University System of Maryland
Capital Asset & Depreciation Guidance

Prepared by USM Office
Final as of June 27, 2002

Introduction

The purpose of this document is to provide guidance for the uniform recording of capital assets and annual depreciation as required under GASB Statement No. 35 "Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities – Amendment of GASB Statement No. 34 (GASB34/35). In accordance with GASB 35, the University System of Maryland is required to record depreciation expense beginning with the June 30, 2002 audited financial statements. This document is to be used as a supplement to the Board of Regent's Policy for Capitalization and Inventory Control (VIII-1.1).

Requirements

Fixed asset records are to be maintained in a manner that will support financial statement disclosure and recording requirements. Institutions will need to report depreciation expense in total and by program. Required in the notes to the financial statements is a report of capital asset activity, including additions, retirements and accumulated depreciation by major categories.

1. Requirements for a complete fixed asset record are as follows: asset description, acquisition date, useful life and historical cost. In addition, there should be a basis to identify improvements with the original asset.

2. Fixed asset records should reconcile to the audited financial statements.

3. Periodic comparisons of real property records to facilities map, and inventory of personal property.

4. Accumulated depreciation as of July 1, 2001 will be recorded as a prior period adjustment on the June 30, 2002 financial statements. Depreciation expense will be recorded annually, and allocated by program expense beginning with the June 30, 2002 financial statements.

Asset Categories

Categories	Capitalization Threshold
Land	$ 1
Land Improvements and Infrastructure	250,000
Buildings and Building Improvements	250,000
Equipment (Furniture, equipment, vehicles, books)	5,000
Construction in Process	1
Works of Art	1

All assets must be included in one of the above categories for financial statement disclosure purposes. GASB 34/35 also requires a separation of depreciable and non-depreciable assets. For example, historical library books, which are not depreciated, should be accounted for separately from the other library books for financial statement disclosure purposes.

Generally, assets that cost less than the established thresholds should be expensed in the period the cost are incurred. Due to materiality, annual additions of library books should be used to determine the amount capitalized rather than individual purchases.

Transition

Institutions will need to review existing records to ensure they are in compliance with the minimum requirements of record keeping under GASB 34/35. The first step in ensuring the validity of existing records is to compare the balance to the most recent audited financial statements, and to ensure completeness by comparing the records for real property to a facilities map.

Once the records have been inventoried and reconciled to the financial statements, the next step is to ensure the completeness of the records for each asset listed. The following information should be included for each asset: historical cost, acquisition date, useful life, asset class, project, and program. Possible resources that may be used to complete fixed asset records include manual reports, facilities records, internal reporting tools, appraisals and purchase documents. Institutions have the flexibility of determining the most appropriate method for compiling fixed asset listings based on the information available.

For equipment acquired prior to July 1, 2000, Institutions may use an estimation method to allocated depreciation among program expenses. It is preferred that all assets be assigned a related program expense that most closely relates to its purpose. However, Institutions may review equipment acquisitions over a two-year period as a basis for allocating depreciation expense among program expenses for equipment acquired prior to July 1, 2000. For assets acquired after June 30, 2000, assignment of the asset to a related program should be based on its actual purpose and maintained as part of the fixed asset record.

The Institution must document how their existing records have been maintained, and what assumptions or judgements were required to meet the requirements under GASB 34/35.

Historical Cost and Records

A complete fixed asset record includes asset description, acquisition date, and historical cost.

By comparing the detail real property listing to facilities maps, Institutions should be able to identify incomplete or missing records. Institutions may need to use a number of resources to complete detail records during the implementation phase of GASB 34/35. Resources include invoices, "Financial Reports" issued by the former University of Maryland, bond records, board minutes, and internal facilities reports.

