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. 17

Approach to Depreciating Equipment

Define Issues

In order to comply with the requirements of GASB Statements 34 and 35, the University must establish procedures for the consistent treatment and reporting of equipment depreciation (campus and medical centers).

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 GAAP (generally accepted accounting principles) and are subject to audit under GAAS (generally accepted auditing standards).

University-Owned Equipment

All University-owned equipment is reported on the balance sheet. The University does not currently report depreciation in its consolidated audited financial statements, although depreciation is reported in the audited financial statements of individual medical centers.

University-Wide Useful Life Table

Depreciation of equipment is calculated based on a single University-wide useful life table using the straight-line method. The table is used currently for medical center costing and reporting, F&A rate proposals, and State budget reporting.

Authoritative Guidance

Authoritative guidance is provided in Appendix 1.

Recommended Approach

The University will depreciate all capitalized items of University-owned equipment (items with a useful life greater than one year and acquisition value of $1,500 or more).

Determining the Accumulated Depreciation Balance as of June 30, 2000

- OP will generate depreciation history (accumulated depreciation balances) for all University-owned equipment reported on the EFA100 file (equipment inventory) submitted for FY 1999-2000. The depreciation history will not be calculated for classification code H50XX–Works of Art, Antiques, and Special Collections because under GASB Statements No. 34 and 35 these items are not depreciated.
- The annual depreciation expense will be calculated for each item of equipment, for each year, from the original acquisition date through June 30, 2000, and totaled to establish the accumulated depreciation balance at June 30, 2000 (not to exceed the original acquisition value).
- Depreciation expense for each asset will be calculated for whole years (12 months per year), regardless of the specific month of acquisition.
- The University will assume that the acquisition balance at June 30, 2000 is equal to the original acquisition value. This assumption ignores the possibility that additions or enhancements may have been made to individual items from their original date of acquisition to June 30, 2000, because such modifications are judged to be immaterial.

Calculating Depreciation Expense for Fiscal Year Beginning July 1, 2000

- All University-owned equipment (not including H50XX–Works of Art, Antiques, and Special Collections) will be included in the University's depreciation database.
- University-owned equipment will be identified using the title field in the EFA100 file.
- The University will calculate the annual depreciation expense for UC-owned equipment included in the depreciation database.
- Each year, the University will perform a data file comparison between the prior year equipment depreciation database and the current year EFA100 to track the following actions:
  - new pieces of equipment;
  - equipment where title has been transferred to the University;
  - equipment that has been disposed;

    - inter-campus and intra-campus (general campus, medical center, etc.) equipment transfers;
    - funding source changes/corrections; and
    - acquisition cost changes/corrections.

- Useful lives will be established at the time of acquisition and will be based on the classification code assigned to the equipment and the University-wide useful life table. Therefore, it is critical that campuses use the correct classification code at the time the item of equipment is added to the equipment management system. The useful life assigned to an item of equipment will not be adjusted, regardless of additions or deletions. However, equipment with additions will effectively be depreciated over a period of time longer than its assigned useful life.

  The following provides an illustration of the recommended approach to equipment depreciation:

    - An item of equipment is purchased in October 2001 for $50,000 and has a five year useful life. The annual depreciation expense is $10,000.
    - In August 2004, a $20,000 addition is made to the equipment.
    - Although the useful life for the equipment is five years, the equipment will be fully depreciated in six years when the accumulated depreciation equals the acquisition value.

FY	Acquisition Value	Useful Life	UC Reported Depreciation Expense	UC Reported Accumulated Depreciation
2001	$50,000	5	$10,000	$10,000
2002	50,000	5	10,000	20,000
2003	50,000	5	10,000	30,000
2004	70,000	5	14,000	44,000
2005	70,000	5	14,000	58,000
2006	70,000	5	12,000	70,000

Approach to Title Transfers of Non-University-Owned Equipment

Title of non-University-owned equipment is occasionally transferred to the University at a later date. The following describes the recommended approach for the treatment of these items.

- Campuses will continue to report non-University-owned equipment on the equipment inventory (EFA100).
- Non-University-owned equipment will be identified using the title field in the EFA100 file.

