This document reflects the result of analyses, discussions and review by UCOP staff and PricewaterhouseCoopers (PwC) to date. The document is subject to change pending additional discussions with PwC and the Division of Cost Allocation, U.S. Department of Health and Human Services (DCA-DHHS); however, it represents the best information available to date.

University of California
GASB 35 Depreciation Reporting

Issues Resolution Memo No. 1

Consistency in Calculation Methodology – Depreciation of Buildings

Description of the Issue

Government Accounting Standards Board (GASB) Statement No. 35 will require the University to report depreciation in its financial statements for the fiscal year beginning July 1, 2001, with comparative information for the prior year. Financial statements must be prepared in accordance with Generally Accepted Accounting Principles (GAAP) and are subject to audit under Generally Accepted Auditing Standards (GAAS). Thus, for financial statement purposes, the University must use the same depreciation method and the same useful lives consistently throughout the entire institution (campuses and medical centers).

GAAP and GAAS do not necessarily apply to costing procedures. Costing procedures are governed by specific rules and regulations contained in documents such as OMB Circular A-21, *Principles for Determining Costs Applicable to Grants, Contracts, and Other Agreements with Educational Institutions*, the *Medicare Provider Reimbursement Manual*, and the *American Hospital Association Estimated Useful Lives of Depreciable Assets*. OMB Circular A-21 requires depreciation to be calculated using the same method as that used for financial reporting. University medical centers currently use the Medicare approved costing method to report depreciation in their financial statements. Consistency in depreciation methodology between these functions was not required prior to GASB Statement No. 35. GASB Statement No. 35 links these functions and necessitates a level of consistency across these functions.

Background

During 1999 the Government Accounting Standards Board introduced GASB Statements 34 and 35. Amongst other matters, these statements will require the University to account for

depreciation in its financial statements. The introduction of depreciation accounting has a number of implications for the University and its campuses.

The revisions to OMB Circular A-21, *Principles for Determining Costs Applicable to Grants, Contracts, and Other Agreements with Educational Institutions*, issued on June 1, 1998 require institutions that report depreciation on their financial statements to use the same depreciation method and useful lives for their Facilities & Administrative (F&A, i.e. indirect) cost rate proposals.

Currently, depreciation is calculated and reported for many purposes throughout the University. The straight-line method of depreciation is currently used throughout the University. Depreciation of equipment is currently calculated based on a single University-wide useful life table, and meets the consistency requirements of GAAP, OMB Circular A-21 and all other applicable rules and regulations. However, useful lives applied to buildings vary depending on the purpose and the office making the calculation. While this practice complies with current rules, regulations and University policy, the implementation of GASB Statement No. 35 and the requirements of OMB Circular A-21 will mandate a level of consistency in the useful lives of buildings used to calculate depreciation for these differing functions.

The University must consider the requirements of GASB Statement No. 35, GAAP, GAAS, Medicare costing rules, OMB Circular A-21, Internal Revenue Service (IRS) Tax Code, and other applicable rules and regulations to determine the required level of consistency in the useful lives of buildings that must be utilized across differing segments and purposes. The University seeks the level of consistency that will comply with all applicable rules and regulations while maintaining the flexibility necessary to achieve University goals.

Authoritative Guidance

GAAP and GAAS

Financial statements must be prepared in accordance with GAAP and are subject to audit under GAAS. GAAP includes GASB statements and additional pronouncements in the official canon of accounting literature that were issued prior to the establishment of the GASB. GAAP, including GASB Statement No. 35, do not specify depreciation procedures or useful lives. Accounting Research Bulletin (ARB) 43 Ch.9A, published in 1952 is the authoritative GAAP pronouncement that deals with depreciation. ARB 43 states that: “Depreciation accounting, [is] a system of accounting which aims to distribute the cost or other basic value of tangible capital assets, less salvage (if any), over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner. It is a process of allocation, not of valuation.” Thus, for financial statement purposes, the University must use depreciation methods and useful lives that meet the “systematic and rational” tests of ARB 43 throughout the entire system (campuses and medical centers).

GASB Statement 34 and 35

The GASB published Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities,* on December 2, 1999. The Statement effectively extended the new governmental financial reporting model required by GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments,* to include public colleges and universities. Depreciation of capitalized assets is required by these rules. The University is required to comply with the new requirements for the fiscal year beginning July 1, 2001.

The University currently does not report depreciation in its University-wide audited financial statements. Depreciation is being reported in the audited annual financial statements of the individual medical centers.

