30.20 Valuing, Capitalizing, and Depreciating Capital Assets

30.20.10 How to value capital assets

July 1, 2009

Capital assets should be valued at cost including all ancillary charges necessary to place the asset in its intended location and condition for use.

Determine the value of capital assets in the following manner:

30.20.10.a **Purchased Assets**. Use historical costs including all nonrefundable purchase taxes (e.g., sales taxes), and all appropriate ancillary costs less any trade discounts or rebates. If the historical cost is not practicably determinable, use the estimated cost.

If land is purchased, the capitalized value is to include the purchase price plus costs such as legal fees, filing, and excavation costs incurred to put the land in condition for its intended use. The cost of the land also includes indefinite land use rights, such as easements, mineral, timber, and water rights, acquired with the purchase of the underlying land. Land use rights acquired separately from a land purchase and those with definite useful lives are classified as intangible assets.

Building costs include both acquisition and capital improvement costs, including, in enterprise and trust funds, net construction period interest. Capital improvements include structures (e.g., office buildings, storage quarters, and other facilities) and all other property permanently attached to, or an integral part of, the structure (e.g., loading docks, heating and air-conditioning equipment, and refrigeration equipment). Agencies have the option of capitalizing buildings by components when the useful lives of the components vary.

Furniture, fixtures, or other equipment not an integral part of a building are not considered capital improvements and should be classified as equipment. The cost for this asset type reflects the actual or estimated cost of the asset.

Software, licenses of commercially available software, patents, and other purchased intangible assets are valued at historical cost, including all appropriate ancillary costs.

30.20.10.b **Self-Constructed Assets, including Internally Developed Computer Software**. Capitalize all direct costs and agency project management costs associated with a construction/development project. Agency project management costs may be capitalized in one of two ways:

1. Use actual project management costs when they are practicably discernible and directly associated with the project; or

2. Apply a percentage of total budgeted project costs. The application rate may or may not be designed to recover total agency project management costs. Exclude indirect costs unless they are increased by the construction. Refer to the OFM Capital Plan instructions for discussion of maximum percentage limitations.

In enterprise and trust funds, include net interest costs incurred during the period of construction in the capitalized cost of the asset, if material. Capitalized interest on assets constructed with tax-exempt borrowing should be netted against any interest earned on the investment of the proceeds of the related tax-exempt borrowings. Interest costs are always recorded as expenditures in governmental fund type accounts and as expenses in internal service funds. Refer to Subsection 85.85.50.

Once identifiable as defined in Subsection 30.20.20, costs incurred for the development of internally generated intangible assets are capitalized only upon the occurrence of **all** of the following criteria; costs incurred prior to meeting these criteria are not capitalized:

1. 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 the completion of the project.

2. Demonstration of the technical or technological feasibility for completing the project so that the intangible asset will provide its expected service capacity. For example, technical feasibility can be demonstrated by the selection of a commercially available software package or by the selection of a development path to meet service capacity requirements.

3. 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.

Specifically with respect to internally developed computer software, there are three stages involved in the development and installation:

1. Preliminary project stage, which includes conceptual formulation and evaluation of alternatives, determination of the existence of needed technology, and the final selection of alternatives for the development of software. Costs associated with this stage are not capitalized.

2. Application development stage, which includes design, configuration and interfaces, coding, installation of hardware, installation and licensing of commercially available software, and testing, including parallel processing. This includes data conversion only to the extent it is necessary to make the software operational. Costs associated with this phase are capitalized when both of the following occur:

   - Activities of the preliminary project stage are completed.

   - Management implicitly or explicitly authorizes and commits to funding the software project.

   Capitalization of costs should cease when the computer software is substantially complete and operational.

3. Post-implementation/operation stage, which includes application training and software maintenance. This includes other data conversion costs. Costs associated with this stage are not capitalized.

Refer to Subsection 85.60.90.

30.20.10.c **Ancillary Costs**. Normally, ancillary costs should be included in the cost of a capital asset. However, minor ancillary costs, not measurable at the time a capital asset is recorded in an authorized property inventory system, are not required to be capitalized but may be capitalized if the information becomes readily available. Ancillary costs include such items as:

For land:

- Legal and title fees;
- Professional fees of engineers, attorneys, appraisers, financial advisors, etc.;
- Surveying fees;
- Appraisal and negotiation fees;
- Damage payments;
- Site preparation costs; and
- Costs related to demolition of unwanted structures.