- The University will capitalize and begin to record and report depreciation and accumulated depreciation only when title is transferred to the University.
- The original acquisition value will be used to capitalize and report depreciation expense and accumulated depreciation.
- The useful life will be established at the time of title transfer and will be based on the classification code and the useful life table at that time.
- The following examples provide illustrations of the recommended treatment of title transfers to the University:

  Example 1:

  - A $200,000 item of equipment is purchased with federal funds in February 2000 and has a useful life of five years. The federal government retains title to the equipment. The item is not capitalized and not depreciated.
  - In November 2001, title is transferred to the University.
  - At December 31, 2001, the equipment will be capitalized using the original acquisition value of $200,000.
  - Depreciation expense will be calculated and reported in the financial statements beginning in FY 2002.
  - The acquisition value will be depreciated over the useful life determined by the classification code assigned at the time title is transferred to the University.

FY	Acquisition Value	Useful Life	UC Reported Depreciation Expense	UC Reported Accumulated Depreciation	UC Title
2000	200,000	5	n/a	n/a	N
2001	200,000	5	n/a	n/a	N
2002	200,000	5	$40,000	$40,000	Y
2003	200,000	5	40,000	80,000	Y
2004	200,000	5	40,000	120,000	Y
2005	200,000	5	40,000	160,000	Y
2006	200,000	5	40,000	200,000	Y

Next Steps—Required Actions

- OP will seek campus concurrence with the recommended approach at the January North/South meeting.
- Campuses will provide the December 31, 2000 EFA100 data files and reconciliation schedules to OP as described in IRM No. 2 and IRM No. 5, Addendum A. These files are due no later than April 11, 2001.

Appendix 1—Authoritative Guidance

GASB Statement No. 34

GASB Statement No. 34 sets forth the requirement for reporting depreciation in a public institution's annual financial statements.

> *Paragraph 18*—Capital assets should be reported at historical cost. The cost of a capital asset should include capitalized interest and ancillary charges necessary to place the asset into its intended location and condition for use. Ancillary charges include costs that are directly attributable to asset acquisition—such as freight and transportation charges, site preparation costs, and professional fees. Donated capital assets should be reported at their estimated fair value at the time of acquisition plus ancillary charges, if any.
>
> *Paragraph 19*—As used in this Statement, the term capital assets includes land, improvements to land, easements, buildings, building improvements, vehicles, machinery, equipment, works of art and historical treasures, infrastructure, and all other tangible and intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period…
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> *Paragraph 20*—Capital assets that are being or have been depreciated (paragraph 22) should be reported net of accumulated depreciation in the statement of net assets. (Accumulated depreciation may be reported on the face of the statements or disclosed in the notes.)…
>
> *Paragraph 21*—Capital assets should be depreciated over their useful lives unless they are either inexhaustible or are infrastructure assets reported using the modified approach in paragraphs 23 through 25. Inexhaustible capital assets such as land and land improvements should not be depreciated.
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> *Paragraph 22*—Depreciation expense should be reported in the statement of activities as discussed in paragraphs 44 and 45. Depreciation expense should be measured by allocating the net cost of depreciable assets (historical cost less estimated salvage value) over their estimated useful lives in a systematic and rational manner. It may be calculated for (a) a class of assets, (b) a network of assets, (c) a subsystem of a network, or (d) individual assets. (Composite methods may be used to calculate depreciation expense. See paragraphs 161 through 166 for a more complete discussion of depreciation.)
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> *Paragraph 117*—Information presented about major classes of capital assets should include:
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> a. Beginning- and end-of-year balances (regardless of whether beginning-of-year balances are presented on the face of the government-wide financial statements), with accumulated depreciation presented separately from historical cost

b. Capital acquisitions

c. Sales and other dispositions

d. Current-period depreciation expense, with disclosure of the amounts charged to each of the functions in the statement of activities.

OMB Circular A-21

OMB Circular A-21, *Principles for Determining Costs Applicable to Grants, Contracts, and Other Agreements with Educational Institutions*, sets forth the guidelines for the treatment of equipment in the development of facilities and administrative (F&A) cost rate proposals.

J.12—Depreciation and use allowances

a. The computation of depreciation or use allowances shall be based on the acquisition cost of the assets involved. For this purpose, the acquisition cost will exclude (1) the cost of land; (2) any portion of the cost of buildings and equipment borne by or donated by the Federal Government, irrespective of where title was originally vested or where it is presently located; and (3) any portion of the cost of buildings and equipment contributed by or for the institution where law or agreement prohibit recovery. For an asset donated to the institution by a third party, its fair market value at the time of the donation shall be considered as the acquisition cost.

b. In the use of the depreciation method, the following shall be observed:

(1) The period of useful service or useful life established in each case for usable capital assets must take into consideration such factors as type of construction, nature of the equipment, technological developments in the particular area, and the renewal and replacement policies followed for the individual items or classes of assets involved.

(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.