OMB Circular A-21

OMB Circular A-21, *Principles for Determining Costs Applicable to Grants, Contracts, and Other Agreements with Educational Institutions,* was revised on June 1, 1998 to require institutions that report depreciation in their financial statements to use the same depreciation method for their F&A rate proposals.

> J.12.b.(2) The depreciation method used to charge the cost of an asset (or group of assets) to accounting periods shall reflect the pattern of consumption of the asset during its useful life. In the absence of clear evidence indicating that the expected consumption of the asset will be significantly greater in the early portions than in the later portions of its useful life, the straight-line method shall be presumed to be the appropriate method. Depreciation methods once used shall not be changed unless approved in advance by the cognizant Federal agency**. The depreciation methods used to calculate the depreciation amounts for F&A rate purposes shall be the same methods used by the institution for its financial statements.** This requirement does not apply to institutions (e.g., public institutions) which are not required to record depreciation by applicable generally accepted accounting principles (GAAP).

While not incorporated into the text of the Circular, the June 1, 1998 announcement of the rule change also contained the following language:

> SUPPLEMENTARY INFORMATION: C.3.(b) Require institutions that report depreciation on their financial statements to use the same depreciation method and **useful lives** for the F&A proposals (see subsection J.12.b).

Medicare Provider Reimbursement Manual

Depreciation expenses for inclusion in Medicare reimbursements are defined in Section 104 of the Manual. In general, the straight-line method is required, using the useful lives established by the publication**,** *American Hospital Association (AHA) Estimated Useful Lives of Depreciable Assets*.

IRS Tax Code

Internal Revenue Service Tax Code Title 26, Subtitle A, Chapter 1, Subchapter B, Part VI, Sec. 168 establishes the Accelerated Cost Recovery System (ACRS). The ACRS method of depreciation is the most accelerated method allowed by the Tax Code. Taxpayers may use other less accelerated methods. The University uses the straight-line depreciation method for costs included in its Unrelated Business Income Tax Returns (Form 990T).

Affected Functional Parties

The implementation of depreciation reporting has the potential to affect many functions and offices throughout the University. They include the following:

Accounting / Control / Financial Management

- Financial statements must report depreciation, calculated and reported consistently throughout the institution. Lack of consistency may be misleading and may result in audit findings or a qualified audit opinion.

Indirect Cost Management

- Indirect cost rate proposals must be prepared with depreciation calculated in compliance with OMB Circular A-21, using the same method of depreciation and useful lives as that used for financial reporting purposes. Failure to comply may lead to audit findings, difficulty in negotiating rates with the federal government, reduced indirect cost rates and reduced cost recovery.

- Use of the same useful lives for financial reporting and A-21 costing may limit the University's ability to maximize indirect cost rates and may result in reduced recovery in future years.

- The University currently applies a 2% use allowance to buildings when calculating depreciation for A-21 purposes. This implies a 50-year useful life for buildings.

Medical Centers

- Financial statements must report depreciation, calculated and reported consistently throughout the institution. Medical centers may be required to maintain separate depreciation records, one for financial statement purposes consistent with the rest of the University, and one for Medicare costing purposes.

Planning and Budget

- Implementation of GASB No. 35 may limit the University's ability to maximize indirect cost recovery in future years.

- Depreciation reported in the financial statement may need to be explained and reconciled with requests to the State for funding of capital programs and equipment replacement.

Questions and Answers Forming the Alternatives

The answers to the following questions are crucial to defining a level of consistency in depreciation methodology that will comply with all applicable rules and regulations while providing the flexibility sought by the University.

(Note: All answers below are based on discussions with and review by PricewaterhouseCoopers.)

Financial Reporting Requirements under GAAP

1. The medical centers currently use the same methodology to report depreciation in their individual annual financial statements and in their Medicare costing reports. The medical center financial statements have been used to provide revenue bond holders with required financial information. Changing the depreciation method and useful lives used by the medical centers would require adjustments to their procedures and disrupt continuity in their financial statements. To avoid such adjustments and disruption in continuity, can the medical centers continue to use their current method and useful lives for their individual financial reports while a different set of useful lives is used for the total (primary) institutional financial statements? If so, what parameters and procedures would need to be implemented?

   Answer: The institution may continue to use the current method and useful lives for their individual medical center financial statements, and use a different set of useful lives for the institution's total (primary) financial statements. The segment reporting disclosure footnote in the total institution's financial statements will show the information from the individual audited medical center financial statements. This approach would require a footnote to the financial statements along the following lines: 'The medical centers use the lives specified by the AHA which approximate those used in the institution's financial statements.'