For infrastructure:

- Professional fees of engineers, attorneys, appraisers, financial advisors, etc.;
- Surveying fees;
- Appraisal and negotiation fees;
- Damage payments;
- Site preparation costs; and
- Costs related to demolition of unwanted structures.

For buildings and improvements other than buildings:

- Professional fees of architects, engineers, attorneys, appraisers, financial advisors, etc.;
- Damage payments;
- Costs of fixtures permanently attached to a building or structure;
- Insurance premiums, interest in certain situations (refer to Subsection 30.20.10.a), and related costs incurred during construction; and
- Any other costs necessary to place a building or structure into its intended location and condition for use.

For furnishings, equipment, intangibles, collections, and other capital assets:

- Transportation charges;
- Sales tax;
- Installation costs;
- Warranties; and
- Any other normal or necessary costs required to place the asset in its intended location and condition for use.

30.20.10.d **Donated Assets, including Donated Intangible Assets and those acquired through Non-exchange Transactions**. Use the fair market value at the time of acquisition plus all appropriate ancillary costs. If the fair market value is not practicably determinable due to lack of sufficient records, use the estimated cost. If land is acquired by gift, the capitalized value is to reflect its appraised or fair market value at the time of acquisition.

30.20.10.e **Capital Assets for Income Purposes**. Capital assets acquired or created primarily for the purpose of obtaining income or profit should be valued pursuant to the investment policy in Section 85.52.

30.20.20 When to capitalize assets

March 17, 2010

The state's capitalization policy is as follows:

- All land, including land use rights with indefinite lives acquired with the purchase of the underlying land, and ancillary costs;
- The state highway system operated by the Department of Transportation;
- Infrastructure, other than the state highway system, with a cost of $100,000 or greater;
- Buildings, building improvements, and leasehold improvements with a cost of $100,000 or greater;
- Intangible assets, either purchased or internally developed, such as land use rights not acquired with the purchase of land, software, patents, and trademarks, with a cost of $1,000,000 or more that are "identifiable" by meeting either of the following conditions:
    - The asset is capable of being separated or divided and sold, transferred, licensed, rented, or exchanged; or
    - The asset arises from contractual or other legal rights, regardless of whether those rights are transferable or separable;
- All other capital assets with a unit cost (including ancillary costs) of $5,000 or greater, or collections with a total cost of $5,000 or greater, unless otherwise noted; and
- All capital assets acquired with Certificates of Participation (COP).

For capital assets acquired by and used in the operations of **governmental fund type accounts**, record the value of the assets in the General Capital Assets Subsidiary Account (Account 997). Refer to Subsection 85.60.30.a.

For capital assets acquired by and used in **proprietary and trust fund type accounts**, record the value of the assets in the account itself. Refer to Subsection 85.60.30.b.

Although small and attractive assets do not meet the state's capitalization policy above, they are considered capital assets for purposes of marking and identifying capital assets (refer to Section 30.30), inventory records requirements (refer to Section 30.40), and physical inventory counts (refer to Section 30.45).

Close out the construction in progress and capitalize the costs into the appropriate asset classification when a project is substantially complete, accepted, and placed into service. Refer to Subsection 85.65.64.

30.20.20.a **New Acquisitions**. Capitalize new aquisitions that meet the state's capitalization policy as stated above. Additions, improvements, repairs, or replacements to existing capital assets are not considered new acquisitions and are discussed below.

30.20.20.b **Additions**. Capitalize expansions of or extensions to an existing capital asset that meet the state's capitalization policy above.

30.20.20.c **Extraordinary Repairs, Betterments, or Improvements**. Capitalize outlays that increase future benefits from an existing capital asset beyond its previously assessed standard of performance if they meet the state's capitalization policy as stated above. Increased future benefits typically include:

- An extension in the estimated useful life of the asset.
- An increase in the capacity or efficiency of an existing capital asset.
- A substantial improvement in the quality of output or a reduction in previously assessed operating costs.

Leasehold improvements that meet the state's capitalization policy are recorded to General Ledger Code 2350 "Leasehold Improvements."

30.20.20.d **Replacements**. For buildings, improvements other than buildings, and equipment, capitalize the cost of outlays that replace a part of another capital asset when the cost of the replacement is $100,000 or more **and** at least 10 percent of replacement value of the asset.

