The City of Traverse City

Office of the City Clerk

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City of Traverse City
Capital Asset and Controlled Capital-Type Items Policy

The purpose of establishing this policy is to provide guidelines for management regarding the;

1. Determination of what assets qualify to be capitalized.
2. Procedure to identify assets.
3. Depreciation methods and determination of useful life.
4. Basis for formulating capital asset acquisition maintenance and retirement procedures.
5. Data needed for financial reporting.
6. Demonstration of appropriate stewardship responsibility for public assets.
7. Procedures to protect public safety and avoid potential liability.

Definitions

1. **Ancillary Costs:** costs in addition to purchase or construction costs, related to placing a capital asset into its intended state of operation. Normally, ancillary costs are included in the cost of the capital assets. Ancillary costs include the following:
    a. Buildings and improvements: professional fees of architects, engineers, attorneys, appraisers, financial advisors and similar fees, damage claims, costs of permanently attached fixtures, insurance premiums during construction, interest expense, other related costs incurred during construction and other expenses necessary to place the asset into its intended state of operation.
    b. Land: legal and title fees, surveying fees, appraisal and negotiation fees, damage payments, site preparation costs, costs related to demolition of unwanted structures and other expenses necessary to place the asset into its intended state of operation.
    c. Machinery, equipment, and other: transportation charges, installation costs, maintenance/warrant contracts and any other normal necessary expenses required to place the asset into its intended state of operation.
    d. Infrastructure: landscaping and any other expenses to place the asset into its intended state of operation.
2. **Building:** walled and roofed structures plus improvements that are permanently attached. This capital asset is recorded at cost including ancillary costs. Land costs are excluded. Building improvements include items that are permanently attached to the structure. Items not included are furniture, movable equipment, carpeting, and other pieces of equipment that are not an integral part of the structure where the allocation of costs for the bulk assets over time are matched to the corresponding benefits generated by the bulk assets.
3. **Building Improvements:** any expenditure that will increase the value of the building, extends its useful life or caused a material change in the building's efficiency or function will be capitalized subject to this policy threshold. Improvements shall include but not limited to sprinkler systems, HVAC systems, electrical systems, etc.

4. **Bulk Purchases:** bulk purchases of capital assets with unit costs of less than capitalization threshold may be capitalized as a group.
5. **Capital Asset:** include any piece of land valued greater than the capitalization threshold which the City of Traverse City holds title. Capital assets also include buildings, improvements other than buildings, construction in progress, easements, infrastructure, machinery and equipment with a value greater than the capitalization threshold.
6. **Capitalization Threshold:** monetary criterion used to determine whether a given capital asset should be reported on the balance sheet. The Government Finance Officers Association's (GFOA) recommended practice on "Establishing Appropriate Capitalization Thresholds for Capital Assets" recommends that state and local governments consider the following guidelines:
    - Potentially capitalize items should only be capitalized if they have an estimated useful life of at least two years following the date of acquisition;
    - Capitalization thresholds are best applied to individual items (e.g. desks and tables), unless the effect of doing so would be to eliminate a significant portion of total assets (e.g. books of a library district);
    - In no case should a government establish a capitalization threshold of less than $5,000 for any individual items;
    - In establishing capitalization thresholds, governments that are recipients of federal awards should be aware of federal requirements that prevent the use of capitalization thresholds in excess of certain specified maximum amounts (i.e. currently $5,000) for purposes of federal reimbursements; items that fall under the operative capitalization threshold.
7. **Capital Lease:** lease with contractual terms transferring to the Department substantially all benefits and risks inherent in ownership of the property. Capital leases are capital assets as long as one of the following criteria applies.
    a. Ownership of the leased property is transferred to the Department as a capital lease.
    b. The lease contains a bargain purchase option.
    c. The lease term is equivalent to 75 percent or more of the estimated useful life of the leased property.
    d. The present value of the minimum lease payments (at inception of the lease), excluding executory costs (usually insurance, maintenance, and taxes, including any profit thereon) is 90 percent or more of the fair value of the leased property.
8. **Construction in Progress:** capital asset reflecting the cost of construction work undertaken, but not completed that will result in a capitalized asset when completed.
9. **Controlled Capital-Type Items**: non-capitalized items that require special attention because they are sensitive for one or more of the following reasons:
    a. Items that require special attention to ensure legal compliance. Legal or contractual provisions may require a higher than ordinary level of accountability over certain capital-type items (e.g., items acquired through grant contracts);
    b. Items that require special attention to protect public safety and avoid potential liability. Some capital-type items by their very nature pose a risk to public safety and could be the source of potential liability (e.g., police weapons);
    c. Items that require special attention to compensate for a heightened risk of theft ("walk away" items). Some capital-type items are both easily transportable and readily marketable or easily diverted to personal use (e.g., sound equipment).

10. **Depreciation:** systematic allocation of the cost of a depreciable capitalized asset (less salvage value) over its estimated useful life.
11. **Donated Capital Asset:** recorded at estimated fair value plus any ancillary costs.
12. **Easement:** a capital asset that reflect the purchased right to use land without ownership of the land. This right is considered permanent and inexhaustible therefore non-depreciable. Easements are in perpetuity and transfer with the land if the land is sold.
13. **Impairment:** a significant, unexpected decline in the service utility of a capital asset.
14. **Infrastructure:** long lived capital assets that typically are stationary in nature and can be preserved for a significantly greater number of years than most capital assets.
15. **Land:** real property, excluding buildings, with the title held by the Department including any ancillary costs, and right of ways. Land is a non-depreciable asset.
16. **Land Improvements:** expenditures that do not produce permanent benefits including, but not limited to landscaping, fences, parking lots, irrigation systems, general signage, and trails.
17. **Machinery, Equipment, and Other:** durable capital assets that are complete in and of themselves and are not permanently attached to a building or land. This asset category includes but not limited to office equipment and other similar equipment.
18. **Vehicles:** includes all motorized assets including trailers.

