CAPITAL ASSET GUIDE

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Presented by:
Office of the Controller

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Objective

The Denver Public Schools (DPS) Capital Asset Guide is for internal use only and provides a basis on how to account for the district's capital assets. The purpose of this guide is to document district policies in accordance with Generally Accepted Accounting Principles (GAAP) and to establish appropriate control and accountability over capital assets. The Capital Asset Guide is not all inclusive and the application of the guidance requires professional judgment. Please reach out to your Capital Accountant with questions relating to this guide.

GASB Statements

GASB 34 establishes financial reporting standards for state and local governments including school districts. Capital assets are presented in the government-wide financial statements of the Comprehensive Annual Financial Report (CAFR), which provides information to readers on the extent to which the District has invested in capital assets including land, buildings, and equipment.

GASB 42 establishes guidelines to account for the impairment of capital assets and for insurance recoveries associated with impairment loss. See the Impairment section of this document for details.

GASB 49 addresses financial reporting for pollution remediation obligations, and is referenced in this guide as it relates to handling asbestos in newly purchased buildings.

GASB 51 establishes accounting and financial reporting standards for intangible assets to reduce inconsistencies. Specifically, it states that intangible assets are recognized if they are identifiable. GASB 51 also provides detailed guidelines for the capitalization of internally generated intangible assets (software) which can be found here:

http://gasb.org/jsp/GASB/Document_C/GASBDocumentPage?cid=1176159972237&acceptedDisclaimer=true.

GASB 72 focuses on fair value measurements and requires that donated capital assets be accounted for at acquisition value.

In addition, GASB is proposing a model for both lessees and lessors that would eliminate the current distinction between operating and capital leases.

Definitions

Capital assets include land, improvements to land, easements, buildings, building improvements, vehicles, machinery, equipment, works of art and historical treasures, infrastructure, and all other tangible or intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period. (GASB 34)

Capitalization Thresholds

DPS has maintained a capitalization threshold of $5,000 for all asset types. All capitalized assets must have a projected useful life that is greater than one year. DPS also monitors simulated assets subject to flight risk (which are not capitalized) ranging in value between $150 - $4,999.

Capital Asset Acquisition Costs

Capital assets are valued at cost (or estimated historical cost) and updated for additions and retirements during the year. Donated capital assets are recorded at acquisition value. Improvements to the District's capital assets are capitalized. However, repair and maintenance to the District's capital assets that do not increase capacity, increase the value of the asset, or extend an asset's estimated useful life are not capitalized. All capital assets, with the exception of land and construction in progress, are depreciated.

Depreciation and Estimated Useful Lives

DPS uses a monthly straight-line depreciation method for all assets. Construction in Progress (CIP) must be monitored closely, because projects must be closed at the time the asset becomes operational or can be used for its intended purpose. When an asset is capitalized, it is reflected on our balance sheet and depreciated over the useful life of the asset as follows:

Description	Estimated Useful Lives
Buildings and Improvements	5-39 years
Furniture and Equipment	5 years
Computer Equipment	3-5 years
Buses	7 years
Other Vehicles	5 years

Capital Asset Categories

Most capital assets have durable, physical form (land, buildings and equipment) and are known as tangible capital assets. Other assets lack physical form (such as computer software) and are known as intangible capital assets. Accounting for tangible and intangible capital assets are treated the same.

Land

Land is typically associated with some other asset (e.g. land under a building). No matter how close this relationship may be, land should always be treated separately. Land is normally characterized by an indefinite useful life and should appear as a single line on the face of the government wide financial statements. Therefore, land purchased to build a school should not be capitalized as part of the cost of the school building, but capitalized separately.

The cost of land should include its acquisition price and the cost of initial preparation of the land for its intended use, provided these preparations have an indefinite useful life, like the land itself. Examples of items that might be capitalized as part of the cost of land include basic site improvements (excavation, fill and grading) as well as the cost of removing, relocating, or reconstructing the property of others (power lines). Asset descriptions for land should include physical address, because names of schools are subject to change.