   Implication for UC: This process would allow UC to retain the current practices for the individual medical center financial statements and apply a uniform process for the institution's total financial statements.

2. The OMB said in J.12.b.(2), "The depreciation methods used to calculate the depreciation amounts for F&A rate purposes shall be the same methods used by the institution for its financial statements". Is the institution required to use the same useful lives for its financial statements and for F&A rate purposes?

   *Answer: Yes. The preamble to the revision "Require institutions that report depreciation on their financial statements to use the same depreciation method and **useful lives** for the F&A proposals". According to Gilbert Tran of the OMB, the same useful lives are required. The*

intent of the revision was to have the institution's external auditor report on the adequacy of the institution's asset depreciation methods, including the reasonableness of a particular asset's useful life.

According to PwC, the OMB and DHHS-DCA understand that the amount of depreciation to be reported in the institution's financial statements will not equal the amount included in the F&A rate proposals, but that the Institution should be able to demonstrate that the amounts reconcile.

Implication for UC: A strict application of this requirement will eliminate flexibility at the campus level. GAAP will require financial statements to apply the same method and lives to all buildings (or categories of buildings) across all campuses and medical centers. OMB Circular A-21 will require the same for grants and contract costing. A campus will not be able to depreciate buildings by their component parts unless all campuses are willing to do so for all similar buildings for both A-21 and financial reporting purposes.

3. If the intent of the OMB in requiring the same useful lives for costing and financial reporting was to have the external auditor report on the reasonableness of the useful lives used to calculate indirect costs charged to grants and contracts, it may be possible for the external auditor to test for reasonableness without the useful lives being the same for costing and financial reporting. Reasonable lives for financial reporting may not necessarily be reasonable for costing purposes. Can the institution comply with the requirement of A-21 without using the exact same useful lives for A-21 costing and financial statement reporting?

   Would the following procedure meet the requirements of OMB Circular A-21 as revised on June 1, 1998? If not, would the Institution's use of this process result in a finding by the auditor in the A-133 Audit Report? If so, what would be the likely finding?

   - Establish a institution-wide useful life table applicable to buildings. It will establish the useful lives for the following:

     (a) Life for entire building (not componentized) applicable to all buildings at campuses where no buildings are componentized -- 35 years.

     (b) Lives for individual building components if buildings are componentized:
     - Building shell -- 50 years.
     - Building services systems -- 25 years.
     - Fixed equipment -- 15 years.

     (c) Life for entire building (not componentized) applicable to non-componentized buildings, at campuses where some buildings are componentized: 40 years life.

   - The table above would be used in the following fashion:

     - Financial reporting: based on (a).

- Medicare costing: based on (b).
- A-21 costing: based on (b) and (c).

This alternative would allow the institution to retain its current practices, maximize campus flexibility and report depreciation in the institution's total financial statements using a uniform, centralized procedure. The institution would maintain three separate records. Records already exist for Medicare costing and A-21 contracts and grants costing. An additional process will be implemented to report depreciation for financial reporting. Since the new process will not be required to address the needs of Medicare or A-21, it would be much simpler to develop and implement.

Answer: No. The method described would not satisfy the consistency requirement. Although it provides for consistency across the institution for financial reporting, meets Medicare costing requirements, and satisfies the intent of OMB Circular A-21 to rely on the institution's external auditor to report on the reasonableness of the useful life assigned to a particular class of assets, it would fail the requirement for useful lives to be the same. It would result in a finding in the A-133 audit report.

Implication for UC: The implementation of GASB No. 35 will reduce the flexibility currently practiced by the University.

4. If the useful lives used for A-21 costing must be exactly the same as those used for financial statement reporting, and if the institution chooses to depreciate its buildings using a single useful life applicable to all buildings, what would be a reasonable average useful life for buildings at the institution?

Answer: Appraisal literature suggests that between 30 and 40 years may be reasonable. If such an approach is adopted, the institution should conduct a study to determine what would be reasonable.

Implication for UC: A study is required to determine a reasonable life. Shorter life may result in a loss of indirect cost recovery for older buildings due to "imputed" depreciation, but should increase recovery for newer buildings. A more in-depth study may be necessary to justify a shorter life.

5. What would be an example of an acceptable study to determine a reasonable useful life for buildings?

Answer: The institution could use the Uniform Building Code (UBC) and the lives recommended by references such as the Marshal & Swift – Uniform Architectural Valuation Handbook to calculate a weighted average life. Another method could be to use an industry average based on a survey of peer institutions.

