Capital Asset Policy

for the

Town of Seabrook, NH

August 2003

Prepared by the

Office of Finance

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Chapter 1
INTRODUCTION

The purpose of this Policy is to introduce capital asset accounting concepts and to establish the Town of Seabrook's own capital asset systems. The capital asset system is a subsystem of the entity accounting system and can be subdivided further into a capital asset accounting system and a capital asset management system.

A capital asset accounting system is a system of policies, procedures and methods for recording and reporting monetary amounts associated with capital asset transactions.

A capital asset management system is a system of methods, policies and procedures, which address the acquisition, use, control, protection, maintenance and disposal of assets.

Throughout this Policy, the two subsystems will be discussed together as they form the Town's capital asset system.

Chapter 2
CAPITAL ASSET DEFINITION

A capital asset is defined as a financial resource meeting all of the following criteria:

1. It is tangible in nature.
2. It has an extended useful life, of five years or longer. See BOS Minutes 06/22/11
3. It is not a repair part or supply item.
4. It has a value greater than $10,000. See BOS Minutes 12/17/08

Items meeting the capital asset criteria are classified by major categories such as land, buildings, improvements other than buildings, equipment, and construction-in-progress. Other categories may be identified and reported by the town if considered significant.

Chapter 3
CAPITAL ASSET PURPOSES

The purposes of a capital asset system may include financial statement information, insurable values, control and accountability, accounting for depreciation, preparation of capital and operating budgets, and debt management.

3.1 Financial Statement Information

The Governmental Accounting Standards Board requires capital assets reporting in order for a governmental entity to be in conformity with generally accepted accounting 'principles. A primary objective in the development of any capital asset system for governmental entities planning to prepare their financial statements according to generally accepted accounting principles is the ability to meet the various requirements for correct and complete presentation of capital asset financial information.

3.2 Insurable Values

Complete capital asset identification and valuation may prevent the local government from being over or under insured. In the event of a loss, property valuations, descriptions, and locations are necessary to insure full recovery under the policy. Insured losses are normally settled on the basis of reproduction cost new, less depreciation, less exclusions. Specific supportable insurable values are defined in the insurance policy in effect and should be reviewed. In some instances, an in-house estimate of cost or insurable value may not be sufficient to substantiate the amount of a loss. Rather, an appraisal by an independent third party may be required. The Town will maintain current Assessed Value of Land and the Replacement Value of Buildings.

3.3 Control and Accountability

The capital asset system will be used to maintain information regarding the location and responsible party of public property. The system permits loss, theft, or damage to property to be identified by a comparison of the asset on hand to the information found in the capital asset records.

3.4 Accounting for Depreciation

Depreciation of capital assets must be recorded to determine total expenses, net income and changes in fund equity of proprietary and government wide income statements. The amount of accumulated depreciation plus the amount of depreciation expense for the current period must be maintained for reporting purposes.

3.5 Debt Management

Being able to prepare a long-term capital budget allows management to identify both long and short term financing needs and to prepare to meet those needs.

Chapter 4
ACCOUNTING FOR CAPITAL ASSETS

The appropriate accounting treatment for the acquisition of a capital asset is governed by the fund type from which the capital asset was purchased and the ultimate use of the asset.

4.1 Fund Categories

There are three categories of funds used in governmental accounting. They are Governmental, Proprietary and Fiduciary funds.

1. Governmental Funds

Often called "source and disposition" funds, governmental funds are those funds through which most governmental functions typically are financed. A government's expendable financial resources and related liabilities, except those accounted for in proprietary funds, are accounted for through governmental funds. The four governmental fund types are: general, special revenue, capital projects and debt service.

2. Proprietary Funds

Sometimes called "commercial-type" funds, proprietary funds are used to account for a government's ongoing organizations and activities that are similar to those found in the private sector. All assets, liabilities, equities, revenues, expenses and transfers relating to the government's business activities are accounted for through proprietary funds. Proprietary fund are of two types: enterprise and internal service funds.

