**

The FAACS Input Form is used by those departments who are offline and not on the FAACS System. It can be used to make changes to existing assets or to create a new asset. All columns have self explanatory notes. The form can be obtained from the Controller's Office FAACS Administrator. Once complete, the department should forward a signed copy to the Controller's Office FAACS Administrator so that the information can be input into FAACS.



**FAACS Retired/Disposed Assets Form**

The FAACS Retired/Disposed Assets Form is used by those departments who are offline and not on the FAACS System. It can be used to report fixed assets that are retired or disposed. The form may be obtained from the Controller's Office FAACS Administrator.

Only four fields are required:

- Property ID
- Disposition Date
- Asset Description
- Explanation

Once complete, the form should be signed by the Department Head and forwarded to the Controller's Office FAACS Administrator for manual input into FAACS.



**FAACS CIP Transfer Form**

The FAACS CIP Transfer Form is used by those departments who are offline and not on the FAACS System. It should be used to report transfers out of CIP to create a new fixed asset. The form may be obtained from the Controller's Office FAACS Administrator.

All columns are self-explanatory and require department input except for the Asset Property ID column. Once complete, the form should be signed by the department's FAACS Manager and forwarded to the Controller's Office FAACS Administrator for manual input into FAACS.



## ***Conducting the Physical Inventory***

### **Background**

In accordance with City policy governing fixed assets, departments are to conduct periodic inspections of all property and equipment within their areas of responsibility, and reconcile those inventories with the property and equipment records. This section provides some basic guidelines to be followed when conducting those inspections.

### **Initiate Project Planning**

1. Conduct a planning meeting with all key members of the inventory team and department personnel. Issues to be discussed during the meeting include:
  - a. Reviewing the project scope
  - b. Identifying specific properties to be included from the inventory
  - c. Identifying specific properties to be excluded from the inventory
  - d. Establishing time frames for completion of the entire project, as well as each phase of the project
  - e. Identifying and specifying elements expected to be part of the final product (e.g., special reports, asset classes and codes, and tagging procedures)
  - f. Establishing specific dollar amount cut-offs for items to be excluded or grouped into specified classes of assets
  - g. Specifying types of tags and identification procedures, if tagging is to be utilized
  - h. Maintaining the inventory through with manual or computer applications

### **Develop a Detailed Project Plan**

2. Develop a detailed project plan that incorporates the above issues and includes the following:
  - a. An internal budget of hours by task and individual assigned to the inventory
  - b. A detailed task list that includes all steps necessary to conduct the inventory
  - c. An example of the inventory forms being used to capture the fixed asset data, and instructions as to the use of the forms
  - d. A detailed description of the inventory tagging process to be employed during the performance of the physical inventory
  - e. Maps and plot plans of areas to be included in the inventory
  - f. A listing of all available information such as blueprints, drawings and plans, existing inventory listings, space utilization studies, contractor's cost breakdowns for construction, recent purchase orders, and anything else that may be used in establishing actual costs
  - g. A list of names, phone numbers, and email addresses of key personnel that will be involved in the process
  - h. Any special circumstances and procedures for the inventory including infrastructure valuation
  - i. Specific work hours for the performance of the inventory process

### **Obtain or Prepare Inventory Tags and a Tag Control Listing**

3. Obtain or prepare inventory tags to be affixed to assets once they have been inspected to prevent double counting of assets.
  - a. The tags should be individually numbered in sequential order and the tag numbers should be summarized on a comprehensive tag control listing. Inventory tags should be affixed to all fixed and moveable equipment once the necessary data is recorded on the form to signify that the asset was inspected.

### **Assign Control Tags to Inspection Teams**

4. Assign the responsibility of maintaining control over the inventory tags to one individual. Tags should be assigned to the inspection teams in blocks and the tag numbers should be recorded on the tag control listing as each team receives a block of tags.