Implication for UC: The University currently assigns the following UBC to its buildings:
- Fire Resistive Construction.
- Heavy Timber Construction.

- Ordinary Masonry Construction.
- Light Incombustible Construction.
- Wood Frame Construction.

UCOP will obtain the references and calculate the weighted average lives based on the UBC.

6. Must the institution apply the same useful life to all buildings?

   Answer: No, all buildings do not need to have the same useful life. However, similar buildings, with similar circumstances, should have similar useful lives. GAAP requires that depreciation be calculated in a systematic and rational manner. Thus, a reasonable average useful life for each category of similar buildings could be established and used.

   Implication for UC: It may be beneficial for the University to establish certain "categories of buildings" with associated useful lives.

7. If the institution may assign different useful lives to different categories of buildings, what are some examples of acceptable (and workable) "categories"?

   Answer: A good categorization could include those by type of building, such as laboratories, classrooms and offices, athletics, housing, libraries, etc. Categories could be established where there is a distinct pattern of construction (e.g., dollars per foot or systems value vs. shell) and consumption (e.g., frequent renovations).

   Implication to UC: UC could establish "laboratories" as a category. Definition of "laboratory" buildings would need to be developed.

8. If the institution chooses to conduct building componentization surveys and uses the results to calculate the depreciation of its buildings, must it survey all buildings, or can it choose to survey certain buildings and not others?

   Answer: When building componentization surveys are used to calculate a weighted average useful life per building (in total or per annual capitalization increment), it is viewed as a refinement in the estimate of useful life. Thus, the institution may survey individual buildings and not others if the surveys are used to calculate a weighted average useful life per building. Under this method the institution would need to track and depreciate future capitalizations (values capitalized on or after July 1, 2000) by the annual increment per building. These annual increments could be depreciated by the weighted average life of that specific increment per building (based on an analysis of the component parts), or by the weighted average life of buildings established for that category of buildings.

   If the institution uses the results of the survey to track and depreciate the individual components separately per building (rather than using it to establish a weighted average

useful life), it will be viewed as a change in methodology. Thus, the institution would not be allowed to survey, track and depreciate some buildings by their individual component parts and not others. However, the institution may apply this method to all buildings within a category of buildings and not to others. The categories must differentiate buildings by objectively definable criteria that are dependent on factors that affect the overall life of the building. The need to survey must be systematic and rational; that is, there should be a good reason to survey only one class and none of the rest. Within the "systematic and rational" criteria of GAAP, component lives should not vary significantly from those used for the rest of the buildings without a good reason.

Implication for UC: A special study would be required. Shorter weighted average life or depreciation by individual components may result in a loss of indirect cost recovery for older buildings due to "imputed" depreciation, but should increase recovery for newer buildings. Surveys will require additional allocation of resources.

Record keeping requirements would need to be changed to account for building values by their annual capitalized increment.

9. If the institution may componentize a category of buildings and not others, what are some examples of acceptable (and workable) categories for componentization?

Answer: The same categories listed in Answer No. 7 could apply (type of building, such as laboratories, classrooms and offices, athletics, housing, libraries, etc.)

Implication to UC: UC could establish "laboratories" as a classification. Definition of "laboratory" buildings would need to be developed.

10. To establish a weighted average useful life per building as described in Answer No.8 above, must the institution review each building individually, or can the weighted average life be established for all "laboratory" buildings based on a survey of some "laboratory" buildings?

Answer: Survey results from a representative sample of buildings may be applied to the unsampled buildings in that category. The acceptability of sampling would need to be confirmed with Department of Health and Human Services. It is likely that the sample would need to constitute a large portion of the building population for that category of buildings.

Implication for UC: Study to determine the weighted average useful life on a sample basis will require allocation of additional resources, but much less than having to analyze each building. However, the use of a sample study may not maximize indirect cost recovery since the cost of individual improvements of unsurveyed buildings will not be assigned to specific space.

11. Are any other acceptable alternatives available to the institution that will meet the A-21 useful lives requirement in concept without using the same lives for all purposes?

Answer: The institution could conduct a detailed componentization survey (10-15 components) for some buildings and summarized componentization (2-3 components) for others.

Viable Alternatives

Alternatives were developed based on the questions and answers presented above. Each alternative was analyzed for their compliance with requirements and for their operational practicality. The viable alternatives are presented below and summarized in Attachment 1. Some alternatives were considered and rejected. They are presented in Attachment 2 for your information.