A. Enterprise Funds account for operations that are financed and operated in a manner similar to private business enterprises, i.e., where the intent is that the costs of providing goods or services to the general public on a continuing basis be financed through user charges.
B. Internal Service Funds account for the financing of goods or services provided by one department or agency to other departments or agencies of the governmental unit, or to other governmental units, on a cost reimbursement basis.

3. Fiduciary Funds

Fiduciary Funds are of two types, trust funds and agency funds. They are used to account for assets held by governmental unit in a trustee capacity and/or as an agent for individuals, private organizations, other governmental units or other funds.

4.2 Capital Assets Categories

Capital assets may be classified in three categories: general capital assets, fund capital assets and infrastructure, depending on whether the asset is associated with a governmental or proprietary fund type operation.

1. General Capital Assets

Capital assets associated with governmental functions are known as general capital assets. General capital assets are not included at the Fund Level, but are reported on the Government wide statements. The source of the money used to acquire general capital assets may include individual funds, federal or state grants, taxes, debt proceeds, etc. Source disclosure for general capital assets is only required if a comprehensive annual financial report is prepared. If the governmental entity is unable to identify sources from prior years, source disclosure may begin with the year for which the statements are prepared.

2. Fund Capital Assets

Capital assets utilized in proprietary (Enterprise and Internal Service) fund activities or in trust funds are accounted for in the appropriate fund, and are referred to as fund capital assets.

Enterprise fund capital assets are capitalized (recorded) in the fund because the capital assets are used in the production of the goods or services provided and sold. In order to determine profit or loss, the expense of using these assets (depreciation) must be included as an operating cost.

Internal Service fund capital assets are recorded in the fund accounts for similar reasons. These assets are also directly related to fund operations, as in the case with enterprise fund capital assets. Depreciation must be recorded to determine fund expenses, charges to departments, and changes in fund equity.

The identification of the source of capital assets associated with an enterprise or internal service fund is required in order for the entity to be able to properly prepare financial statements in accordance with generally accepted accounting principals. Sources may include federal grants, special assessments, property taxed, contributions from other funds or developers, and purchase or construction by the enterprise or internal service fund itself.

Capital assets associated with trust funds are also accounted for in those funds. This requirement assists in assuring compliance with the terms of the trust instrument, provides a deterrent to mismanagement of trust assets, and facilitates accounting for depreciation where the trust principal must be maintained intact.

3. Infrastructure

According to GASB 34, reporting public domain or 'infrastructure' capital assets - roads, bridges, curbs and gutters, streets and sidewalks, drainage systems, lighting systems, and similar assets that are immovable and of value only to the governmental unit is **not** optional. The Town of Seabrook has until December 30,2010 to record its Infrastructure.

Those capital assets belonging to an enterprise, internal service or trust fund must be recorded and reported within the fund. As an example, if the governmental entity had a sewer enterprise fund, then the underground sewer lines are to be considered fund capital assets and must be identified and reported.

4. Leased Assets

A review of each lease is necessary to determine whether the lease should be classified as an operating lease or a capital lease. There are four criteria used to make this classification, the underlying issue being whether the benefits and risks of ownership are transferred from the lessor to the lessee.

The purpose of the criteria is to establish the substance of the transaction and determine whether the lease is merely an extended rental agreement or actually an installment purchase in the form of a capital lease.

If a lease is classified as a capital lease, the asset and a corresponding liability for the lease payments will be reported on the financial statements of the lessee. A further discussion of leases is beyond the scope of this policy.

Chapter 5
VALUING CAPITAL ASSETS

As per the "Codification of Governmental Accounting and Financial Reporting Standards" section 1400.111, capital assets will be reported at cost or, if the cost is not practicably determinable, at estimated cost. Cost is defined as the cash price, or its equivalent, plus all other costs necessary to place the asset in its intended location and condition for use.

Donated capital assets shall be recorded at their estimated fair value at the time received.

