CITY OF NORTH MANKATO

CAPITAL ASSET POLICY

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PURPOSE

It is the policy of the City of North Mankato to maintain appropriate procedures regarding the procurement, management, and disposal of all capital assets, in accordance with Governmental Accounting Stands Board Statement No. 34 (GASB 34). The Capital Assets Policy addresses classes of assets, determination of useful lives, and calculation of depreciation.

SECTION I
DEFINE CAPITAL ASSETS AND CAPITALIZATION THRESHOLDS

A capital asset is real or personal property used in operations and having a value equal to or greater than the capitalization threshold set forth by the City, for that specific asset classification, and has an estimated useful life greater than one year. For financial reporting purposes only, the City will classify and establish capitalization thresholds for each asset class as follows:

CAPITAL ASSET CLASSIFICATION	CAPTILIZATION THRESHOLD
Buildings and Building Improvements	$ 25,000
Infrastructure;	$250,000
Land	$1
Land and Other Improvements	$ 25,000
Machinery and Equipment	$,000
Vehicles	$,000
Other Capital Assets	$,000

Another criterion for recording capital assets is **capital-related debt.** Capitalize capital assets purchased with debt proceeds and depreciate over their estimated useful life. Capitalizing these assets will minimize the potential of reporting negative net assets in the statement of net assets. In most cases, these assets will meet the thresholds and guidelines for recording as a capital asset.

SECTION II
REPORTING CAPITAL ASSETS

Report capital assets at historical costs, which includes most costs necessary to placing a capital asset into its intended use or state of operation. Historical cost includes the vendor's invoice, the value of any trade-in or allowance, sales tax, initial installation cost (excluding in-house labor), modifications, attachments, accessories or apparatus; and ancillary charges such as freight and transportation charges, site preparation costs, and professional fees.

In the event the historical cost of a capital asset is not practicable determinable, it will be necessary to record an estimated historical cost of the asset using alternative methods. Alternative methods include standard costing and normal costing. Standard costing estimates the historical cost of a capital asset by establishing the average cost of obtaining the same or a similar asset at the time of acquisition. Normal costing estimates historical cost based on the current cost to either reproduce or replace the capital asset, indexed by a reciprocal factor from the estimated acquisition date, i.e., taking the value of acquiring the asset new today and then discounting that amount by an appropriate inflation factor back to the date of acquisition.

Capital assets donated to the City shall be reported at fair value. Fair value is the amount at which an asset could be exchanged in a current transfer at *arm's length* between willing parties, other than in a forced or liquidation sale. Donations are defined as voluntary contributions of resources to the City by a non-governmental entity. A voluntary contribution of resources between governmental entities is not a donation.

SECTION III
DEPRECIATION CAPITAL ASSETS

Depreciation is the process of allocating the cost of a tangible asset to the periods of benefit. Capital assets shall be depreciated over their estimated useful live with exception of the following:

- Inexhaustible assets, i.e., land, and land improvements that do not require maintenance or replacement, e.g., certain works of art and historical treasures;
- Infrastructure assets reported using the modified approach; and

For financial purposes the City will use the straight-line method of depreciation, which allocates the cost evenly over the life of the asset. Generally, at the end of an asset's life, the sum of the amounts charged for depreciation in each accounting period, or accumulated depreciation, will equal the original cost less salvage value.

A significant issue when recording capital assets is the question of, “ when is an expenditure capitalized as an improvement versus recorded as repairs or maintenance expense.” The key consideration for determining whether to capitalize expenditures depends on whether the cost incurred, significantly extends the asset's useful life, increases its capacity, or improves its efficiency. Therefore, capitalize capital asset improvement costs if:

- The costs exceeds the capitalization thresholds; and
- One of the following criteria is met:
  - The value of the asset or estimated life is increased by 25% of the original cost or life period;
  - The cost results in an increase in capacity of the asset; or
  - The efficiency of the asset is increased by more than 10%.

SECTION IV
CAPITAL ASSET DEFINITIONS AND CATEGORIES

Buildings refer to a structure that is permanently attached to the land, has a roof, is partially or completely enclosed by walls, and is not intended to be transportable or moveable. Certain buildings or structures that are an ancillary parts of infrastructure networks, such as well houses and pumping stations will reported as infrastructure rather than as buildings.

Examples of items to be capitalizes as building: Purchased Buildings

- Original purchase price;
- Expenses for remodeling, reconditioning, or altering a purchased building to make it

ready for its intended purpose;
- Environmental complies, i.e., asbestos abatement;
- Professional fees, includes architect, engineer, management fees for design and supervision, legal;
- Cancellation or buyout of existing leases; and
- Other costs required to place or render the asset into operation.