The following principles apply to the alternatives presented below:

- The more evidence that supports the estimates of useful lives, the better. Hence campuses may add buildings to the component analysis in accordance with the alternative chosen even if other buildings are not analyzed. This approach provides campuses with a degree of flexibility.
- If different lives are assigned to similar buildings used in like circumstances, these should be justified by specific evidence. The different lives must also be within a reasonable range.
- A campus may initially select from methods 1 through 4 independently of other campuses. Method 5 will require simultaneous adoption by all campuses.
- A campus may change in future years from Method 1 to 2, 3 or 4 or other combinations in ascending order; however, a campus may not change from 4 to 3, or other combination in descending order.

Method 1 -- (Campus by Campus Option)
Establish a single useful life for all buildings.

A single campus-wide weighted average building useful life (likely to be between 30 and 40 years, 32 years is used here for discussion purposes) would be developed through the analysis of UBC and the *Marshall and Swift – Uniform Architectural Valuation Handbook* and applied to all buildings.

- Each building capitalization (including additions and renovations to existing buildings) made on or after July 1, 2000 would be tracked and depreciated separately with a new 32-year life cycle.
- When appropriate, campuses may associate the annual capitalized increment of the building with the specific space to which the capitalization relates to effect more accurate costing.
- Building values capitalized before July 1, 2000 would be depreciated based on the established single useful life. Depreciation will be taken until the building is fully depreciated. Refer to IRM No. 3 for information on establishing the June 30, 2000 balance of accumulated depreciation for each existing building.

Medical centers would maintain current process for individual medical center financial statements and Medicare costing.

Advantages:

- Simplicity in calculation.
- Easiest to justify the life used.
- Compliant with GAAP (with appropriate disclosure footnotes).
- Compliant with A-21.
- Increases indirect cost recovery by applying a shorter life than the current use allowance life of 50 years.

Disadvantages:

- Calculated indirect costs may be less compared to depreciation based on building component surveys.

Method 2 -- (Campus by Campus Option)
Establish a single life per category of buildings ("laboratory" and "all other").

Two separate campus-wide weighted average building useful lives (likely to be between 30 and 40 years; 30 years for "laboratory" and 32 years for "all other" is used here for discussion purposes) would be developed through the analysis of UBC and the *Marshall and Swift – Uniform Architectural Valuation Handbook* and applied to each category of buildings.

- All buildings will be assigned to one of two categories ("laboratory" buildings and "all other" buildings) based on predominance of room type within a building. Specific definitions will be developed by UCOP.
- Two separate campus-wide weighted average useful lives would be developed through the analysis of UBC for each category of buildings and used to depreciate each building.
- Each building capitalization (including additions and renovations to existing buildings) made on or after July 1, 2000 would be tracked and depreciated separately with a new 30 or 32-year life cycle depending on the category of building.
- When appropriate, campuses may associate the annual capitalized increment of the building with the specific space to which the capitalization relates to effect more accurate costing.
- Building values capitalized before July 1, 2000 would be depreciated based on the established single useful life. Depreciation will be taken until the building is fully depreciated. Refer to IRM No. 3 for information on establishing the June 30, 2000 balance of accumulated depreciation for each existing building.

Medical centers would maintain current process for individual medical center financial statements and Medicare costing

Advantages:

- Simplicity in calculation.
- Easy to justify the lives used.
- Compliant with GAAP (with appropriate disclosure footnotes).
- Compliant with A-21.

- Increases indirect cost recovery by applying a shorter life than the current use allowance life of 50 years.
- May result in a shorter weighted average useful life for "laboratory" buildings than for "non-laboratory" buildings.

Disadvantages:

- Indirect costs would be less compared to depreciation based on building components.
- Somewhat more complex than Alternative No. 1.

Method 3 -- (Campus by Campus Option)
Survey some "laboratory" buildings.

Campus may decide to conduct a survey of certain "laboratory" buildings to establish a weighted average useful life for each surveyed building by annual capitalized increment.