(3) Where the depreciation method is introduced to replace the use allowance method, depreciation shall be computed as if the asset had been depreciated over its entire life (i.e., from the date the asset was acquired and ready for use to the date of disposal or withdrawal from service). The aggregate amount of use allowances

and depreciation attributable to an asset (including imputed depreciation applicable to periods prior to the conversion to the use allowance method as well as depreciation after the conversion) may be less than, and in no case, greater than the total acquisition cost of the asset.

e. Charges for use allowances or depreciation must be supported by adequate property records, and physical inventories must be taken at least once every two years to ensure that the assets exist and are usable, used, and needed. Statistical sampling techniques may be used in taking these inventories. In addition, when the depreciation method is used, adequate depreciation records showing the amount of depreciation taken each period must also be maintained.

J.16—Equipment and other capital expenditures

a. For purposes of this subsection, the following definitions apply:

(1) "Equipment" means an article of nonexpendable, tangible personal property having a useful life of more than one year and an acquisition cost which equals or exceeds the lesser of the capitalization level established by the organization for financial statement purposes, or $5000. The unamortized portion of any equipment written off as a result of a change in capitalization levels may be recovered by continuing to claim the otherwise allowable use allowances or depreciation on the equipment, or by amortizing the amount to be written off over a period of years negotiated with the cognizant agency.

(2) "Capital expenditures" means the cost of the asset including the cost to put it in place. Capital expenditure for equipment, for example, means the net invoice price of the equipment, including the cost of any modifications, attachments, accessories, or auxiliary apparatus necessary to make it usable for the purpose for which it is acquired. Ancillary charges, such as taxes, duty, protective in transit insurance, freight, and installation may be included in, or excluded from, capital expenditure cost in accordance with the institution's regular accounting practices.

(3) "Special purpose equipment" means equipment which is used only for research, medical, scientific, or other technical activities.

(4) "General purpose equipment" means equipment, the use of which is not limited only to research, medical, scientific or other technical activities. Examples of general purpose equipment include office equipment and furnishings, air conditioning equipment, reproduction and printing equipment, motor vehicles, and automatic data processing equipment.

b. The following rules of allowability shall apply to equipment and other capital expenditures:

(1) Capital expenditures for general purpose equipment, buildings, and land are unallowable as direct charges, except where approved in advance by the sponsoring agency.

(2) Expenditures for special purpose equipment are allowable as direct charges with the approval of the sponsoring agency.

(3) Capital expenditures for improvements to land, buildings, or equipment which materially increase their value or useful life are unallowable as direct charges, except where approved in advance by the sponsoring agency.

(4) Capital expenditures are unallowable as F&A costs. See Section J.12 for allowability of depreciation or use allowances on buildings, capital improvements, and equipment. Also see Section J.38 for allowability of rental costs on land, buildings, and equipment.

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

III. Depreciation and Use Allowances

2. The amount for depreciation/use charge purposes is acquisition cost except where the asset was donated to the institution by an independent third party, the value is the market value at the time of donation. Where acquisition cost is used it should reflect the actual amount recorded in the records of the institution. If cost records do not exist, an estimate of the acquisition cost is usually based on an independent and professional appraisal. Where such appraisals are used, care should be exercised to ensure that the amount used reflects the cost at the time of purchase and not replacement cost at the time of appraisal. In all cases where depreciation of use charges are material in amount, the negotiator should be satisfied that the valuation bases are proper. Appraised amounts should be performed by independent and professional appraiser or by other reliable methods (e.g., insurance valuation).

4. The term "class of assets" in this context differs from the use of the term in connections with the grouping of assets according to their useful lives for purposes of computing depreciation. Such grouping must include only those assets which have common useful lives… In the case of equipment, institutions may group their equipment into the following classes for purposes of applying the restriction:

   - Office equipment (e.g., desks, files, typewriters, etc.)
   - Scientific equipment (e.g., microscopes, spectrometers, dental chairs and dental treatment units, laboratory benches, x-ray machines, etc.)
   - Automatic data processing equipment (e.g., central processing units, tape drives, disc drives, etc.)
   - Building services equipment (e.g., air conditioning/heating systems, plumbing systems and fixtures, electrical systems, elevators, fire escapes, etc.)…

- Transportation equipment (e.g., automobiles, trucks, trailers, motorcycles, airplanes, etc.)
- Educational and other support equipment (e.g., classroom furniture, audio visual equipment, shop machinery and tools, musical instruments, athletic equipment, etc.)

5. Asset lives should be based on actual history of buildings and equipment at the particular university.

7. With very rare exceptions, Circular A-21 requires the use of the straight-line method.