<u>Constructed Buildings</u>
- Completed project costs;
- Cost of excavation or grading or filling of land for a specific building;
- Expenses incurred for the preparation of plans, specifications, blueprints;
- Building permits;
- Costs of temporary buildings used during construction;
- Additions to buildings, i.e., expansions, extensions, or enlargements.

Building improvements include capitalized costs that materially extend the useful life of a building or increase the value of a building, or both, beyond one year. Building improvements should not include maintenance and repairs done in the normal course of business.

Examples of items to be capitalized as building improvements include:
- Installation or upgrade of heating and cooling systems, including ceiling fans and attic fans;
- Original installation or upgrade of wall or ceiling covering such as carpeting, tiles, paneling, or parquet;
- Structural changes such as reinforcement of floors or walls, installation or replacement of beams, rafters, joists, steel grids, or other interior framing;
- Installation or upgrade of window or door-frames, upgrading windows or doors, built-in closet and cabinets;
- Interior renovation of casings, baseboards,, light fixtures, ceiling trim;
- Installation or upgrade of plumbing and electrical wiring; and
- Installation or upgrade of telecommunication systems.

Examples of items considered repairs or maintenance in nature and **<u>should not be capitalized</u>** as buildings or building improvements include:
- Adding, removing and/or moving of walls relating to renovation projects that are not considered major rehabilitation projects and do not increase the value of the building;
- Improvement projects of minimal or no added life expectancy and/or value to the building;
- Plumbing or electrical repairs;
- Cleaning, pest extermination, or other periodic maintenance;
- Interior decoration, i.e., draperies, blinds, curtain roads, wallpaper;
- Exterior decoration, i.e., detachable awnings, uncovered porches, decorative fences;
- Maintenance-type interior renovation including repainting, touch-up plastering, replacement of carpet, tile, or pane sections, and refinishing of sinks and fixtures;
- Replacement of a part or component of a building with a new part of the same type and performance capabilities, e.g., replacement of an old boiler with a new one of the same type and performance capabilities;
- Any other maintenance-related expenditure, which does not increase the value of the building.

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

Examples of infrastructure assets include:

- Roads, streets, curbs, gutters, sidewalks;
- Bridges;
- Water and sanitary sewer systems;
- Drainage and storm water systems;
- Street light systems; and
- Signage.

Infrastructure assets shall be capitalized and depreciated unless the modified approach is used. The modified approach is an alternative to reporting depreciation for infrastructure assets that meet the following criteria:

- The assets are managed using a qualifying asset management system; and
- It is documented that the assets are being preserved at or above a condition level established by the City.

Under the modified approach the infrastructure, assets are not depreciated, and only the costs that increase the capacity or efficiency of the asset are capitalized, while all other expenditures that preserve the useful life of the assets are expensed. Only infrastructure assets that comprise a network or subsystem of a network can be reported using the modified approach.

Land is the surface or crust of the earth, which can be used to support structures, and may be used to grow crops, grass, shrubs, and trees; and is characterized as having an unlimited life, i.e., indefinite. Land is an inexhaustible asset and non-depreciable.

Land improvements consist of betterments, site preparation, and site improvements (other than buildings) that ready land for its intended use. The costs associated with improvements to land are added to the cost of the land. Land improvements can be further categorized as inexhaustible, not requiring maintenance or replacement; or exhaustible, e.g., parking lots, landscaping and fencing.

Examples of items to be capitalized as land and land improvements include:

- Purchase price or fair value at time of gift;
- Commissions;
- Professional fees, includes title searches, architect, legal, engineering, appraisal, surveying, environmental assessments;
- Land excavation, fill, grading, and drainage;
- Demolition of existing buildings and improvements, less salvage;
- Removal, relocation, or reconstruction of property owned by others, i.e., power, telephone and railroad lines;
- Interest on mortgages accrued at date of purchase;
- Accrued and unpaid taxes at date of purchase;
- Other costs incurred in acquiring the land;

- Water wells, including initial cost for drilling, the pump and its casing; and
- Permanent right-of-way.

Other Land Improvements include land improvements that are exhaustible in nature and enhance the quality or facilitate the use of land for a specific purpose.

Examples of items to capitalize as other improvements include:
- Fencing and gates;
- Landscaping;
- Parking lots, driveways, and parking barriers;
- Outdoor sprinkler and irrigation systems;
- Recreation areas and athletic fields, including bleachers;
- Golf courses;
- Paths and trails;
- Septic systems;
- Stadia;
- Swimming pools, tennis courts, basketball courts, skate parks;
- Fountains,
- Plazas and pavilions; and
- Retaining walls.

Machinery, Equipment, and Vehicles refer to fixed or movable tangible assets used for operations, the benefits of which extend beyond one year from date of receipt.