### **Identify the Parcels of Land to Include in the Inventory**

5. Obtain a listing of land (by parcel) from the Assessor's Office, which identifies the parcel number and/or lot, block and tract. Visually inspect the listing for completeness and accuracy, and document the identification or parcel number, year acquired, and cost or value.

### **Conduct a Physical Inspection of Buildings and Building Improvements**

6. Conduct a physical inspection of all buildings and building improvements, and document the asset identification number, year acquired or constructed, location, and cost or value.

The building inventory should include a quantitative description of each structure segregating basic building construction from heating, ventilation, air conditioning, roof elevators, plumbing, lighting, floor and ceiling cover, and other components not directly attributable to the construction itself.

### **Conduct a Physical of Improvements other than Buildings**

7. Conduct a physical inspection of all improvements other than buildings, and document the asset identification number, year acquired or constructed, location, and cost or value.

Improvements other than buildings include all improvements outside a building or improvements to a parcel of land. For paving, include total quantitative and qualitative amounts for the site including beams and parking lot striping. Fencing should be inventoried by total linear feet including gates by type of fence. Playground and picnic equipment should be inventoried. Concrete work should include sidewalks and flatwork with curbs inventoried separately. Plumbing for sites should include drainage, irrigation, drinking fountains, hose bibs, and on-site sewer. Area lighting should be inventoried separately.

### **Conduct a Physical Inspection of Moveable and Fixed Equipment**

8. Conduct a physical inspection of all moveable and fixed equipment ensuring to affix an inventory tag on each asset once it has been inspected to prevent double counting. The area to be inspected should be segregated into specific quadrants and inspection teams should be assigned to each individual quadrant. Each inspection team should document the asset description, quantity, manufacturer, model number, serial number, year acquired (if known), specific location of the asset such as the building and floor in which the asset is maintained, and the tag number that is affixed to the asset.
9. Once the physical inspection of the fixed and moveable equipment is completed in each quadrant, have someone tour the location to ensure that each applicable asset has been properly tagged signifying that it has been inspected.

### **Account for Inventory Tags Used during Inspection**

10. Reconcile the used (based on the tag numbers listed on the inventory forms) and unused tags to the tag control listing to ensure that all tags can be properly accounted for. Missing tags should be investigated and located.



## **Reconciliation and Action on the Results of the Physical Inventory**

11. In order to ensure objective reporting and reconciliation of inventory items, physical inventories should be performed by personnel having no direct responsibility (custody and receipt/issue authority) for assets subject to the inventory count.
12. During a physical inventory, discrepancies might arise as a result of the physical inventory. Reconciliation is the process of identifying, explaining and correcting the differences occurring between the physical count and the inventory records.
  - a. A search of the inventory lists should be made to determine whether inventory listed as unrecorded is not listed on another portion of the inventory.
  - b. Unrecorded inventory should be recorded into the inventory system as soon as possible. If a significant number of unrecorded assets is discovered, the inventory officer should determine why this problem is occurring.
  - c. For assets not located, a search should be conducted in an effort to locate missing assets. The search should include research on transfers to other divisions, scrapping, etc. When the asset is deemed lost, it shall be removed from the inventory and accounting records. In addition, records of this loss shall be maintained in accordance with record retention rules.
13. After the inventory is reconciled, the inventory officer is to certify the reconciliation with a statement and signature indicating his inventory is complete. A copy of this is to be forwarded to the department head as well as the Controller's Office. The department will then have 60 days to respond to the results of the inventory (if discrepancies are noted).

## **Inventory Recounts**

14. Inventory recounts should be performed for all significant unreconciled differences to ensure that the discrepancy between the inventory of fixed assets and the records does in fact exist.
15. Both the inventory taker and the department representative are to sign the reconciliation statement indicating their consent to the results.
16. A copy of this report is to be forwarded to the Controller's Office within 60 days.
17. The department will then be required to fill out a fixed asset change form indicating the assets as lost, stolen, damaged (and should therefore be retired) or destroyed based on the inventory results.