5.1 Sources of Cost Data

Sources of acquisition cost include: vendor invoices, vouchers, canceled checks, check copies, check registers, expenditure journals, construction contracts, purchase contracts, contract payment records, real estate closing documents, purchase requisitions, purchase orders, general ledger accounts, inventory cards, legislative minutes, maintenance records, annual and capital budgets, appropriation documents, insurance values, price lists, and certificates of title. Expenditure vouchers, real estate closing documents, construction contracts and canceled checks are the most reliable cost sources.

Legislative minutes and appropriation and budget documents are good sources of data, particularly for land, buildings, and other costly assets. Adjustments must be made for amounts budgeted but not spent. This data should be supported by other documents, such as vouchers.

5.2 Existing Cost

There are many acceptable direct and indirect costing methods for property. Initial costs of capital assets are usually ascertainable from contracts, canceled checks and other transaction documents at the time of acquisition or construction, called direct costing. However, the Town of Seabrook is faced with the task of establishing capital assets records after many years of operation without such records, therefore being necessary to estimate the cost of such assets.

When it is necessary to estimate cost data, the normal costing method will be used. First determine the cost to reproduce the asset at current prices then using published indices, indexes the reproduction cost back to the acquisition date.

The extent to which capital assets costs have been estimated, and the methods of estimation, should be identified and maintained as part of the capital assets records, and will be disclosed in the notes to financial statements prepared using generally accepted accounting principles. Estimates must have some reasonable authoritative basis.

5.3 Cost of Land

Items that are included as part of acquisition cost for land are: purchase price, legal and title fees, appraisal fees, site preparation, including demolition of existing buildings. Sometimes the purchaser of land assumes certain obligations related to the land, such as liens on the property. In such situations, the cost of the land is the cash paid for it, plus the liens or other liabilities. In addition, if an improvement is permanent in nature, such as landscaping, then the item is properly chargeable to the land account. Improvements with limited lives, such as driveways, walks, fences, and parking lots, are best recorded separately as land improvements so they can be depreciated (expensed) over their estimated lives.

5.4 Land not Considered Capital Assets

Deeded or foreclosures - property acquired through tax deeds unless appropriated for some governmental purpose, should be carried in the taxes receivable account and is not considered a capital assets. Note: the appraised fair value of the property at the time of foreclosures should be noted.

Land purchased for the purpose of sale rather than use should be recorded in "assets held for resale" and is not considered a capital asset.

Cemetery - are considered non-capital land and therefore not recorded in the capital assets.

5.5 Cost of Buildings

The cost of buildings should include all expenditures related directly to their acquisition or construction. These costs include (1) purchase price, (2) direct materials, direct labor and overhead (indirect) costs incurred during construction, (3) fees, such as attorneys, architects and building permits, and (4) interest charges incurred during construction.

Financial Accounting Standards Board (FASB) Statement No. 34, "Capitalization of Interest Cost", requires the capitalization of material interest charges incurred when constructing a capital asset or preparing it for its intended use.

Example 5-1 Estimated Cost

Year of Acquisition: 1975
Taxable value - 1980: $35,000 - Land
$101,000 - Building
Taxable value is 35% of appraised value.
Estimated index= .65, i.e. historical cost is estimated to be 65% of the cun-ent value.

For reporting purposes, estimated cost is calculated as follows:

Land: (35,000/.35) * .65 = $65,000

Building: (101,000/.35) * .65 = $188,500

5.6 Cost of Machinery and Equipment

The cost of machinery and equipment includes the purchase price, freight and handling charges, insurance on the equipment while in transit, cost of special foundations if required, assembling and installation costs, and costs of conduction trial runs. Costs thus include all expenditures incurred in acquiring the machinery or equipment and preparing it for use, plus the market value of any trade-ins or exchanges. (See section entitled Special Cost Considerations).

5.7 Individual Item VS. Group Costing

Capital assets items may be capitalized in the following ways:

1. Capitalized - Individual Control:

Those items which can be identified by manufacturer, model and serial number, and, as such, are identifiable from other like items should be listed individually. Generally, examples of this classification include business machines, major machinery and equipment, audio visual equipment, communication equipment, etc.