Approaches for estimating historical cost for infrastructure assets, when detail is not available are specifically identified within GASB Statement 34. However, an acceptable approach for determining cost when you may not know the date the work was completed is as follows:

Set up three categories – excellent, good and poor.
Determine the condition of the infrastructure, i.e. roads.
Determine what category the infrastructure belongs – either in total or in-groups.
Assign a remaining useful life to each category – excellent 20 years, good – 10 years remaining, and poor 2 years remaining
Using today's cost deflate back accordingly – excellent – use current cost, good – 10 years and poor 18 years
Accumulated depreciation would be recorded consistent with the assigned category

Whatever approach is used, assumptions and calculations must be fully documented.

All significant assets must be accounted for even if fully depreciated.

Capital Assets

Capital assets include land, land improvements, buildings, building improvements, vehicles, machinery, equipment, works of art, infrastructure, library books, and all other assets that are used in operations, and have useful lives extending beyond a single reporting period. The historical cost of these assets must also meet the established capitalization thresholds.

Depreciation Method and Convention

Depreciation expense will be recorded using the straight-line method. Recording depreciation in the month of acquisition is preferred. Alternatively, Institutions may elect to recognize a full year's depreciation in the year of acquisition and none in the year of disposal. The composite method is an acceptable method to calculate depreciation for library books and infrastructure.

Asset Unit

GASB 34 allows for depreciation to be calculated for a class of assets, a network of assets, a subsystem of network or individual assets. Institutions may use their judgement and experience to determine the best means to account for their assets. It is suggested that certain assets, such as roads, sidewalks and library books may be best accounted for by grouping annual capitalizable costs, rather than individual additions.

Land

All land acquired by purchase is recorded at cost including the amount paid for the land itself and all related acquisition costs. Land acquired by gift or bequest is recorded at the fair market value at the date of acquisition. When land is acquired with buildings erected thereon, total cost is allocated between the two in reasonable proportion at the date of acquisition. If the buildings were demolished the total contract price along with the cost of the razing are allocated to land.

Some of the specific elements of land cost include the following:

1. Original contract price
2. Broker's commission
3. Legal fees for examining and recording ownership
4. Cost of ownership guarantee insurance policies
5. Cost of real estate surveys.
6. Cost of an option when it is exercised.
7. Cost of razing an old building
8. Cost of canceling an unexpired lease.
9. Payment by the purchaser of accrued or unpaid taxes on the land at the time of purchase.

Land Improvements and Infrastructure

Infrastructure assets are long-lived capital assets that normally are stationary in nature and normally can be preserved for a significantly greater number of years than most capital assets.

Examples of infrastructure assets include roads, bridges, curbs, sidewalks, tunnels, drainage systems, water and sewer systems, and lighting systems. When ownership is unclear, if the Institution is responsible for maintaining infrastructure it should also report the asset.

Generally, infrastructure assets serve the general public, while land improvements will serve the use of a particular site or building. Examples of land improvements are parking lots, swimming pools and fencing. For financial statement disclosure purposes, infrastructure and land improvements will be combined.

Buildings

Buildings include permanent structures, and fixtures, machinery, and appurtenances that cannot be readily moved without disrupting the basic building structure or services to the building.

All buildings including those constructed by the Institution, and those purchased or received via gift have a useful life of 40 years beginning the date the building is placed in service. No depreciation should be recorded while a building is out of service for renovations. Partial depreciation should be recorded on a pro-rata basis if the building is only partially out of service. The existing structure will be assigned a useful life of 40 years.

Renovations that virtually replace all the internal and/or external structure of a building should be considered a new building structure, and depreciated accordingly.

Specific cost elements of buildings include the following:

1. Original contract price, cost of construction, or fair market value at time of gift or bequest.
2. Expenses incurred in remodeling, reconditioning or altering a purchased building to make it suitable for the purpose for which it was acquired.
3. Cost of excavation or grading or filling of land for the specific building.
4. Expenses incurred for the preparation of plans, specifications, blueprints
5. Cost of building permits.
6. Payment by the purchaser of unpaid or accrued taxes o the building to date of purchase.
7. Architects' and engineers' fees for design and supervision.
8. Other costs such as temporary buildings used during the construction period.
9. Unanticipated expenditures such as rock blasting or piling.