Example: A $120,000 replacement of a heating system in a building having a replacement value of $1.5 million would not be capitalized. In this case $120,000 is not at least 10 percent of the building's replacement value. Had the building's replacement value been less than $1.2 million, the $120,000 heating system replacement would have been capitalized.

Exceptions to this policy are:

- Replacement roof coverings are not capitalized (whether or not the replacement is with superior materials) unless the replacement extends the useful life of the building.

- Replacement floor coverings and window coverings are not capitalized.

- Costs to remodel (convert) a building to a different use are not capitalized, where the remodeling does not extend the useful life of the structure itself, unless the conversion increases the capacity or efficiency of the existing asset.

Remove the capitalized value and the associated accumulated depreciation of the replaced capital asset or original building component from the accounting records if the amounts are determinable, and capitalize the cost of the replacement. Refer to Subsection 85.60.50.

30.20.20.e **Bulk Purchase**. For proprietary fund type accounts, bulk purchases of like capital assets with unit costs of less than $5,000 may be capitalized as a group where the allocation of costs for the bulk assets over time is matched to the corresponding revenue generated by the bulk assets. For other fund type accounts, bulk purchases are capitalized when the purchase is made using the Office of the State Treasurer's (OST) Certificate of Participation (COP) program.

30.20.20.f **Collections**. Capitalize art collections, library reserve collections, and museum and historical collections when the conditions described in Subsection 30.20.22 are not met. Agencies meeting these conditions have the option of capitalizing their collections. Library resources are capitalized and may be carried on the agency's property records as a single item.

30.20.22 Assets not capitalized

July 1, 2001

30.20.22.a

Art collections, library reserve collections, and museum and historical collections that are considered inexhaustible, in that their value does not diminish over time, are not required to be capitalized if all of the following conditions are met:

- The collection is held for public exhibition, education, or research in furtherance of public service, rather than financial gain.
- The collection is protected, kept unencumbered, cared for, and preserved.
- The collection is subject to an agency policy that requires the proceeds from sales of collection items to be used to acquire other items for the collections.

Agencies must be able to provide descriptions of the collections and the reasons the collections are not capitalized.

30.20.22.b

While these collections are not required to be capitalized, they are to be catalogued per Subsection 30.40.10.

30.20.30 Capital leases – definition

March 17, 2010

A capital lease is a lease that transfers substantially all the benefits and risks inherent in the ownership of property to the state. A lease must meet one or more of the following four criteria to qualify as a capital lease:

1. Ownership of the leased property is transferred to the state by the end of the lease term; or
2. The lease contains a bargain purchase option; or
3. The lease term is equal to 75 percent or more of the estimated useful life of the leased property; or

4. If, at the inception of the lease, the present value of the future minimum lease payments, excluding executory costs (usually insurance, maintenance, and taxes paid in connection with the leased property, including any profit thereof) is 90 percent or more of the fair value of the leased property. The interest rate to be used in the computation of the present value is available by contacting the Debt Management Division of OST, and is the rate in effect at the execution date of the lease.

30.20.40 Accounting for capital leases

March 17, 2010

30.20.40.a When the state's capitalization policy (refer to Subsection 30.20.20) is met:

- Account for a capital lease as an acquisition of a capital asset and the incurrence of a liability. If a lease involves the acquisition of more than one asset, each asset is to be capitalized if its fair value meets the state's capitalization threshold. Refer to Subsections 85.60.70 and 85.72.30.

- If title to a leased asset transfers to the state at the conclusion of an operating lease (refer to Subsection 30.20.30), capitalize the fair market value of the asset upon receiving title.

30.20.40.b If a lease meets the requirements of a capital lease per Subsection 30.20.30, record a capital lease between state agencies as follows:

- The lessor agency is to treat the lease as a sales type lease (record a sale on account and remove the asset from inventory).

- The lessee agency is to treat the lease as a capital lease (record the acquisition of a capital asset and the incurrence of a liability).

30.20.40.c Capital leases are to be used only to acquire capital assets. Refer to Subsection 30.20.20.

30.20.50 Capital assets acquired through Certificates of Participation (COPs)

July 1, 2009

Capital assets acquired through OST's Certificate of Participation (COP) program are to be capitalized. Refer to Subsections 85.60.80 and 85.72.40.

30.20.60 Accounting for infrastructure

June 1, 2012

30.20.60.a In accordance with the Governmental Accounting Standards Board Statement Number 34, acquisitions of capital assets defined as infrastructure, which meet the state's capitalization policy, are to be capitalized.