<u>Examples of expenditures to be capitalized with the acquisition of land</u>:

- Purchase price or, if donated, acquisition value at time of donation
- Commissions
- Professional fees (title searches, architect, legal, engineering, appraisal, surveying, environmental assessments, etc.)
- Permanent landscaping such as land clearing, excavation, fill, grading, drainage, etc.
- Demolition of existing buildings and improvements (less salvage)
- Interest on mortgages accrued at date of purchase
- Accrued and unpaid taxes at date of purchase
- Other costs incurred in acquiring the land
- Right-of-way

Land Improvements

Land improvements are defined as permanent improvements (non-moveable), other than buildings that add value to land, but do not have an indefinite useful life.

<u>Examples of expenditures to be capitalized as land improvements</u>:

- Fences
- Retaining walls
- Asphalt and paving for parking lots
- Landscaping of non-temporary nature
- Athletic dugouts
- Outside sprinkler systems
- Recreation areas and athletic fields (including bleachers)
- Paths and Trails

- Septic systems
- Swimming pools
- Tennis Courts
- Fountains
- Lighting systems

Buildings

A building is defined as 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 mobile.

There are two ways to acquire a building: by either purchasing a building or constructing a new building. Asset descriptions for buildings should include physical address, because names of schools are subject to change.

Expenditures to be capitalized as Purchased Buildings:

- Original purchase price
- Expenses for remodeling, reconditioning or altering a purchased building to make it ready to use for the purpose for which it was acquired
- Environmental compliance (i.e., asbestos abatement)
- Professional fees (sales commission, legal, architect, inspection, appraisal, title search, etc.)
- Payment of unpaid or accrued taxes on the building at the date of purchase
- Cancellation or buyout of existing leases on the building
- Other costs required to place or render the asset into operation

Expenditures to be capitalized as Constructed Buildings:

- Completed project costs
- Cost of excavation or grading or filling of land for a specific building
- Expenses incurred for the preparation of plans, specifications, blueprints, etc.
- Cost of building permits
- Professional fees (architect, engineer, management fees for design and supervision, legal)
- Costs of temporary buildings used during and for the construction

Example: Northfield is an example of a land purchase with a newly constructed building. In this situation professional fees and the Master Plan were capitalized because the project was completed as planned. When capital assets are purchased or constructed in bundles (like land and a building) an appropriate portion of the cost must be assigned to each. DPS deemed an 80/20 split between building and land (respectively) to be our appropriate portion. To review this example in more detail, reference the following activity in Lawson:

Northfield

- PP2037 GB20349 (Northfield 6-12 Campus – Phase 1)
- Spend of $35,844,507
- Default account identified project as bond new building construction
  - 41 6009834500 9722 (new construction)
  - Account Category 20.00 (Construction Cost)

Building Improvements

Building improvements are defined as capital expenditures if they increase the value of the building, materially extend the useful life of a building, or add capacity and functionality to the overall building. Expenses must exceed the capitalization threshold of $5,000. A building improvement should be capitalized with the same location code of the existing building, so that the additional value to that building can be tracked, and disposed of appropriately.

Building improvement capital expenditures include but are not limited to:

1. Conversion of attics, basements, etc. to usable office, clinic, research or classroom space. (adds capacity)
2. Structures attached to the building such as covered patios, sunrooms, modular units, garages, carports, enclosed stairwells, etc. (adds capacity)
3. Installation/upgrade of heating and cooling systems, including ceiling fans, attic vents, boilers, boiler room pumps, and piping. (extends useful life)
4. Installation/upgrade of wall or floor covering such as carpeting, tiles, paneling or wood flooring. (extends useful life)
5. Structural changes such as reinforcement of floors or walls, installation or upgrade of beams, rafters, joists, steel grids or other interior framing. (extends useful life)
6. Installation or upgrade of windows or door frames, upgrading of windows and doors, built-in closets and cabinets. (extends useful life)
7. Installation or upgrade of plumbing and electrical wiring. (extends useful life)
8. Installation or upgrade of phone systems, closed circuit television systems, networks, fiber optic cable, sound systems, video/security systems, fire alarm and suppression, temperature controls, and other wiring required in the installation of equipment that will remain in the building. (adds capacity)
9. Permanently attached fixtures or machinery (most of which cannot be removed without impairing the use of the building), such as light fixtures, stage curtains/auditorium, safety/stage rigging, bleachers, dimmer system, and galvanized piping. (adds capacity)(extends useful life)
10. Additions to buildings such as expansions, extensions, or enlargements. This includes modular classrooms. (adds capacity)

11. Other costs associated with the above improvements to be capitalized may include asbestos/hazmat remediation (for newly acquired buildings or buildings being prepped for sale), ADA compliance, building code issues, master plans and assessments, and potable water distribution.

Example: Montbello Middle School renovation is an example of a remodel that was capitalized because it increased capacity and value of the school. Expenditures were made for: a 13-classroom addition with gym; library remodel; upgrade of all heating/cooling systems; fire sprinkler system; pool and piping equipment; ADA improvements; science lab remodel; and other upgrades.

To review this example in more detail, reference the following activity in Lawson:

Montbello MS remodel/renovation

- PP2324 GB21009 (Montbello Campus MS – Addition)
- Spend of $10,174,234.24
- Default account identified project as bond major renovation
  - 41 6004594600 9723 (Major Renovations)
  - Account category 20.00 (Construction Cost)

Leasehold Improvements

DPS may undertake major improvements to property we do not own, but use per a non-cancellable multi-year operating lease. Such improvements would themselves be capitalized because the cost will benefit multiple periods, even though the leased property itself is not capitalized. The period to amortize the leasehold improvement cannot exceed the term of the lease.

Equipment

This major asset class is used for machinery, furniture, fixtures, vehicles and technology.

Expenditures to be capitalized as equipment:

- Machinery
- Vehicles

  Frequently vehicles are purchased with accessories. If the accessories are permanently attached to the vehicle, they should be included in the cost of the vehicle. For example, if a snow plow or other accessory is purchased either with the vehicle or as a separate purchase and is a permanently attached, the additional cost should be capitalized with the vehicle. If the plow or accessory will change vehicles and is over $5,000, it should be capitalized separately.

- Furniture and fixtures and technology equipment purchased to outfit a new school or a new building addition to a school, such as desks, chairs, file cabinets and classroom technology can be capitalized. However, smaller purchases under $5,000 that are not associated with a construction project and/or do not reach the capitalization threshold should be expensed.
- Computers, printers and other equipment with a unit cost over $5,000.

Software

Externally Purchased Software:

Externally purchased software licensed for more than one year should be capitalized and amortized over the period of the license. Software purchases of $5,000 or more without a license should be capitalized and amortized over its estimated useful life.

Software includes externally purchased software such as Infor Lawson. Software is considered an intangible asset which can be purchased or licensed. Per GASB 51, an intangible asset must be identifiable, have an initial useful life extending beyond a single reporting period, and must be amortized over the length of the contractual or legal obligation. An intangible asset is considered identifiable when either of the following conditions are met:

1. The asset is separable, that is, the asset is capable of being separated or divided from DPS and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract, asset, or liability.

2. The asset arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights or obligations.

Internally Generated Software:

Per GASB 51, 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 DPS personnel or by a third-party contractor on behalf of DPS. Commercially available software that is purchased or licensed by DPS and modified using more than minimal incremental effort before being put into operation also should be considered internally generated for purposes of GASB 51. Internally generated computer software can be grouped into the following stages:

1. 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 software.

2. 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.
3. Post-Implementation/Operation Stage. Activities in this stage include application training and software maintenance.

