

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**

### **Addendum C to Issues Resolution Memo No. 1**

#### **Consistency in Calculation Methodology—Depreciation of Buildings**

This addendum addresses campus comments to IRM No. 1, and Addenda A and B to IRM No. 1. It provides information on the following topics:

- critical elements that campuses must consider before selecting a depreciation method; and
- a review of the A-21 costing allocation algorithm developed to optimize the distribution of building costs under Methods 3 and 4.

#### **Limitation on Campus Options**

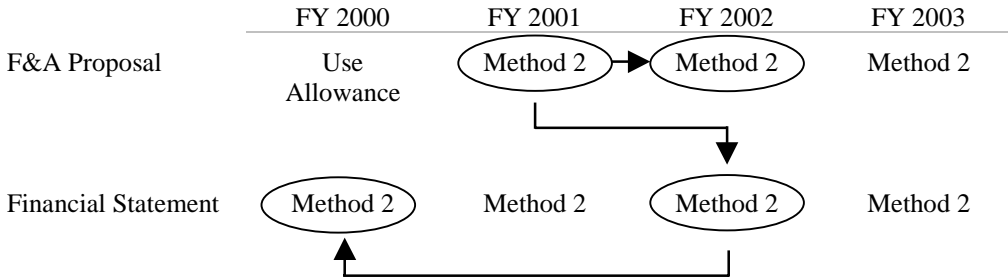
Several campuses have elected to perform building componentization studies to support their F&A cost rate proposals before the FY 2001–02 depreciation reporting implementation year. Electing to perform these studies has a direct impact on the depreciation methods these campuses must choose.

Performing a building componentization study provides a campus with significantly better information than the default depreciation methodologies (Methods 1 and 2). As such, those campuses who will perform building componentization studies before July 1, 2002, will be limited to choosing between Methods 3 (A or B) and 4. The University cannot ignore a known change in estimate in future years, especially when a campus has (or will have) better building data from which to calculate depreciation expense and accumulated depreciation.

Below are examples that describe several F&A proposal scenarios and their impact on which depreciation methodology may be selected for the purposes of implementing depreciation reporting.

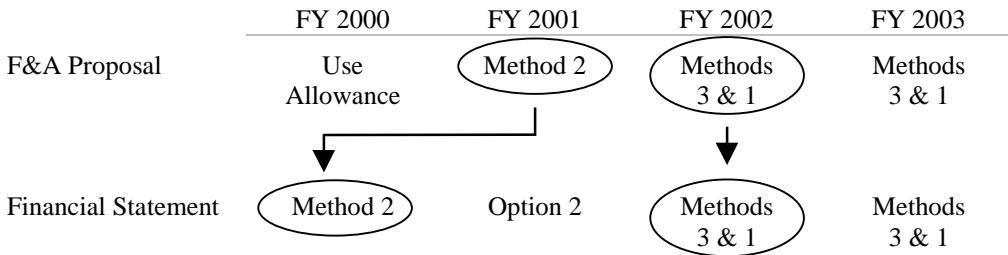
**Example 1: Campus' next F&A rate proposal will be based on FY 1999–00 or FY 2000–01 costs, and plans to use Methods 1 or 2 for the rate proposal.**

**A.**



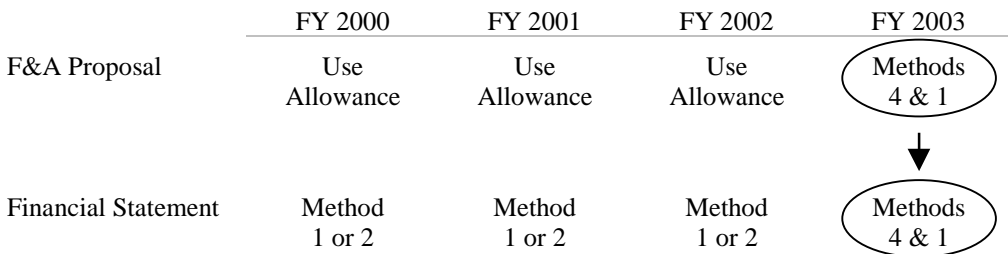
- Campus would most likely choose Method 2.
- There is no motivation to consider Methods 3 or 4 until the next F&A rate proposal is prepared and submitted.
- However, if the campus calculates an F&A rate that does not meet its expectations, the campus may elect to use the provisional rates for one year and prepare a rate proposal using Method 3 for lab buildings and Method 1 for all other buildings (based on FY 2001–02 data).