2. Capitalized - Group Control:

Group costing will only be used for Infrastructure. Those items which (a) are homogeneous and not individually identifiable; (b) may or may not have a unit cost meeting the threshold level for capitalized assets but the practice is to purchase in groups and capitalize the total group cost; and, (c) will be maintained together or in the same general area, should be listed by homogeneous grouping.

5.8 Special Cost Considerations

Special cost considerations arise when dealing with group purchases, trade-ins, gifts, cash discounts and purchases on deferred payment plans:

1. Group Purchases

If several dissimilar assets are purchased for a lump sum, the total amount paid should be allocated to each individual asset on the basis of its fair market value (FMV). This is accomplished by use of the equation:

ASSET Y = (TOTAL COST OF ASSETS)* (TOTAL FMV/FMV OF Y)

2. Trade-Ins

The cost of the asset acquired when payment includes both cash and a trade-in is the sum of the cash paid plus the fair market value of the asset traded-in. If the fair market value of the asset being traded-in is not readily determinable, cost may be recorded as the cash paid plus the book value (cost minus accumulated depreciation) of the asset traded-in.

3. Gifts

Assets acquired by gift should be recorded on the basis of their estimated fair market value at the time of acquisition.

4. Cash Discounts

Assets should be recorded net of any quantity or trade discounts received. The asset is recorded at a cost equal to the amount of cash paid, not the gross amount of the invoice.

5. Purchase on Deferred Payment Plan

Assets purchased on long-term credit contracts should be recorded at the present value of the payments to be made - the cash equivalent price of the asset. An asset, therefore, that requires five annual payments of $1,000 should not be recorded originally at $5,000. The cash equivalent price (present value) would be an amount less than $5,000 because of the time value of the money involved. This value of money over time is represented by the interest rate.

6. Sources of Fund Capital assets

To prepare financial statements in accordance with generally accepted accounting principles, it is essential to identify the source of proprietary fund capital assets. Sources may include taxes, contributions from other funds, debt proceeds, donations from developers, federal or state grants, and revenue generated by the operation of the proprietary fund itself.

Chapter 6
COSTS SUBSEQUENT TO ACQUISITION

After capital assets are acquired and made ready for use, additional costs are incurred that range from ordinary repair costs to significant additions. Accountants for the most part have adopted the position that costs incurred to achieve greater future benefits should be capitalized, whereas expenditures that simply maintain a given level of services should be expensed. In addition, most expenditures below the capitalization threshold are not capitalized.

The distinction between a capital expenditure and an expense is not always quickly determinable. Generally, the major types of expenditures incurred relative to existing assets are:

A. Additions - Increase or extension of existing assets.
B. Improvements and Replacements - Substitution of an improved asset for an existing one.
C. Repairs - Expenditures that maintain assets in condition for operation.

6.1 Additions

Any additions to assets are capitalized because a new asset has been created that increases the ability to provide service.

Accounting for changes related to the existing structure must also be considered. The cost that is incurred to tear down a wall of the old structure to make room for the addition would normally be expensed and the cost of the wall subtracted from the cost of the original structure. Although theoretically correct, this may not be possible or necessary due to the inability to establish a cost for the wall being tom down or because the cost would be immaterial to the total cost of the old structure. However, when significant changes to the existing structure are made as the result of an addition, a determination should be made whether to capitalize the cost of the changes. If a significant portion of the old structure is tom down, the cost of the demolished portion should be removed from the capital assets records.

6.2 Improvements and Replacements

An improvement is the substitution of a better asset for the one currently used, while a replacement is the substitution of a similar asset for the one being used. Sometimes it is difficult to differentiate improvements and replacements from normal repairs. If the expenditure increased the future service potential of the asset, it should be capitalized. If the expenditure maintains the existing level of service, it should be expensed/expended as a normal repair.

To capitalize an expenditure as an improvement or replacement, record the new asset being acquired and remove the old asset from the capital assets records.