## Excerpts from the Financial Accounting Standards Board (FASB) Statement Nos. 34 and 62

### FASB Statement of Financial Accounting Standards No. 34 – Capitalization of Interest Cost:

**Paragraph 8:** In concept, interest cost is capitalizable for all assets that require a period of time to get them ready for their intended use (an “acquisition period”). However, in many cases, the benefit in terms of information about enterprise resources and earnings may not justify the additional accounting and administrative cost involved in providing the information. The benefit may be less than the cost because the effect of interest capitalization and its subsequent amortization or other disposition, compared with the effect of charging it to expense when incurred, would not be material. In that circumstance, interest capitalization is not *required* by this Statement.

#### ***Assets Qualifying for Interest Capitalization***

**Paragraph 9:** Subject to the provisions of paragraph 8, interest shall be capitalized for the following types of assets (“qualifying assets”):

- a. Assets that are constructed or otherwise produced for an enterprise’s own use (including assets constructed or produced for the enterprise by others for which deposits or progress payments have been made).
- b. Assets intended for sale or lease that are constructed or otherwise produced as discrete projects (e.g., ships or real estate developments).

**Paragraph 10:** However, interest cost shall not be capitalized for inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis because, in the Board’s judgment, the informational benefit does not justify the cost of so doing. In addition, interest shall not be capitalized for the following types of assets:

- a. Assets that are in use or ready for their intended use in the earning activities of the enterprise.
- b. Assets that are not being used in the earning activities of the enterprise and that are not undergoing the activities necessary to get them ready for use.

**Paragraph 11:** Land that is not undergoing activities necessary to get it ready for its intended use is not a qualifying asset. If activities are undertaken for the purpose of developing land for a particular use, the expenditures to acquire the land qualify for interest capitalization while those activities are in progress. The interest cost capitalized on those expenditures is a cost of acquiring the asset that results from those activities. If the resulting asset is a structure, such as a plant or shopping center, interest capitalized on the land expenditures is part of the acquisition cost of the structure. If the resulting asset is developed land, such as land that is to be sold as developed lots, interest capitalized on the land expenditures is part of the acquisition cost of the developed land.

#### ***The Amount of Interest Cost to be Capitalized***

**Paragraph 12:** The amount of interest cost to be capitalized for qualifying assets is intended to be that portion of the interest cost incurred during the assets’ acquisition periods that theoretically could have been avoided (for example, by avoiding additional borrowings or by using the funds expended for the assets to repay existing borrowings) if expenditures for the assets had not been made.

**Paragraph 13:** The amount capitalized in an accounting period shall be determined by applying an interest rate(s) (“the capitalization rate”) to the average amount of accumulated expenditures for the assets during the period. The capitalization rates used in an accounting period shall be based on the rates applicable to borrowings outstanding during the period. If an enterprise’s financing plans associate a specific new

borrowing with a qualifying asset, the enterprise may use the rate on that borrowing as the capitalization rate to be applied to that portion of the average accumulated expenditures for the asset that does not exceed the amount of that borrowing. If average accumulated expenditures for the asset exceed the amounts of specific new borrowings associated with the asset, the capitalization rate to be applied to such excess shall be a weighted average of the rates applicable to other borrowings of the enterprise.

**Paragraph 14:** In identifying the borrowings to be included in the weighted average rate, the objective is a reasonable measure of the cost of financing acquisition of the asset in terms of the interest cost incurred that otherwise could have been avoided. Accordingly, judgment will be required to make a selection of borrowings that best accomplishes that objective in the circumstances. For example, in some circumstances, it will be appropriate to include all borrowings of the parent company and its consolidated subsidiaries; for some multinational enterprises, it may be appropriate for each foreign subsidiary to use an average of the rates applicable to its own borrowings. However, the use of judgment in determining capitalization rates shall not circumvent the requirement that a capitalization rate be applied to all capitalized expenditures for a qualifying asset to the extent that interest cost has been incurred during an accounting period.