**B.**



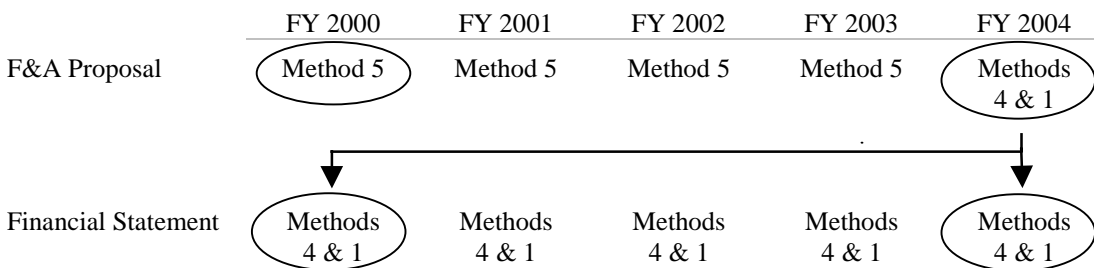
- Example 1B demonstrates a change in estimate that would be reported prospectively only (i.e., there are no prior year adjustments) for the financial statements or for the F&A rate proposal.

**Example 2: Campus' next F&A rate proposal will be based on FY 2001–02 (or after) costs, and plans to use Methods 3 or 4.**



- Campus may choose Methods 1, 2, 3, or 4 for financial statement reporting purposes until the year the F&A rate proposal is prepared and submitted.
- In order to comply with the requirements of OMB Circular A-21, the campus must begin using the same method for financial statement reporting purposes in the year the F&A rate proposal is prepared and submitted.
- Example 2 demonstrates a change in estimate that would be reported prospectively only (i.e., there are no prior year adjustments) for the financial statements or for the F&A rate proposal.

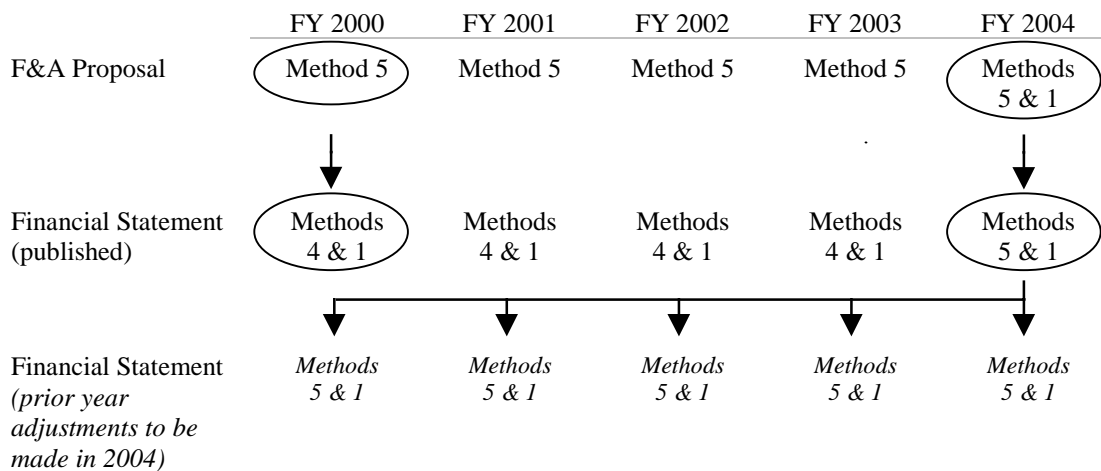
**Example 3: Campus prepares an F&A rate proposal based on FY 1999–00 (or FY 2000–01) costs using Method 5; the next F&A proposal will be submitted based on FY 2002–03 (or later) costs.**



