TAB 2

POINT PAPER

Capitalization Policy
For discussion only

Problem: During the FY07 audit, CPA Associates recommended that the city should review its capitalization policy and increase the threshold. Currently the threshold is set at $500 and the auditors feel it is too low for an organization of our size. The audit comment was repeated with the FY08 audit.

Background: Currently, the city's capitalization threshold is set at $500 per unit of asset regardless of type. The city currently has total assets in excess of $60 million. The auditors feel that this $500 threshold is much too low for a city of our size.

Staff is making the following recommendations:

1. Increase the threshold for equipment and vehicles to $2,000 per unit, and $20,000 for all other categories such as land, buildings, improvements, infrastructure and intangible assets.
2. Do not revalue the current assets, since most assets under $2,000 are already depreciating or are fully depreciated, but implement this change on a "going forward" basis.
3. Continue to track, and inventory, assets between $500 and $2,000 but not include them on the financial statements.

Alternatives:

1. Do nothing.
2. Discuss and give staff direction on the valuation of the city's fixed assets.

Recommendation: Staff recommends Commission's discussion and consensus of the $2,000 and $20,000 thresholds.

Budget Impact: The budget will not be impacted. Any budget now categorized as capital assets between $500 and $2,000 will need to be moved to a non-capital line.

CITY OF PALMETTO FLORIDA
ASSET CAPITALIZATION POLICY

1. Scope of Policy

This Asset Capitalization Policy applies to the capitalization of capital assets in all funds of the City of Palmetto Florida.

2. General Objectives

This Asset Capitalization policy establishes guidelines for determining:

- which expenditures should be capitalized as a capital asset and which expenditures should be expensed.
- how to value capital assets that are reported.
- the estimated useful lives of capital assets.
- the tracking of controllable assets

3. Capital Assets

By definition, any asset, tangible or intangible, that benefits the City more than one fiscal period potentially could be classified as a capital asset. As a practical matter, however, governments capitalize only their higher cost assets. Capitalization thresholds are established to determine which assets are capitalized and which assets are expensed when purchased.

The City must maintain adequate control over all assets, including lower-cost capital assets. Capitalization is designed to focus on the City's financial reporting needs, and is not designed for or particularly suited for the purposes of ensuring control over lower-cost assets. Capitalizing numerous small cost items will actually overburden the overall capital asset management system. Capitalization thresholds are established based on financial reporting needs.

4. Capital Asset Types

Capital assets are divided between assets that are not subject to depreciation and assets that are subject to depreciation.

Assets that are not subject to depreciation include:

- Land. The amount that should be capitalized for land should include the cost of the land itself; professional fees used to acquire the land (legal, engineering, appraisal, survey fees); costs for excavation, fill, grading, or drainage; demolition of any existing buildings or other improvements; and any other costs that are incurred to acquire the land and make the land suitable for use by the Town. The value of easements should also be capitalized. Land is characterized as having an unlimited life and is therefore not depreciated.
- Construction in progress. The costs of assets that the City is constructing, where expenses are incurred over more than one fiscal year, are accumulated as construction in progress until the asset is placed in service. At that time, the total costs are then transferred to the appropriate asset type and depreciated.

Assets that are subject to depreciation include:

- Buildings and building improvements. Buildings are permanent structures that are intended for shelter of persons, materials or equipment. Building improvements are capital events that extend the useful life of a building or increase the value of a building, or both. Repairs that simply maintain the existing life or restore a building to its original condition do not constitute an improvement.