**Paragraph 15:** The total amount of interest cost capitalized in an accounting period shall not exceed the total amount of interest cost incurred by the enterprise in that period. In consolidated financial statements, that limitation shall be applied by reference to the total amount of interest cost incurred by the parent company and consolidated subsidiaries on a consolidated basis. In any separately issued financial statements of a parent company or a consolidated subsidiary and in the financial statements (whether separately issued or not) of unconsolidated subsidiaries and other investees accounted for by the equity method, the limitation shall be applied by reference to the total amount of interest cost (including interest on intercompany borrowings) incurred by the separate entity.

**Paragraph 16:** For the purposes of this Statement, *expenditures* to which capitalization rates are to be applied are capitalized expenditures (net of progress payment collections) for the qualifying asset that have required the payment of cash, the transfer of other assets, or the incurring of a liability on which interest is recognized (in contrast to liabilities, such as trade payables, accruals, and retainages on which interest is not recognized). However, reasonable approximations of net capitalized expenditures may be used.

For example, capitalized costs for an asset may be used as a reasonable approximation of capitalized expenditures unless the difference is material.

### ***The Capitalization Period***

**Paragraph 17:** The capitalization period shall begin when three conditions are present:

- a. Expenditures (as defined in paragraph 16) for the asset have been made.
- b. Activities that are necessary to get the asset ready for its intended use are in progress.
- c. Interest cost is being incurred.

Interest capitalization shall continue as long as those three conditions are present. The term *activities* is to be construed broadly. It encompasses more than physical construction; it includes all the steps required to prepare the asset for its intended use. For example, it includes administrative and technical activities during the pre-construction stage, such as the development of plans or the process of obtaining permits from governmental authorities; it includes activities undertaken after construction has begun in order to overcome unforeseen obstacles, such as technical problems, labor disputes, or litigation. If the enterprise suspends substantially all activities related to acquisition of the asset, interest capitalization shall cease until activities are resumed. However, brief interruptions in activities, interruptions that are externally imposed, and delays that are inherent in the asset acquisition process shall not require cessation of interest capitalization.

**Paragraph 18:** The capitalization period shall end when the asset is substantially complete and ready for its intended use. Some assets are completed in parts and each part is capable of being used independently while work is continuing on other parts. An example is a condominium. For such assets,

interest capitalization shall stop on each part when it is substantially complete and ready for use. Some assets must be completed in their entirety before any part of the asset can be used. An example is a facility designed to manufacture products by sequential processes. For such assets, interest capitalization shall continue until the entire asset is substantially complete and ready for use. Some assets cannot be used effectively until a separate facility has been completed. Examples are the oil wells drilled in Alaska before completion of the pipeline. For such assets, interest capitalization shall continue until the separate facility is substantially complete and ready for use.

**Paragraph 19:** Interest capitalization shall not cease when present accounting principles require recognition of a lower value for the asset than acquisition cost; the provision required to reduce acquisition cost to such lower value shall be increased appropriately.

**FASB Statement of Financial Accounting Standards No. 62 – Capitalization of Interest Cost in Situations Involving Certain Tax-Exempt Borrowings and Certain Gifts and Grants**

**Paragraph 3:** Interest earned shall not be offset against interest cost in determining either capitalization rates or limitations on the amount of interest cost to be capitalized except in situations involving acquisition of qualifying assets financed with the proceeds of tax-exempt borrowings if those funds are externally restricted to finance acquisition of specified qualifying assets or to service the related debt.

**Paragraph 4:** The amount of interest cost capitalized on qualifying assets acquired with proceeds of tax-exempt borrowings that are externally restricted as specified in paragraph 3 shall be all interest cost of the borrowing less any interest earned on related interest-bearing investments acquired with proceeds of the related tax-exempt borrowings<sup>2</sup> from the date of the borrowing until the assets are ready for their intended use. Interest cost of a tax-exempt borrowing shall be eligible for capitalization on other qualifying assets of the entity when the specified qualifying assets are no longer eligible for interest capitalization.

