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; however, it represents the best information available to date.

University of California
GASB 35 Depreciation Reporting

Issues Resolution Memo No. 10

Establishing Capitalization Thresholds for Additions and Modifications to Buildings & Structures, General Improvements and Infrastructure Assets

Define Issues

The University should establish capitalization thresholds for buildings, general improvements and infrastructure additions and modifications. A threshold should promote consistency in the capitalization process throughout the institution. In addition, the University must clarify when expenditures should be capitalized.

Background

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

Current Policies and References

DHHS—Division of Cost Allocation F&A Rate Proposal Review Guide

> The (federal) negotiator should be aware that many universities will expense costly capital construction projects, such as new roofs, completely new heating, ventilation, and air-conditioning (HVAC) systems, road construction, etc. Capital construction, renovation, alteration, equipment, and similar accounts should be analyzed and appropriate adjustments should be made for those assets that were expensed and should have been capitalized.

UC Policy

The UC Accounting Manual chapter, *Investment in Plant* (P-415-3), currently states the following:

- *II.B.*—Buildings & Structures, Account 101801

  All costs incurred in connection with the construction or purchase of a new building or modular unit; costs incurred in connection with significant alterations or structural changes in an existing building that result in greater usefulness, increased efficiency, or the increased life of a building; or improvements over $100,000 to a leased building are to be capitalized. Many types of costs may be chargeable to a building project. Items which are ordinarily capitalized include, but are not limited to, the following:

  1) Preliminary costs (such as site clearance, test boring and material testing, blueprints, plans, specifications, and advertising for bids).
  2) Construction costs (general construction, heating, ventilating, electrical or mechanical work, and interest expense).
  3) Built-in equipment (equipment permanently attached, or attached in such a manner as to be considered permanent).
  4) Architects' and engineers' fees, and the cost of supervision and inspection by the campus architect's office.

- *II.C.*—General Improvements, Account 101802

  General Improvements include landscape and road improvements; external utility systems; and special facilities, such as outdoor water fountains. The external utility systems on a campus are the utility lines constructed outside the buildings and structures. (Costs of utilities constructed within a building are capitalized as part of the building.) On a campus, the utility lines ordinarily consist of such items as the telephone system, electrical system, water distribution system, sewer and drainage system, steam supply and heating system, irrigation system, fire alarm system, service tunnels, and gas service lines.

  General improvements also include preliminary costs and architects' and engineers' fees.

- *III*—Capitalization from Unexpended Plant

  Capitalization is the transfer of capital expenditures—for projects 90% or more completed—from Unexpended Plant to the capital assets accounts in Investment in Plant. (A project less than 90% completed at fiscal year end should be transferred to Construction in Progress.)

- *III.D.*—Reporting

  The cost of completed construction projects should be capitalized at the end of each quarter (i.e., September, December, March, and June).

  (In addition, P-415-8, *Unexpended Plant Funds*, Section IV.A. indicates that "the costs of completed projects are capitalized in the Investment in Plant balance sheet.)

The Accounting Manual chapter, *Capitalization of Expenditures Made From Current Funds* (P-415-1) provides the following:

- *II.B.5.*—Expenditures of $35,000 or More

  Current Funds expenditures that are otherwise determined to be of capital nature should be capitalized when the amount of each job equals or exceeds $35,000. An exception to this policy occurs with respect to a newly acquired building or structure requiring the establishment of an asset on the plant records for the first time. In this case, the expenditure should be capitalized without regard to the $35,000 minimum stated above.

Recommended Approach

- The University will continue to capitalize all costs associated with the construction or purchase of new buildings and structures.
- Building costs should be capitalized when construction projects are 90 percent complete or a certificate of occupancy has been issued.
- The University will establish a threshold of $100,000 for capitalizing improvements, renovations and modifications to buildings, infrastructure assets and general improvements. Items below $100,000 should be expensed.

Next Steps—Required Actions

- OP must determine what the State defines as "minor capitalization lower limit." The University's capitalization policy should match State requirements.
- OP must determine whether the threshold provided in the Accounting Manual P-415-1, Section II.B.5 can be changed from $35,000.
- OP will draft an Accounting Manual chapter to outline capitalization thresholds.
- OP will update the current Accounting Manual regarding when building costs should be capitalized.