Building Improvements

Building improvements are significant additions, alterations, renovations or structural changes that extend the useful life or enhance the value of an existing building.

Improvements for which costs exceed $250,000, and are an integral part of the building, such as a roof, renovations to a floor, air conditioning and electrical work should either be added to the cost of the original building or recorded separately. Improvements should be depreciated over the remaining useful life of the building or its own useful life whatever is shorter. An estimate of the original cost of that portion of the building which has been replaced or removed as a result of the improvement, is deducted from the recorded valuation of the building. Useful lives for improvements should be determined by reference to the AHA "Estimated Useful Lives of Depreciable Hospital Assets (AHA Guide) or the USM List of Useful Lives (USM List) for that

particular asset. A useful life of 20 years has been established for improvements that are not specifically included in either the AHA Guide or the USM List.

Improvements to fully depreciated buildings should be treated as a separate asset, and depreciated over it's own useful life. Improvements made during the final five years of a building's life should also be recorded as a separate asset and depreciated over its own useful life.

Improvements or additions to an existing building which are not an integral part of the original asset, should be depreciated separately over its own useful life of 40 years. Non-integral improvements may include a new wing to an existing building where only a wall is shared between the old and new building. Another example of a non-integral improvement is a gutting of an existing building, where all that remains is the original shell, and a complete renovation is planned for the original building. The portion of the original building that is gutted should be written off and a new asset recorded.

Costs for non-integral improvements and improvements to fully depreciated assets should always be accounted for as separate assets. It is the Institution's option whether to record other "integral" improvements as additions to the cost of the original asset or to record as a separate asset. It is recommended that all (significant) improvements be recorded as separate assets. This allows the Institution to maintain the historical cost of its buildings separate from improvements. In any case, the Institution should be consistent in its accounting of improvements.

Computer Software

Effective for fiscal year ending June 30, 2002, USM has adopted Statement of Position 98-1 "**Accounting for the Costs of Computer Software Developed or Obtained for Internal Use**" as recommended by NACUBO Advisory Report 99-7 **Accounting and Reporting for Capitalization of Software**".

According to SOP 98-1, internal use software is software having the following characteristics:

a. The software is acquired, internally developed, or modified solely to meet the entity's internal needs.
b. During the software's development or modification, no substantive plan exists or is being developed to market the software externally.

There are three stages of computer software development: the preliminary project stage, the application development stage, and the post implementation/operation stage.

Stages of Computer Software Development

Preliminary Project Stage	**Application Development Stage**	**Post-Implementation/ Operation Stage**
Conceptual formulation of alternatives	Design of chosen path, including software configuration and software interfaces	Training
Evaluation of alternative	Coding	Application maintenance
Determination of existence of needed technology	Installation to hardware	
Final selection of alternatives	Testing, including parallel processing phase	

Capitalization of costs should begin when both

a. The preliminary project stage is completed, and
b. Management commits to funding a computer software project and it is probable that the project will be completed and the software will be used to perform the function intended.

Capitalization should cease when all substantial testing is completed.

Allowable capitalizable costs include only the following:

a. External direct costs of materials and services consumed in developing or obtaining internal-use computer software. (Examples of those costs included but are not limited to fees paid to third parties for services provided to develop the software during the application development stage, costs incurred to obtain computer software from third parties, and travel expenses incurred by employees in their duties directly associated with developing software.)
b. Payroll and payroll-related costs (for example, costs of employee benefits) for employees who are directly associated with and who devote time to the internal-use computer software project, to the extent of the time spent directly on the project (Examples of employee activities include but are not limited to coding and testing during the application development stage.)
c. Interest costs incurred while developing internal-use computer software (Interest should be capitalized in accordance with the provision of FASB Statement No. 34, Capitalization of Interest Cost.)