Examples of expenditures to be capitalized as equipment, machinery, and vehicles include:
- Original contract or invoice price;
- Freight charges;
- Handling and storage charges;
- In-transit insurance charges;
- Sales, use and other taxes imposed on the acquisition;
- Installation charges;
- Charges for testing and preparation for use;
- Cost of reconditioning used items when purchased; and
- Parts and labor associated with the construction of equipment, machinery, or vehicle.

Note that the cost of extended warranties and/or maintenance agreements, which can be separately identified from the cost of the equipment, machinery, or vehicle shall not be capitalized.

The capitalization threshold is applied to individual units of fixed assets. For example, 5 desks purchased through a single purchase order each costing $2,000 will not qualify for capitalization even though the total cost of $10,000 exceeds the threshold of $5,000.

Other Capital Assets includes computer software that is either purchased or developed for internal use, which should be capitalized, if the cost of the software exceeds the capitalization threshold and depreciated over the software's estimated useful life. Capitalization of computer software includes software license fees if the total dollar amount of the fee divided by the number of units or terminals exceeds the threshold.

Examples of expenditures to be capitalized as computer software include:

- External direct costs of materials and services, i.e., third-party fees for services;
- Costs to obtain software from third parties;
- Travel costs incurred by employees in their duties directly associated with development;
- Payroll and payroll-related costs of employees directly associated with or devoting time to encoding, installing or testing; and
- Costs to develop or obtain software that allows for access or conversion of old data by new information systems.

Note that upgrades and enhancements should only be capitalized to the extent that they increase the functionality of the product.

Capital Leased Property includes leased real or personal property, for which ownership of the asset substantially transfers to the lessee; therefore meeting the criteria for capitalizing as an asset. Capitalize the cost of the asset if the lease agreement meets any one of four conditions:

- It transfers ownership of the property to the lessee at the end of the lease term;
- The lease contains a "bargain purchase" option-an option that gives the lessee the right to purchase the asset for a future price less than the fair market value;
- The lease term is equal to at least 75% of the asset's estimated economic life; or
- The present value of the minimum lease payments at the inception of the lease, excluding executory costs, equals at least 90% of the fair market value of the leased asset at the time the lessee signs the lease.

Leases that do not meet any of the above conditions shall be recorded as an operating lease and reported in the notes of the financial statements.

SECTION V
CAPITAL ASSETS ESTIMATED USEFUL LIFE[1]

Buildings and Building Improvements

Buildings	40 years
Cabling	10 years
Original Carpeting	7 years
Electrical	20 years
Elevators	20 years
Floor covering other than carpet	15 years
HVAC (heating, ventilation, air conditioning)	20 years
Interior construction	15 years
Interior renovation	10 years
Plumbing	20 years
Roof	20 years
Security and fire alarm system	10 years
Sprinkler System	20 years
Temporary and portable buildings	25 years

Equipment, Machinery, and Vehicles

[1] Estimated useful life values derived from the Internal Revenue Service Alternative Depreciation System (ADS)

Athletic equipment	5 years
Audio/Visual equipment	5 years
Business machines and office equipment	5 years
Cars, light general purpose trucks (actual weight less than 13,000 pounds)	10 years
Computer equipment and software	5 years
Custodial equipment	10 years
Fire Department equipment	10 years
Firefight trucks	25 years
Furniture and fixtures, including structural components of a building	10 years
Ground equipment (mowers, tractors, skid loaders)	10 years
Heavy duty general purpose truck and equipment (front end loaders, graders, etc. with actual weight greater than 13,000 pounds)	15 years
Kitchen equipment (appliances)	10 years
Lab equipment	10 years
Law enforcement equipment	10 years
Law enforcement marked vehicles	5 years
Law enforcement unmarked vehicles	10 years
Machinery, tools, and other equipment	5 years
Outdoor equipment (playgrounds, scoreboards)	15 years
Photocopiers	5 years
Telecommunications equipment	10 years

Infrastructure

Bridges	20 years
Parking Lots	20 years
Roads, Streets, curb and gutter	30 years
Sidewalks	25 years
Water, Sanitary Sewer, Storm Sewer Systems	50 years

Other Improvements

Fencing and gates	20 years
Fountains	20 years
Golf courses	20 years
Landscaping	20 years
Outdoor sprinkler and irrigation systems	20 years
Outdoor lighting	20 years
Parking lots, driveways, and parking barriers	15 years
Paths and trails	15 years
Recreation areas and athletic fields, including bleachers	15 years
Retaining walls	20 years
Septic Systems	15 years
Swimming pools, tennis courts, basketball courts, skate parks	20 years