**Paragraph 6:** The following footnote is added at the end of the first sentence of paragraph 13 of Statement 34, which deals with determining the amount of interest cost to be capitalized:

\*If the qualifying assets are financed with the proceeds of tax-exempt borrowings and those funds are externally restricted to the acquisition of specified qualifying assets or to service the related debt, the amount of interest cost capitalized shall be determined in accordance with FASB Statement No. 62, *Capitalization of Interest Cost in Situations Involving Certain Tax-Exempt Borrowing and Certain Gifts and Grants*.

**Paragraph 7:** the following footnote is added to paragraph 17 of Statement 34, which specifies the period for interest capitalization:

\*In situations involving qualifying assets financed with the proceeds of tax-exempt borrowings that are externally restricted as specified in Statement 62, the capitalization period begins at the date of the borrowing.

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<sup>2</sup> The interest cost and interest earned on any portion of the proceeds of the tax-exempt borrowings that are not designated for the acquisition of specified qualifying assets and servicing the related debt are excluded. The entire interest cost on that portion of the proceeds that is available for other uses (such as refunding of an existing debt issue other than a construction loan related to those assets) is eligible for capitalization on other qualifying assets.

## Summary of the Governmental Accounting Standards Board (GASB) Statement No. 42

### **GASB Statement No. 42 – Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries**

Under this Statement, governments are required to evaluate prominent events or changes in circumstances affecting capital assets to determine whether impairment of a capital asset has occurred. Such events or changes in circumstances that may be indicative of impairment include evidence of physical damage, enactment or approval of laws or regulations or other changes in environmental factors, technological changes or evidence of obsolescence, changes in the manner or duration of use of a capital asset, and construction stoppage. A capital asset generally should be considered impaired if both (a) the decline in service utility of the capital asset is large in magnitude and (b) the event or change in circumstance is outside the normal life cycle of the capital asset.

Impaired capital assets that will no longer be used by the government should be reported at the lower of carrying value or fair value. Impairment losses on capital assets that will continue to be used by the government should be measured using the method that best reflects the diminished service utility of the capital asset. Impairment of capital assets with physical damage generally should be measured using a restoration cost approach, an approach that uses the estimated cost to restore the capital asset to identify the portion of the historical cost of the capital asset that should be written off. Impairment of capital assets that are affected by enactment or approval of laws or regulations or other changes in environmental factors or are subject to technological changes or obsolescence generally should be measured using a service units approach, an approach that compares the service units provided by the capital asset before and after the impairment event or change in circumstance. Impairment of capital assets that are subject to a change in manner or duration of use generally should be measured using a service units approach, as described above, or using deflated depreciated replacement cost, an approach that quantifies the cost of the service currently being provided by the capital asset and converts that cost to historical cost.

Impairment losses should be reported in accordance with the guidance in paragraphs 41 through 46, 55, 56, 101, and 102 of Statement No. 34, Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments, and paragraphs 19 through 24 of Accounting Principles Board Opinion No. 30, Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions. If not otherwise apparent from the face of the financial statements, the description, amount, and financial statement classification of impairment losses should be disclosed in the notes to the financial statements. If evidence is available to demonstrate that the impairment will be temporary, the capital asset should not be written down. Impaired capital assets that are idle should be disclosed, regardless of whether the impairment is considered permanent or temporary.

An insurance recovery associated with events or changes in circumstances resulting in impairment of a capital asset should be netted with the impairment loss. Restoration or replacement of the capital asset using the insurance recovery should be reported as a separate transaction. Insurance recoveries should be disclosed if not apparent from the face of the financial statements. Insurance recoveries for circumstances other than impairment of capital assets should be reported in the same manner.