General and administrative costs and overhead costs should not be capitalized as costs of internal-use software. Internal and external costs incurred during the preliminary project stage should be expensed.

Training costs should be expensed as incurred.

In order for costs of specified upgrades and enhancements to internal-use computer software to be capitalized, it must be probable (reasonably assured) that those expenditures will result in additional functionality.

Licensed internal-use software

According to paragraph 32 of SOP 98-1, "entities often license internal-use software from third parties. Though FASB Statement No. 13, Accounting for Leases, excludes licensing agreements from its scope, entities should analogize to that Statement when determining the asset acquired in a software licensing arrangement."

According to FASB 13, if a lease meets one or more of the following criteria, it should be classified as a capital lease:

a. The lease transfers ownership of the property to the lessee by the end of the lease term.
b. The lease contains a bargain purchase option.
c. The lease term is equal to 75 percent or more of the estimated economic life of the leased property.

d. The present value at the beginning of the lease term of the minimum lease payments equals or exceeds 90 percent of the excess of the fair value of the lease property.

Computer Software to be Sold, Leased or Otherwise Marketed

FASB 86 "**Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed**" identifies costs incurred in the process of creating a software that are research and development costs and those that are production costs to be capitalized.

All costs incurred to establish the technological feasibility of a computer software product are research and development costs. These costs should be charged to an expense as incurred.

Costs of producing product masters incurred subsequent to establishing technological feasibility should be capitalized. However, production costs are not capitalized until both (a) technological feasibility has been established for the software and (b) all research and development activities for the other components of the product or process have been completed.

Capitalization of computer software costs should cease when the product is available for general release to customers.

Capitalized software costs are amortized on a product-by-product basis. The annual amortization is the greater of the amount computed using (a) the ration that current gross revenues for a product bear to the total of current an anticipated future gross revenues or (b) the straight-line method over the remaining estimated economic life of the product including the period being reported on.

At each balance sheet date, the unamortized capitalized costs of a computer software product shall be compared to the net realizable value of the product. The amount by which the unamortized capitalized costs of a computer software product exceed the net realizable value of that asset should be written off. The net realizable value is the estimated future gross revenues from the product reduced by the estimated future costs of completing and disposing of the product including the costs of maintenance and customer support. The amount of the write-down shall not be restored.

Accounting for Infrastructure and Library Books

Institutions may calculate depreciation for library books and infrastructure using the straight-line method or the composite method. A composite method enables the calculation of depreciation based on groups of similar assets.

Straight-line Method

Assume total cost of library books is $10,000,000 @ 6/30/01

	Additions	Accumulated Depreciation	Depreciation Expense
Beginning	$7,350,000	$7,350,000	
Year 10	500,000	500,000	
9	250,000	225,000	$25,000
8	150,000	120,000	15,000
7	150,000	105,000	15,000
6	350,000	210,000	35,000
5	250,000	125,000	25,000
4	100,000	40,000	10,000
3	500,000	150,000	50,000
2	200,000	40,000	20,000
1	200,000	20,000	20,000
Total	10,000,000	$1,535,000	215,000
FY02 Additions	$500,000		50,000
		Depreciation Expense FY02	$265,000

In the above example, disposals reduce the oldest recorded assets first. Assume retirements for FY02 are $50,000 and additions are $500,000.

The retirements of $50,000 will reduce the beginning cost and accumulated depreciation balance of $7,350,000 to $7,300,000. Depreciation Expense for FY02 would be $265,000.

Institutions may implement the policy to systematically write-off fully depreciated infrastructure rather than account for annual retirements.

Composite Method

Institutions may use the composite method to calculate depreciation expense for library books and infrastructure.

1. Determine the accumulated depreciation at June 30, 2001 by reviewing additions for the past 10 years for library books, and 20 years for roads, and calculating depreciation expense for each of those years.