6.3 Repairs

Ordinary repairs are expenditures made to maintain assets in operating condition; they are charged in the period in which they are incurred on the basis that it is the only period benefited. Replacement of minor parts, lubricating and adjusting of equipment, repainting, and cleaning are examples of the type of maintenance charges that occur regularly and are treated as ordinary operating expenses. It is often difficult to distinguish a repair from an improvement or replacement. The major consideration is whether the expenditure increases the future service potential. If a major repair, such as an overhaul, occurs, several periods will benefit and the cost should be handles as an addition, improvement, or replacement, depending on the type of repair made.

Chapter 7
DEPRECIATION

The usefulness of most assets, other than land, declines over time and some type of write-down or write-off of cost is needed to indicate that the usefulness of an asset has declined. Depreciation is the term most often used to indicate that tangible assets have declined in service potential. Where natural resources, such as oil, natural gas,,timber and coal are involved, the term depletion is used.

7.1 Estimated Useful Lives

The ranges of the useful lives used for depreciation are as follows:

A. Buildings	30-100 Years
B. Improvements other than buildings	5-30 Years
C. Machinery and equipment	5 Years
D. Infrastructure	20-50 Years

7.2 Straight Line Depreciation

The Town of Seabrook will depreciate all assets using the straight-line method. Example: The Town purchased a truck to be used in the sewer operation which is accounted for as an enterprise fund. The cost of the truck was $10,000, its estimated useful life is four years and its salvage value is estimated at $1,000. The truck was purchased on January **1**, 1988. On December 31, 1988, the depreciation expense is calculated in the following manner:

Example 8-1 Depreciation Expense

Depreciation Expense= (Cost - Salvage value)/ Estimated useful life

= (10,000 - 1.000) / 4

= $2,250

The book value of an asset is the original cost minus accumulated depreciation. At December 31, 1988, the truck's book value is $7,750.

Depreciation expense is the same for each year of the estimated useful life. Accelerated methods of depreciation such as sum of the year's digits or declining balance may also be used when appropriate.

Chapter 8
DISPOSITION OF CAPITAL ASSETS.

Regardless of the time of disposal, depreciation expense should be taken up to the date of disposition and all amounts related to the retired asset should be removed from the accounts. Ideally, the book value of the specific asset would be equal to its disposal value. This is generally not the case, however, a resulting gain or loss occurs.

Gains or losses on the retirement of assets will be reposted in the income statements along with other non-operating revenues/expenses that arise from ordinary business activities.

Transfers and retirement of capital assets by sale, trade or scrapping will require approval by the Town Manager to guard against illegal unauthorized disposition and the proper documentation forwarded to the Finance office on a timely basis.

Chapter 9
PROCEDURE

A. When a fixed asset is received, department will be responsible for completing the "Capital Asset Addition" form and submitting it to the Finance Department. Departments will also be responsible to make sure all donated assets are accepted at a Public Hearing.

B. Removal of capital assets will require a "Deletion/Transfer" form submitted to the Town Manager for approval, and the final approved form submitted to the Finance Department.

C. Finance will forward all appropriate Additions and Deletion/Transfer forms to the Board of Selectman's Secretary for insurance purposes.

D. An updated list of all capital assets for each department will be distributed by the Finance Department to their respective department for an annual review.

E. Departments will then be required to review, correct, approve and return updated list to the Finance department.

F. The Town will maintain current Assessed Value of Land and the Replacement Value of Buildings.

Chapter 10
REVIEWING CAPTIAL ASSETS

The inventory referred to in this policy is for capital assets only and does not include assets that do not meet the capital assets criteria.

At leased annually a list of capital assets will be provided to the department heads for inventory purpose. Finance and/or the independent auditors may perform four comparisons of capital assets on hand and capital assets records. They are:

1. Compare a sample of capital assets purchases to the capital assets list to make sure they were properly recorded;
2. Compare a sample of capital assets sold to the capital assets list to insure that the asset records now indicate that the asset was sold;
3. Compare a sample of assets selected by observation from throughout the entity to the capital assets list to make sure first that the assets are on the list and second that other attributes such as department, location, etc. have been properly recorded;
4. Select a sample of assets from the capital assets list, go to the location indicated in the record, and make sure that the asset is really there.