- Improvements Other Than Buildings. Improvements Other Than Buildings are those improvements, other than ordinary and regular site preparation, which ready the land for its intended use. Such improvements can include parking lots, athletic fields, fencing, paths and trails, and landscaping.
- Infrastructure. Infrastructure assets are long-lived capital assets that are stationary in nature and can be preserved for a significantly greater number of years than most capital assets. Such assets can include streets and roadways, bridges, sidewalks, water mains and distribution lines, sewer mains and collection lines, and treatment plants.
- Equipment. Equipment is an item of tangible, nonexpendable personal property with a useful life of more than one year, and includes machinery and vehicles.
    - Leased assets are all assets acquired by a capital lease and shall be treated as a City owned asset and capitalized according to the appropriate capitalization threshold. Assets acquired through an operating lease are returned to the lessor at the end of the tease term and are not deemed to be owned by the City.
- Intangible or Other Capital Assets. Intangible assets can be identified by determining if the asset can be separated or divided from the government by sale, transfer, license, rental or exchange or if it arises from contractual or other legal rights.
    - Software. Software is an intangible item that is used on a computerized piece of equipment. Software is capitalized only when it is an integrated system that entails several modules such as an accounting software used city wide or the historical cost of the system exceeds $20,000.
    - Other intangible assets could include water rights, patents.

5. Acquisition and Valuation of Assets

All capital assets are acquired in accordance within the City's budget and according to purchasing policy. Capital assets should be reported at their historical cost. In the absence of historical cost information, the assets estimated historical cost may be used. If capital assets are moved from one fund or activity to another, the recipient fund or activity should continue to report those assets at their historical cost as of the date they were originally acquired.

The historical cost of a capital asset should include ancillary charges necessary to place the asset in its intended location (freight charges, for example); ancillary charges necessary to place the asset in its intended condition for use (installation or site preparation charges, for example); and capitalized interest (only for those assets that are utilized in enterprise funds that are reported as a part of business-type activities).

Estimating the historical cost of capital assets for which invoices or similar documentation of historical cost are not available can use either standard costing or normal costing. Standard costing involves using historical sources, such as old vendor catalogs, to establish the average cost of obtaining the same or a similar asset at the time of acquisition. Normal costing involves establishing the current cost of the same or similar asset and deflating that cost using an appropriate price index.

Donated capital assets are recorded at fair market value at the time of acquisition. Assets estimated to have a value in excess of $5,000 must be appraised by a person knowledgeable and qualified with respect to that type of asset.

All land or building acquisitions with an estimated value in excess of $20,000 must be appraised by a licensed real estate appraiser.

Assets acquired through capital leases meeting the capitalization requirements should be recorded at the historical cost of the asset not including any lease interest payments.

Assets acquired by the exercise of eminent domain powers shall be capitalized in the General Fixed Asset Account Group in the amount of compensation awarded the property owner plus legal service costs incidental to the acquisition.

6. Expenditure Types

Controllable assets are defined as assets (excluding software) having values of $500 to $2,000 and a useful life of greater than one fiscal period. These assets are required to be expensed but are to be controlled for insurance and inventory reporting purposes and will be assigned an asset number. However, these controllable assets will not be capitalized and will not be reported as capital assets in the City's CAFR. Sample controllable assets are: computer equipment and software, tools,

Repair and Maintenance costs are expenditures necessary for the upkeep of the property that neither add to the permanent value of the property nor appreciably prolong its intended life, but keep it in an efficient operating condition. All repair and maintenance costs to capital assets are to be treated as an annual operating expense and charged to the appropriate Cost Center or Fund.

6. Capitalization Thresholds

The City establishes the following Capitalization Thresholds for the following groups of assets:

Land and easements	$ 20,000
Buildings and building improvements	$ 20,000
Equipment and vehicles	$ 2,000
Infrastructure	$ 20,000
Improvements Not Buildings	$ 20,000
Software	$ 20,000

7. Depreciation

Assets that are capitalized will be depreciated over their estimated useful lives. Depreciation will be calculated on the straight-line basis, using estimated useful lives as follows:

Buildings and building improvements	30 years
Furniture, fixtures, equipment and vehicles	7 years
Infrastructure – Utility systems, roads and sidewalks	50 years
Intangibles (excluding land related assets)	7 years