### **How the Changes in This Statement Improve Financial Reporting**

This Statement improves financial reporting because it requires governments to report the effects of capital asset impairments in their financial statements when they occur rather than as a part of the ongoing depreciation expense for the capital asset or upon disposal of the capital asset. Users of financial statements will better understand when impairments have occurred and what their financial impact is on the government. This Statement also enhances comparability of financial statements between governments by requiring all governments to account for insurance recoveries in the same manner.

## Summary of the Governmental Accounting Standards Board (GASB) Statement No. 51

### **GASB Statement No. 51 – Accounting and Financial Reporting for Intangible Assets**

Governments possess many different types of assets that may be considered intangible assets, including easements, water rights, timber rights, patents, trademarks, and computer software. Intangible assets, and more specifically easements, are referred to in the description of capital assets in Statement No. 34, Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments. This reference has created questions as to whether and when intangible assets should be considered capital assets for financial reporting purposes. An absence of sufficiently specific authoritative guidance that addresses these questions has resulted in inconsistencies in the accounting and financial reporting of intangible assets among state and local governments, particularly in the areas of recognition, initial measurement, and amortization. The objective of this Statement is to establish accounting and financial reporting requirements for intangible assets to reduce these inconsistencies, thereby enhancing the comparability of the accounting and financial reporting of such assets among state and local governments.

This Statement requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. Accordingly, existing authoritative guidance related to the accounting and financial reporting for capital assets should be applied to these intangible assets, as applicable. This Statement also provides authoritative guidance that specifically addresses the nature of these intangible assets. Such guidance should be applied in addition to the existing authoritative guidance for capital assets.

The guidance specific to intangible assets referred to above includes guidance on recognition. This Statement requires that an intangible asset be recognized in the statement of net assets only if it is considered identifiable. Additionally, this Statement establishes a specified-conditions approach to recognizing intangible assets that are internally generated. Effectively, outlays associated with the development of such assets should not begin to be capitalized until certain criteria are met. Outlays incurred prior to meeting these criteria should be expensed as incurred. This Statement also provides guidance on recognizing internally generated computer software as an intangible asset. This guidance serves as an application of the specified-conditions approach described above to the development cycle of computer software.

This Statement also establishes guidance specific to intangible assets related to amortization. This Statement provides guidance on determining the useful life of intangible assets when the length of their life is limited by contractual or legal provisions. If there are no factors that limit the useful life of an intangible asset, the Statement provides that the intangible asset be considered to have an indefinite useful life. Intangible assets with indefinite useful lives should not be amortized unless their useful life is subsequently determined to no longer be indefinite due to a change in circumstances.

The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2009. The provisions of this Statement generally are required to be applied retroactively. For governments that were classified as phase 1 or phase 2 governments for the purpose of implementing Statement 34, retroactive reporting is required for intangible assets acquired in fiscal years ending after June 30, 1980, except for those considered to have indefinite useful lives as of the effective date of this Statement and those that would be considered internally generated. Retroactive reporting of these intangible assets by phase 3 governments is encouraged but not required. Retroactive reporting is not required but is permitted for intangible assets considered to have indefinite useful lives as of the effective date of this Statement and those considered to be internally generated.

### **How the Changes in This Statement Improve Financial Reporting**

The requirements in this Statement improve financial reporting by reducing inconsistencies that have developed in accounting and financial reporting for intangible assets. These inconsistencies will be reduced through the clarification that intangible assets subject to the provisions of this Statement should be

classified as capital assets, and through the establishment of new authoritative guidance that addresses issues specific to these intangible assets given their nature (for example, recognition provisions for internally generated intangible assets, including computer software). This Statement also fosters greater comparability among state and local government financial statements and results in a more faithful representation of the service capacity of intangible assets—and therefore the financial position of governments—and of the periodic cost associated with the usage of such service capacity in governmental financial statements.