Making the comparisons by themselves is not sufficient. Any time a comparison indicates that a problem exists or is beginning to develop, additional steps should be taken. This may mean implementing better controls to insure all purchases and sales are recorded, tracking assets that are not at the listed location, retraining inventory takers so that all assets are listed, etc. The follow-up that is necessary will depend on the problem(s) identified by making the comparisons.

Inventorying is necessary for accountability and control. Inventorying establishes a direct relationship between actual and recorded capital assets. An inventory insures that capital assets transactions have been and are being recorded properly; and, the inventory provides the database for capital assets accounting and management systems.

Chapter 11
ENFORCEMENT

Department Heads are responsible for the accuracy of their Department's Capital Assets. The Town Manager is responsible for the uniform and impartial application of the policy and procedures.

Chapter 12
GLOSSARY

ACQUISITION - obtaining an asset by purchase lease, loan, donation, construction, or sharing
ACQUISITION DATE - date asset is acquired (actual or estimated) and becomes available for use

AVERAGE LIFE - normally expected duration of an asset capitalization threshold a dollar amount, established by the entity. Assets with an original cost in excess of threshold are capitalized while those assets with an original cost below the threshold are not reported as capital assets

CODING - associating a unique number with a particular asset

CONTROLLED ASSET - property that fails the capitalization threshold criteria but is inventoried and controlled because of its sensitive, portable, and/or theft-prone nature

DIRECT COSTING METHOD - the method of using source documents to obtain the actual original cost

DISPOSAL - a retirement of an asset that has become obsolete, or has exhausted its useful life

FIDUCIARY TYPE FUNDS - Expendable Trust Funds, Nonexpendable Trust Funds, and Agency Funds

CAPITAL ASSETS - any object tangible in nature, having a life longer than one year, not considered a repair part or supply item, and either having a value greater than the capitalization threshold or being considered a controlled asset

CAPITAL ASSETS ACCOUNTING - a system of methods, policies, and procedures for system recording and reporting monetary amounts associated with capital assets transactions

CAPITAL ASSETS CONTROL - a system of methods, policies, and procedures to system determine if deviations have occurred between actual capital assets data and recorded capital assets data and how to bring those deviations into line with management's objectives. A system of checks on the capital assets system

CAPITAL ASSETS MANAGEMENT - a system of methods, policies and procedures to system acquire, use, dispose, maintain, and safeguard asset

FUND CAPITAL ASSETS - capital assets associated with Enterprise Funds, Internal Service Funds or Trust Funds

GENERAL CAPITAL ASSETS - capital assets not associated with the activities of Enterprise Funds, Internal Service Funds, or Trust Funds

GOVERNMENT AL TYPE FUNDS - General Fund, Special Revenue Funds, Capital Project Funds, Debt Service Funds and Expendable Trust Funds

INFRASTRUCTURE - also known as "public domain" capital assets. Assets that are normally immovable and are of value only to the governmental unit

NORMAL COSTING METHOD - an indirect method of estimating the original cost of an asset by using the reproduction cost new at time of appraisal and indexing it back to the estimated acquisition date

ORIGINAL COST - cost of property at date constructed or installed

PROPRIETARY TYPE FUNDS - Enterprise Funds, Internal Service Funds and Non-Expendable Trust Funds

REPLACEMENT COST - the cost, usually determined by independent appraisal, to replace an asset with one of equal usefulness. Usually used for budgeting the replacement of an asset. In some cases, replacement cost and reproduction cost new will be the same

REPRODUCTION COST - the cost, determined by independent appraisal, to reproduce an asset of like kind with similar materials and techniques

SURPLUS ASSET - an asset that is not currently in use but is still retained by the entity

TAGGING - placing identifying information physically on an asset

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