2. In future years, depreciation expense would be computed by applying the annual depreciation rate to the current balance in the library or road account. For example:

Beginning balance	$10,000,000
Retirements	(999,990)
Additions	2,500,000
Adjusted balance	$11,500,010
Depreciation Rate	.05
Depreciation expense	$575,001

3. Using this method, no gain or loss is recorded upon the retirement of assets within the group. The cost is removed from the asset account and charged to the accumulated depreciation account. One way to determine the cost of the roads removed is by using average cost.

Assumptions	
total miles	300
miles replaced	30
beginning balance	$10,000,000
average cost/mile	$10,000,000/300= $33,333
cost of roads removed	30*33,333 = $999,990

Works of Art and Historical Treasures

All works of art, historical treasures and other similar assets should be capitalized at their historical cost or fair value at the date of donation. Capitalized collections or individual items that are exhaustible should be depreciated over their estimated useful lives. Depreciation is not required for collections or individual items that are inexhaustible.

According to GASB 34, an inexahustible collection, would meet the following criteria:

a. Held for public exhibition, education, or research in furtherance of public service, rather than financial gain
b. Protected, kept unencumbered, cared for, and preserved
c. Subject to an organizational policy that required the proceeds from sales of collection items to be used to acquire other items for collections.

Repairs and Maintenance

Ordinary repairs and maintenance costs should be expensed in the period in which they are incurred. Maintenance costs are incurred to keep operational assets in usable condition. Examples of ordinary maintenance costs include cleaning, painting, and lubrication. Ordinary repairs are recurring and usually involve small expenditures. Ordinary repairs represent outlays for parts, labor, and related supplies necessary to keep the asset in operation condition. Ordinary repairs and maintenance neither add materially to the value of the asset nor prolong its life considerably.

Extraordinary repairs that exceed the capitalization threshold, not recurring in nature, and increase the use value or the service life of the asset should be capitalized.

Allocation of Depreciation Expense

Depreciation expense for capital assets that can specifically be identified with a program should be included in its direct expense. Institutions should be able to reasonably allocate real property and related depreciation expense to the appropriate program expense. Depreciation expense for "shared" capital assets should be ratably included in the direct expenses of the shared expenses.

Depreciation for general infrastructure should not be allocated to various programs. It should be reported as a "operations and maintenance expense".

Process for Changing Useful Lives

The Institution that wants to change the useful life assigned to an asset, should provide documentation for the suggested change, including a comparison of their asset to other similar system assets and a quantification of the financial impact of using a different useful life.

USM Schedule of Useful Lives

Buildings	
Buildings (brick or concrete structures)	40 yrs
Other Buildings (wood barns or sheds, greenhouses, temporary structures)	25
Building improvements *(for assets not included in the AHA Guide or listed below)*	*20*
Land improvements	
Structure (parking lots, sidewalks, bus ramp, fencing, running track)	20
Groundwork (Golf Course, Ball Fields, Park Landscaping)	20
Infrastructure	
Utilities, water, drainage & sewer systems	25
Roads	20
Equipment – office (computers, AV equipment, building maintenance)	3-5
Equipment (copiers, printing equipment, communications equipment)	8-10
Equipment – non office (kitchen, lab equipment)	7-12
Computer Software	10-15
Medical Equipment	8-15
Agriculture & grounds equipment	10
Athletic/Recreational Equipment	8-12
Office Furniture (chairs, desks, file cabinets)	12-15
Marine Equipment	20
Musical Instruments	20
Vehicles	4-8
Library books	10
Art collections	7-10

Institutions may use the "American Hospital Association Estimated Useful Lives" to assist in determining the useful lives of assets not included above. The Institution however should select a useful life that falls within the range provided for the general category for which the asset in question will be reported. If the asset does not fall within any of the categories listed above, the Institution should document the reasoning for the specific useful life decision.