Computer software developed or obtained for internal use can be capitalized and include the following guidelines:

- Design of selected software, including software configuration and software interface
- Coding
- Installation of software
- Quality assurance testing

However, we CANNOT capitalize preliminary stages such as feasibility studies or post-implementation including training.

Capital Leases

Capital Leases are generally for equipment. To qualify as a capital lease, instead of an operating lease, ***one*** of the four following conditions must exist:

1) The lease transfers ownership of the property to the lessee by the end of the lease term

2) The lease contains an option to purchase the leased property at a bargain price.

3) The lease term is equal to or greater than 75 percent of the estimated economic life of the leased property.

4) The present value of rental or other minimum lease payments equals or exceeds 90 percent of the fair value of the leased property less any investment tax credit retained by the lessor.

Assets held under a capital lease, must be monitored and disposed when the lease is complete, assuming they are not purchased. For DPS this includes copiers leased to schools and administrative offices. Lease agreements are used to determine the cost and useful life of capital leases.

Repair and Maintenance Expenses

Maintenance costs allow an asset to continue to be used during its originally established useful life. Maintenance costs are expensed in the period incurred.

The following are examples of expenditures NOT to be capitalized as building improvements. Instead, these items should be recorded as repair and maintenance expense:

- Adding, removing and/or moving of walls relating to renovation projects that are not considered major rehabilitation projects, do not increase the value of the building and do not add capacity
- 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 decoration, such as draperies, blinds, curtain rods or wallpaper
- 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 repair of a boiler with new parts to set it to its original capacity/useful life.
- Any other maintenance related expenditure which does not increase the value of the building.
- Removal of asbestos that is *not* in preparation for the sale or purchase of the building.

In order for a replacement expense to be capitalized, it must be a part of a major repair or rehabilitation project that increases value, increases capacity and/or increases the estimated useful life of the building (such as a renovation of a student center) and meets the capitalization threshold. A replacement may also be capitalized if the new item or part is of higher quality and value compared to the old item, or part can be sold as an asset as is for more than $5,000. Replacement or restoration of an item to its original utility level is not capitalized. Determinations must be made on a case-by-case basis.

<u>Insurance reimbursement example</u>: Typically, repairs made with insurance reimbursements are expensed, because they do not add value to the asset. On occasion, however, additional spend will be pooled with insurance reimbursement dollars to upgrade the asset. In this case the value of the asset should be adjusted and/or useful life extended to reflect the upgrade.

<u>Office remodel example</u>: If an office is being remodeled with new carpet, new electrical outlets and painted – this is not capital. This is a renovation project that does not add capacity nor extend the estimated useful life of the asset – even if the project costs over the $5,000 threshold limit.

DPS takes on many capital type projects such as the expansion of a building, or a complete remodel of a facility. The majority of these costs can be rolled up to the project level and capitalized even though individual expenses are less than the $5,000 threshold, because they "outfit a school". However, discretion is advised in determining which expenses should be rolled up to the capital asset. For example, if a cafeteria is built-out and there are costs incurred in the shelving, tables and chairs and kitchen appliances that is considered capital in nature as it increases functionality of the building. However, buying the napkins, food and other miscellaneous items that can be depleted are expensed, not capitalized.

Determining whether or not to capitalize or expense an item (Exhibit A – Decision Tree)

Repairs and maintenance retain value rather than provide additional value; whereas improvements (or betterments) provide additional value. Added value is achieved by lengthening a capital asset's estimated useful life or by increasing a capital assets ability to provide service (i.e., greater effectiveness or efficiency). Improvements should be capitalized and depreciated over the estimated useful life of the improvement. The cost of repairs and maintenance must be reported as expense of the period in which incurred.

Often a single project will have elements of both a repair and an improvement. If any aspect of an activity is considered capital in nature then all costs associated with that activity are to be treated as capital.