- The campus submits an F&A proposal based on FY 1999–00 costs and performs a building componentization survey for all lab buildings and uses a 50 year life (A-21 use allowance) for all other buildings.
- The campus’ next F&A proposal will be developed based on FY 2003–04 costs and it is likely the campus will select Method 4 (or 5, if possible) for lab buildings and Method 1 for all other buildings to prepare the proposal and to continue to optimize F&A costs recovery.
- In order to simplify the implementation of depreciation reporting, the campus may initially wish to select Methods 1 or 2 for financial reporting. However, because the campus elected to perform a building survey in FY 2000 and had “better” information for it’s lab buildings, the campus would be required to select Method 4 for all lab buildings and Method 1 for all others. The University cannot ignore a known change in estimate in FY 2003–04, when a campus has “better” information in FY 1999–00 and it is likely to use Method 4 in the future.
- This example applies whether the building componentization studies are performed in FY 2000 or FY 2001. Building componentization studies that are planned for FY 2001 must be completed and the data provided to OP by April 2001.

- In Example 3, there is a change in method (i.e., from accelerated depreciation to straight line depreciation) impacting the FY 2004 F&A proposal. The treatment of the difference will have to be addressed in the that proposal and through negotiations with the federal government.

**Example 4: Campus prepares an F&A rate proposal based on FY 1999–00 (or FY 2000–01) costs using Method 5; the next F&A proposal will be submitted based on FY 2003–04 costs. In FY 2004, all UC campuses agree to employ Method 5.**



- Campus submits an F&A proposal based on FY 1999–00 costs and performs a building componentization survey for all lab buildings and uses a 50 year life (A-21 use allowance) for all other buildings. Therefore, in FY 2000, the campus must choose Methods 4 and 1 for financial statement reporting purposes.
- The campus' next F&A proposal will be developed based on FY 2003–04 costs. However, in FY 2004, all ten UC campuses agree to move to Method 5 (lab buildings) and Method 1 (all other buildings) for calculating and reporting depreciation.
- The University-wide move to Method 5 constitutes a change in method and would require the University to recalculate depreciation expense and accumulated depreciation for prior years.

### **Allocation of Building Costs to Functions for F&A Proposal Development**

Several comments were received regarding the allocation limitations of Methods 3 and 4 in optimizing recovery, especially of fixed equipment costs. Building componentization studies segregate fixed equipment costs which have shorter useful lives and higher costs. One of the benefits of performing a building componentization study is the ability to

identify fixed equipment costs by room so that these costs subsequently may be allocated to A-21 room functions in the development of F&A proposals. Typically, organized research employs significantly higher fixed equipment costs than other activities (e.g., instruction, academic support, etc.). We have developed an algorithm that would use the building componentization data to optimize building costs allocation, as well as comply with the OMB Circular A-21 requirement that colleges and universities use the same depreciation methods for financial statement reporting.

In the following example, the campus has a six room building with an annual capitalized increment of \$6 million. A building survey is performed and provides the following information:

Annual Capitalized Increment FY 1999–00 at \$6 million  
 Weighted Average Life is 28.33 years  
 Annual Depreciation Expense = \$211,790

Building Component	Room Number						Total
	101	102	103	104	105	106	
Fixed Equipment (15 years)	500,000	500,000					1,000,000
Systems (25 years)	500,000	500,000	500,000	500,000			2,000,000
Shell & Other (35 years)	500,000	500,000	500,000	500,000	500,000	500,000	3,000,000
<b>Total</b>	<b>1,500,000</b>	<b>1,500,000</b>	<b>1,000,000</b>	<b>1,000,000</b>	<b>500,000</b>	<b>500,000</b>	<b>6,000,000</b>
	25.00%	25.00%	16.67%	16.67%	8.33%	8.33%	100.00%

*Note:* Useful lives of 15, 25, and 35 years were used as place holders for this example. UCOP will consult with PwC regarding the final lives to be used.

Based on the information provided by the building survey, the campus can identify the building’s annual depreciation expense by room and allocate the room costs to the appropriate A-21 function.

	Room Number						Total
	101	102	103	104	105	106	
Depreciation Expense	\$52,947	\$52,947	\$35,298	\$35,298	\$17,649	\$17,649	\$211,790

*Note:* \$211,790 is the depreciation expense reported in the financial statements and the F&A proposal (\$6 million ÷ 28.33 years).