- All buildings will be assigned to one of two categories ("laboratory" buildings and "all other" buildings) based on predominance of room type within a building. Specific definitions will be developed by UCOP.
- The surveyed "laboratory" buildings would be depreciated individually by annual increment by building, using the useful lives determined by the survey.
- The unsurveyed "laboratory" buildings would be depreciated in total by building (not by past annual increments) by the weighted average useful life of the surveyed "laboratory" buildings taken in total.
- Building values of "all other" buildings would be depreciated in total by building (not by past annual increments) based on the UBC analysis described in Method 2. Depreciation will be taken until the building is fully depreciated. Refer to IRM No. 3 for information on establishing the June 30, 2000 balance of accumulated depreciation for each existing building.
- Each building capitalization (including additions and renovations to existing buildings) made on or after July 1, 2000 would be tracked and depreciated separately with a new life cycle. The new life cycle may be based on an analysis of the specific building increment, or on the weighted average life used for unsurveyed "laboratory" buildings, or UCB life for "all other" buildings.
- When appropriate, campuses may associate the annual capitalized increment of the building with the specific space to which the capitalization relates to effect more accurate costing.

Medical centers will maintain current system for individual medical center financial statements and for Medicare costing.

Advantages:

- Sample study will reduce implementation costs (compared to study of all buildings).
- Increase indirect cost recovery for newer buildings.
- Compliant with GAAP (with appropriate disclosure footnotes).
- Compliant with A-21.

Disadvantages:

- Requires a defendable survey of a sample of "laboratory" buildings (implementation costs).
- Must objectively identify "laboratory" buildings.
- Must assign and track specific lives to individual buildings.
- May reduce indirect cost recovery for older buildings.

Method 4 -- (Campus by Campus Option)
Survey all "laboratory" buildings.

Conduct a survey of all "laboratory" buildings to establish a weighted average componentized useful life for each "laboratory" building by annual capitalized increment. These buildings would be depreciated individually by their annual capitalized increment with the useful lives as determined by the survey.

- All buildings will be assigned to one of two categories ("laboratory" buildings and "all other" buildings) based on predominance of room type within a building**.** Specific definitions will be developed by UCOP.
- The surveyed buildings would be depreciated individually by annual increment by building, using the useful lives determined by the survey.
- The useful life of "all other" buildings would be determined through the UBC analysis described in Method 2.
- Each building capitalization (including additions and renovations to existing buildings) made on or after July 1, 2000 would be tracked and depreciated separately with a new life cycle. The new life cycle may be based on an analysis of the specific building increment, or on the weighted average life used for surveyed or unsurveyed buildings.
- When appropriate, campuses may associate the annual capitalized increment of the building with the specific space to which the capitalization relates to effect more accurate costing. .
- Building values of unsurveyed buildings ("all others") capitalized before July 1, 2000 would be depreciated based on the life determined by the UBC analysis. Depreciation will be taken until the building is fully depreciated. Refer to IRM No. 3 for information on establishing the June 30, 2000 balance of accumulated depreciation for each existing building.

Medical centers will maintain current system for individual medical center financial statements and for Medicare costing.

Advantages:

- Increase indirect cost recovery for newer buildings.
- Compliant with GAAP (with appropriate disclosure footnotes).
- Compliant with A-21.

Disadvantages:

- Requires a survey of all "laboratory" buildings (implementation costs).
- Must objectively identify "laboratory" building.
- Must assign and track specific lives to individual buildings.
- May reduce indirect cost recovery for older buildings

Method 5 -- (Must be Adopted by All Campuses)
Survey all "laboratory" buildings UC-wide and depreciate by individual building component.

Survey each and every "laboratory" building UC-wide to establish, track and depreciate each component separately for each building.

- All buildings will be assigned to one of two categories ("laboratory" buildings and "all other" buildings) based on predominance of room type within a building. Specific definitions will be developed by UCOP.
- All "laboratory" buildings will be surveyed and depreciated individually by the annual increment by component by building, using the useful lives determined by the survey.
- The useful life of "all other" buildings would be determined through the UBC analysis described in Method 2.
- Each component of each building capitalization (including additions and renovations to existing buildings) made on or after July 1, 2000 would be tracked and depreciated separately with a new life cycle. The new life cycle would be based on established lives assigned to each component type.
- When appropriate, campuses may associate the annual capitalized increment of the building with the specific space to which the capitalization relates to effect more accurate costing.
- Building values of "all other" buildings capitalized on or after July 1, 2000 (including additions and renovations to existing buildings) would be tracked and depreciated separately by their annual increment per building with a new life cycle. The new life cycle would be based on the life determined through the UBC analysis as described in Method 2.
- Building values of unsurveyed buildings ("all others") capitalized before July 1, 2000 would be depreciated in total (not by annual increment) based on the life determined by the UBC analysis. Depreciation will be taken until the building is fully depreciated. Refer to IRM No. 3 for information on establishing the June 30, 2000 balance of accumulated depreciation for each existing building.