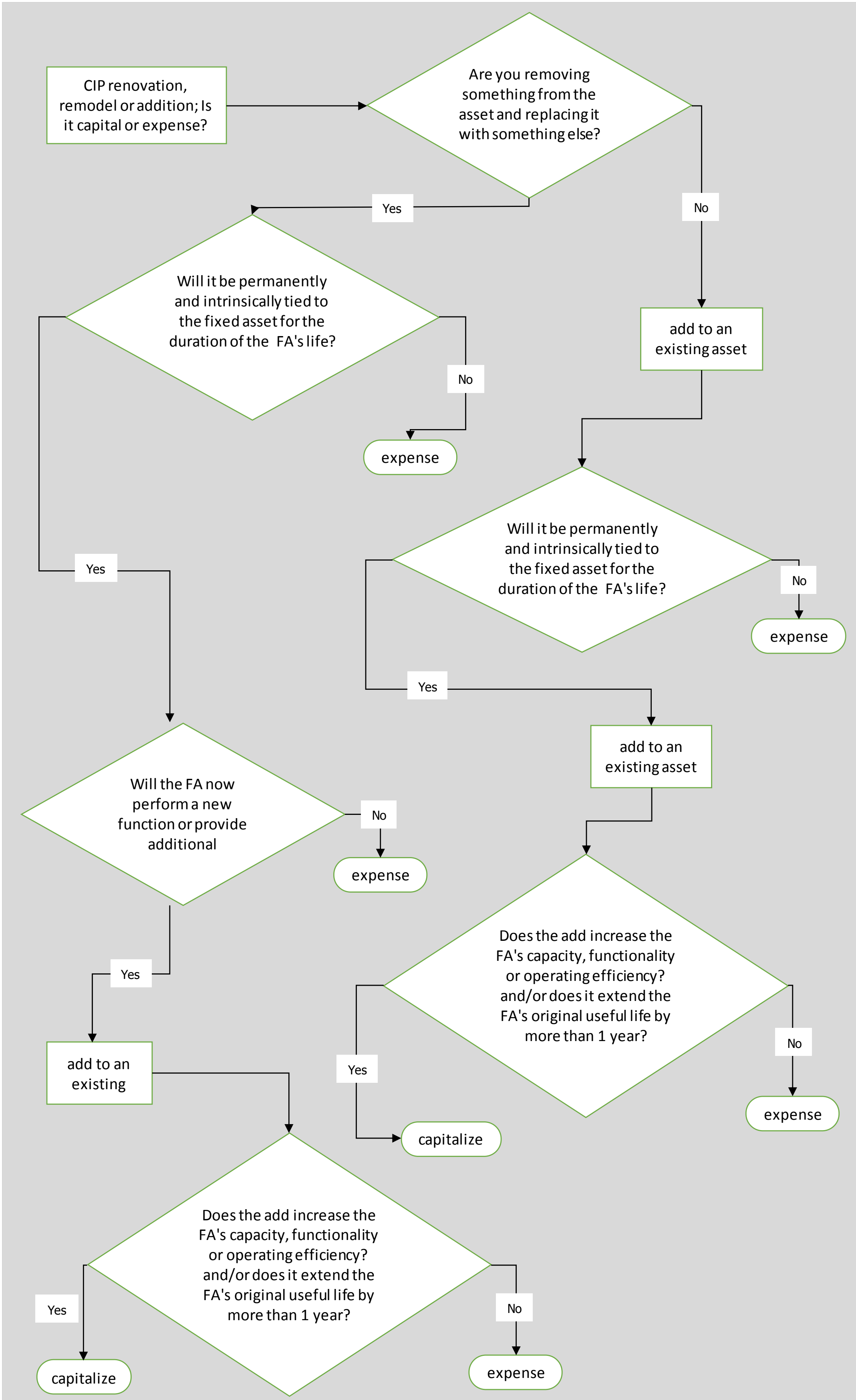

Chart modified from the State of Wyoming chart[3]

Items that shouldn't be capitalized

- General and administrative costs
- The cost of training employees to utilize a newly acquired capital asset unless it is within the scope of the project
- Advertising or payroll
- Retro-commissioning