30.20.60.b The state highway system operated by the Department of Transportation is classified by the state as Transportation Infrastructure-Modified Approach. Refer to Subsection 30.20.80.

30.20.60.c All transportation-related infrastructure not included in Subsection 30.20.60.b and all non-transportation infrastructure assets are required to be depreciated. Refer to Subsection 30.20.70.

30.20.70 Depreciation policy

February 1, 2011

30.20.70.a Calculate and record depreciation or amortization for all depreciable capital assets. Refer to Subsection 85.60.40.

Non-depreciable capital assets include:

- Land;
- The state highway system operated by the Department of Transportation, which is classified as Transportation Infrastructure-Modified Approach (refer to Subsection 30.20.80);
- Art collections, library reserve collections, and museum and historical collections that are inexhaustible (refer to Subsection 30.20.22);
- Construction in progress; and
- Intangible assets with indefinite useful lives.

30.20.70.b **Depreciation** normally begins when an asset is purchased or completed, and accepted. However, if it is not placed into service immediately, depreciation should begin when the asset begins to lose value. Either option should be applied consistently and should be reasonable in the circumstance. Depreciation may be calculated using either the straight-line or composite method.

- To calculate depreciation using the **straight-line method**:

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

- Calculate the **composite method** based on weighted average estimated lives or an estimate of the useful life of the grouping of assets, such as library resources. The assessment could be based on condition assessments or experience with the useful lives of the groupings of assets. A consistent composite depreciation rate should generally be used throughout the life of the grouping of assets, but the rate should be recalculated if the composition of the assets or estimate of the useful lives changes significantly. For example, if the average useful life of library resources, or portion thereof, was estimated to be 25 years, an annual depreciation rate of 4 percent would be used. The annual depreciation expense would be calculated by multiplying the annual depreciation rate by the cost of the collection.

30.20.70.c **Useful Life for Capital Assets**. Agencies are required to use the useful life shown in Schedule A, Capital Asset Class Codes and Useful Life Schedule (Subsection 30.50.10.a) for capital assets acquired in new condition. For energy efficiency equipment and products, refer to the Addendum to Schedule A (Subsection 30.50.10.b).

However, a shorter or longer estimated life may be used depending on factual circumstances, replacement policies, or industry practices. Proposed deviation in useful life from Schedule A requires prior written approval from the OFM Accounting Division.

When establishing an asset's useful life:

- Agencies are responsible for establishing and utilizing an appropriate useful life for assets acquired in less than new condition.

- The useful life for leasehold improvements is the estimated service life of the leasehold improvements, or the remaining term of the lease, whichever is shorter.

- The useful life for intangible assets acquired by contract generally should not exceed the period of the contract.

For depreciation purposes, the useful life of assets should be reviewed to ensure it has remained the same. Impairment of assets or changes in contractual provisions may impact the useful life and remaining depreciation.

30.20.80 Non-depreciable transportation-related infrastructure assets reported using the modified approach

June 1, 2002

The state capitalizes the state highway system as a class of infrastructure assets and reports these assets using the “modified approach" to depreciation. Under the modified approach, these infrastructure assets are not depreciated as long as two requirements are met:

- The assets are managed in an asset management system, which includes keeping an up-to-date inventory of assets, performing condition assessments of the assets and summarizing the results, and estimating the annual amount to maintain and preserve the assets.
- The state documents that the assets are being preserved approximately at or above the condition level established and disclosed previously by the state.

30.20.90 Impairment of capital assets and related insurance recoveries

July 1, 2005

30.20.90.a A capital asset is considered to be impaired if the asset experiences a significant and unexpected decline in its service utility. The service utility of a capital asset is the expected usable capacity at acquisition. A capital asset may be impaired due to events or changes in circumstances, such as physical damage, obsolescence or changes in technology, enactment or approval of laws or regulations or other changes in environmental factors, a change in manner or duration of use, or a construction stoppage. A capital asset that becomes impaired is to be revalued to reflect its decline in service utility. Refer to Subsection 85.60.45.

30.20.90.b Insurance recoveries related to impaired assets are reported net of the related loss when the recovery is realized or realizable in the same fiscal year as the loss. Otherwise, restoration or replacement costs of an impaired capital asset are reported as a separate transaction from the related insurance recovery.