Medical centers will maintain current system for individual medical center financial statements and for Medicare costing.

This alternative must be implemented by all campuses, and cannot be implemented on a campus by campus basis since it bases depreciation on each component, rather than using the components to establish a weighted average, and therefore represents a different "accounting method".

Advantages:

- Compliance with GAAP (with appropriate disclosure category).
- Compliance with A-21.
- Maximize indirect cost recovery for newer buildings.

Disadvantages:

- Must be adopted by all campuses. May not be implemented on a campus by campus basis.
- Requires study of each and every building within a category (implementation costs).
- Requires tracking and depreciation by individual building components (ongoing record maintenance and calculation costs).
- Would reduce indirect cost recovery for older buildings.

Recommendation / Conclusion

- Begin collecting information for the implementation of Method 1 (single building life applicable to all buildings based on analysis of UBC) for the fiscal year beginning July 1, 2000. Also develop numbers for Method 2.

- Each campus must decide if they desire to implement Method 3, 4 or 5. Campuses may select among Method 1 through 4 independently of other campuses. Method 5 can be adopted only if all campuses are willing to do so.

- Campuses electing Method 3 or 4 must proceed to conduct necessary surveys. Upon completion of the surveys, the campuses will incorporate the results into the electronic files to be sent to UCOP (according to specifications to be defined).

- If all campuses desire Method 5, campuses must proceed to conduct necessary surveys. Upon completion of the surveys, the campuses will incorporate the results into the electronic files to be sent to UCOP (according to specifications to be defined).

Next Step – Required Action

1. PwC and UCOP will continue to discuss the viability and details of the presented methods.
2. Seek campus concurrence with the recommended approach at the May summit meeting.
3. Set schedule for implementation.
4. Begin implementation.

Depreciation Methods -- Viable Alternatives

Coarser information → **Finer information**

	Individual Campus Options -- A campus may move from one method to another in ascending order over time.				**Must be adopted by all campuses**
	Method 1	**Method 2**	**Method 3**	**Method 4**	**Method 5**
	Single weighted average life for all buildings based on UBC analysis	**Separate lives for labs and other buildings based on UBC analysis**	**Survey some lab buildings; apply results individually to surveyed buildings; weighted average life applied to non-surveyed lab buildings**	**Survey every lab building and apply results individually to surveyed buildings.**	**Survey every lab building and depreciate individual component per building**
Use of Building	**Life**	**Life**	**Life**	**Life**	**Life**
Labs	Building 1 32 2 3 4 … 20 … 28 29 30 32	Building 1 30 2 3 4 … 20 … 28 29 30 30	Building 1* 28 2* 27 3* 26 4* 25 26 … 20* 28 … 28** 26 29** 30**	Building 1* 28 2* 27 3* 26 4* 25 … 20* 28 … 28* 25 29* 30 30* 27	Building 1* 28 2* 27 3* 26 4* 25 … 20* 28 … 28* 25 29* 30 30* 27
Other Buildings	Building 31 32 70 71 … 200 … 226 … 229 32	Building 31 32 70 71 … 200 … 226 … 229 32	Building 31 32 70 71 … 200 … 226 … 229 32	Building 31 32 70 71 … 200 … 226 … 229 32	Building 31 32 70 71 … 200 … 226 … 229 32
Source of Lives - Labs	Average of appraisal based on UBC of all buildings.	Average of appraisal based on UBC of laboratory buildings.	Survey of components applied to each building in aggregate (weighted average of components) per building (not by individual component).	Survey of components applied to each building in aggregate (weighted average of components) per building (not by individual component).	Component study applied to each component in the buildings studied
Source of Lives - Other Bldg.	Average of appraisal based on UBC of all buildings.	Average of appraisal based on UBC of all other buildings.	Average of appraisal based on UBC of all other buildings.	Average of appraisal based on UBC of all other buildings.	Average of appraisal based on UBC of all other buildings.
How Life is Applied					
Capitalized after 7/01/00	By annual increment, life based on specific analysis of increment, or UBC.	By annual increment, life based on specific analysis of increment, or UBC.	By annual increment, life based on specific analysis of increment, or weighted average life of category.	By annual increment. For "labs" -- life based on specific analysis of increment, for "other buildings" -- based on UBC.	For "labs", by annual increment, by individual component based on specific analysis of increment. For "other buildings", by annual increment, based on UBC.
Capitalized before 7/01/00	By Total building based on UBC.	By Total building based on UBC.	By annual increment for surveyed buildings, by total building for unsurveyed buildings based on weighted average life of category.	For "labs" -- by annual increment, life based on specific analysis of increment. For "other buildings" -- by total building, life based on UBC.	For "labs", by annual increment, by individual component based on specific analysis of increment. For "other buildings", by total building, based on UBC.
Comments	Assumes UBC per building is available.	Assumes UBC per building is available.	Definition of "lab" buildings to be established. Must survey majority of lab buildings (by value).	Definition of "lab" buildings to be established.	Each component depreciated over its own life