Items that should be capitalized

- A cost should be capitalized only if it is directly identifiable with a specific asset, and only if incurred after acquisition of the related asset has come to be considered probable.
- Internal costs directly related to the acquisition of a specific asset (or group of assets) should be capitalized.
- Master plans (when a project is completed as planned)

Capital Asset Donation

A donation is defined by GASB Statement 33 as a voluntary non-exchange transaction entered into willingly by two or more parties. Both parties may be governments, such as the Federal Government, another state, a county or municipality, or one party may be a nongovernmental entity, including an individual.

Per GASB 72, donated assets are reported at their acquisition value.

Disposal of Assets

If DPS permanently retires a capital asset from service, either voluntarily or involuntarily, it ceases to be a capital asset. All retired assets should be disposed.

In order to enable the proper management and monitoring of DPS property, employees are not allowed to discard, donate, lease, loan, remove, rent, return, trade, transfer, sell, or give away DPS property unless specifically authorized.

An Equipment Activity Request forms should be completed and submitted to the Fixed Asset department when an asset is ready for disposal. EAR for*ms are available at http://enterprisemanagement.dpsk12.org/fixed-assets/property-control/*.

Impairment

An impairment is a significant and unexpected decrease in the service utility of a capital asset that will continue to be used in operations, and the book value needs to be reduced to reflect the loss in service utility resulting from the impairment.

Events or changes in circumstances that would give rise to an impairment will be prominent. They are generally significant events expected to have prompted discussion by the governing board, management or media. Thus, governments such as DPS are not expected to undertake special efforts to discover potential impairments.

Examples of an impairment:

1. Physical damage where action would be needed to restore lost service utility;
2. Changes in laws, regulations, or other environmental factors that negatively affect service utility;
3. Evidence of obsolescence;
4. Stoppages of construction or development

Generally, capital assets should be impaired if both (1) the decline in utility of the asset is large and (2) the event is outside the normal life of the asset. Method to measure impairment loss varies depending on the type of loss. Insurance recovery associated with an impairment of a capital asset should be netted with the impairment loss. For details, please refer to GASB Statement 42.

Inventory of Capital Assets

DPS maintains a perpetual inventory system which is regularly updated for additions, deletions, and relocation of capital assets. In addition, the district cycles through a complete physical inventory of its tangible capital assets every three years. Upon inventory, the working condition of the asset is recorded. Certain stationary assets such as land, buildings, and building improvements are captured in our perpetual inventory process.

Monitored Assets

A monitored asset lasts longer than a year, but has a value of $150 to $4,999.99 that does not meet the capitalization threshold of fixed assets for financial statement reporting. Monitored assets are tracked because of the risk of theft or loss. Typically, they include technology, custodial and grounds-keeping equipment. Monitored assets are identified with a DPS bar code label and tracked over the asset's useful life. Accounting recommends coding all monitored assets to account 9735 to isolate them for inventory purposes. For more information about Monitored Assets please refer to the fixed asset department and property control manual located here: *http://enterprisemanagement.dpsk12.org/fixed-assets/property-control/*

Federally Funded Assets

Assets purchased with Federal funds or grant money must be identified and managed according to the requirements of the grant. Each grant has unique specifications about the capitalization and disposal of assets that should be followed on a case by case basis, to comply with audit requirements.

References:

1. Gauthier, Stephen J., *Accounting for Capital Assets: A Guide for State and Local Governments* (Chicago: Government Finance Officers Association of the United States and Canada, 2008), 22, 28-29, 53-54, 70.
2. GASB. "Summary of Statements" (Statements 34, 42, 49, 51, 72). http://www.gasb.org/st/summary.
3. State of Wyoming, *Fixed Asset Guide,* Decision Tree. http://faculty.wiu.edu/P-Schlag/supplemental/pdfs/19-23%20Fixed%20Asset%20Criteria.pdf.