UBC = Uniform Building Codes.
Lives shown are examples for discussion purposes and do not necessary reflect the actual lives to be used.
* Surveyed laboratory buildings.
** Non-surveyed laboratory buildings.

Rejected Alternatives

The following alternatives were considered, and rejected for the following reasons:

- Not in compliance with GAAP.
- Not in compliance with GAAP, OMB Circular A-21.
- Required additional resources without benefits beyond those offered by other accepted alternatives.

Method A
Individual building componentization through review of each and every building – all buildings

Review each and every building to establish cost of each component for each building for use in financial reporting, A-21 and Medicare costing purposes. All buildings and components acquired after July 1, 2001 (including additions and renovations to existing buildings) would be tracked and depreciated individually by their components or by the total annual increment. Buildings (or portion of buildings) acquired prior to July 1, 2001 could be tracked and depreciated by their components, or could be tracked and depreciated based on a weighted average useful life based on the componentization study.

Advantages:

- Full compliance with GAAP (with appropriate disclosure footnote).
- Full compliance with A-21.
- Consistent with process currently used by medical centers.
- Fully documented and justified.
- Maximize indirect cost recovery for newer buildings.

Disadvantages:

- Requires study of each and every building (greatest implementation costs).
- Requires tracking and depreciation by individual building components (greatest ongoing record maintenance and calculation costs).
- Difficult to establish accumulated depreciation to date (see IRM #3).
- Would reduce indirect cost recovery for older buildings.

Method B
Single average componentized life applied to all buildings based on sample study

Conduct UC-wide sample study to develop a single weighted average componentized useful life for all buildings for use in financial reporting and A-21 costing. Medical centers would maintain current system for individual medical center financial statements and Medicare costing. All buildings and components acquired after July 1, 2001 (including additions and renovations to existing buildings) would be tracked and depreciated individually by their components or by the

total annual increment. Buildings (or portion of buildings) acquired prior to July 1, 2001 would be tracked and depreciated by the single weighted average useful life based on the sample componentization study.

Advantages:

- Full compliance with GAAP (with appropriate disclosure footnote) assuming validity of sample study.
- Full compliance with A-21 assuming validity of sample study.
- Sample study will reduce implementation costs.
- Increase indirect cost recovery for newer buildings.

Disadvantages:

- Requires valid sample study (implementation costs and difficulty of establishing validity of overall sample without extensive coverage).
- Requires tracking and depreciation by individual building components for future acquisitions (ongoing record maintenance and calculation costs).
- Difficult to establish accumulated depreciation to date (see IRM #3).
- May reduce indirect cost recovery for older buildings.
- Indirect cost recovery would be less compared to Alternative #2.

Method C
Establish a UC-wide building useful life table, applied selectively (a process to conceptually comply with the requirements of OMB Circular A-21)

Establish UC-wide building useful life table containing:

If no buildings are componentized (use for financial reporting):

(a) Single life for entire uncomponentized building (Between 30 and 40 years). All buildings and components acquired after July 1, 2001 (including additions and renovations to existing buildings) would be tracked and depreciated separately based on between 30 and 40 years

Or, if some buildings are componentized (use for A-21 and Medicare costing):

(b) Life for each type of component e.g.:
    - building shell (50 years)
    - building services systems (25 years)
    - fixed equipment (15 years)

(c) Life for entire uncomponentized building (Between 30 and 40 years)

Advantages:

- Allow maximum flexibility by maintaining status quo for A-21 and Medicare costing.
- Simplicity in calculation for financial reporting.
- Easier to justify the life used.
- Easier to establish accumulated depreciation to date (see IRM #3).
- Full compliance with GAAP.

- Up to individual campus to decide to depreciate by component for A-21 costing purposes to increases indirect cost recovery for newer buildings.

Disadvantages:

- May require study to justify the lives used (implementation costs).
- Does not fully comply with the requirements of A-21.