Capitalized Assets

Any asset that has a cost greater than the capitalization threshold is capitalized by the Department with the following considerations:

1. Construction in progress is not capitalized until the project is complete. All projects have to be approved by the City Manager, Department Engineer or Civil Engineer II that they are complete.
2. Repairs and improvements to an existing capital asset that extend the useful life of the asset, or improve its capacity or efficiency, or significantly reduce operating costs should be capitalized if the costs are more than capitalization threshold and has a life expectancy greater than twenty-five percent. Routine repairs and maintenance that help an asset maintain the original useful life are expensed regardless of cost.

Asset Valuation

Capital assets must be recorded at actual cost. Normally the cost recorded is the purchase price or construction cost of the asset, but also includes any ancillary charges.

Donated or contributed assets should be recorded at their fair market value on the date donated.

If a capital asset is traded in the process of purchasing another similar capital asset, the second should be recorded at an amount equal to the book value of the asset surrendered plus any additional monetary consideration provided to the seller.

Asset Identification

Immediately upon receipt and acceptance, all inventoriable capital assets of the Department will be tagged, when practical, with a pre-numbered City property tax affixed in a readily identifiable location. Land and other assets that cannot be reasonably tagged are excluded from the tagging requirement however they are assigned a property number for tracking in the system.

Depreciation and Amortization

The Department depreciates all depreciable capital assets using the straight-line method. *The straight-line method is (asset cost + removal cost of assets – salvage value) / assets useful life = annual depreciation.* Salvage values will be determined on an asset-by-asset basis.

At the direction of the Treasury Department, each Department is to review the actual useful life of their assets and compare it to the useful life assigned to ensure assets are being properly depreciated.

Impairment
Since impaired assets will continue in service rather than be sold, their fair value, as such, is irrelevant (unlike retired assets to be sold for salvage). Impaired asset book value needs to be reduced to reflect the loss in service utility resulting from the impairment.

Authoritative accounting standards state that the types of events or changes in circumstances that would give rise to an impairment will be prominent (i.e. "conspicuous or known to the government"), and generally are expected to have prompted discussion by the governing board, management, or the media. Thus, governments are not expected to undertake special efforts to discover potential impairments.

Capital asset impairments most often result from one of the following events or changes in circumstances:

- Physical damage where action would be needed to restore lost service utility;
- Changes in laws, regulations, or other environmental factors that negatively affect service utility;
- Technological developments that negatively affect service utility, or evidence or obsolescence;
- A change in the manner or duration of use of a capital asset that negatively affects its service utility (e.g. putting an asset to a suboptimal use rather than to use for which it was originally intended);
- Stoppage of construction or stoppage development.

Estimated Useful Lives
The best source of relevant information on the estimated useful lives of a government's capital assets normally is its own past experience with similar assets. In situations where the documentation of a government's own past experience for a given type of capital is not adequate for this purpose, a government should profit as much as possible from the experience of other governments and private-sector enterprises. At the same time, a government should make whatever adjustments are needed to estimated useful lives that were obtained from others to ensure that such estimates are appropriate to its own particular circumstances.

Setting Useful Life for an Improvement
When entering a useful life for an improvement, the useful life of the original asset needed to be considered. The general rule is that the improvement is depreciated over the shorter of the improvement's useful life or the original asset's remaining useful life.

It may be necessary to increase the original asset's useful life if it is anticipated that the improvement will extend the useful life of the original asset. If the original asset is at the maximum range and accordingly, cannot be changed, record the improvement at tits anticipated useful life.

Capital Asset Additions

The Department inventory officer is responsible for supervising the addition of the asset to the inventory system upon receipt and acceptance. As asset should be reported to the inventory officer if items are acquired by regular purchases, lease purchase (see definition above), construction by utility personnel, construction by an outside contractor, resolution/condemnation, donation/contribution, addition to an existing asset, transfer from another department, trade or barter, and annexation. This includes assigning tagging responsibilities to specific individuals as well as developing and implementing Department procedures to ensure that the necessary information is entered into the Department's capital asset inventory.

Capital Asset Dispositions and Retirements

When a capital asset is replaced, transferred or otherwise disposed, the original cost and accumulated depreciation are to be removed from the capital asset records. If the original cost of the asset is unknown, any reasonable method may be used to record the disposition. Reasonable methods can include not recording any cost or recording an estimated amount.

If there is a disposal from a grouped asset, an average cost should be calculated based on the number of assets recorded in the year divided by the total cost. The same shall be done for the accumulated depreciation. Any gain/loss should be recorded during the year of disposition.

Any asset not considered scrap should be approved for disposal by the Traverse City City Commission.

When suspected or known losses of inventorial assets occur, Departments should conduct a search for the missing property. The search should include transfers to other Departments, storage, scrapping, conversion to another asset, etc. If the missing property is not found:

1. Notify the City Manager.
2. Have the employee deemed to be primarily responsible for the asset, as well as, the individual's supervisor complete a sign statement to include a description of events surrounding the disappearance of the property, who was notified of the loss, and steps taken to locate the property.
3. Remove the lost or stolen property from the Department's capital asset records.

Physical Inventory of Capital Assets and Controlled Capital-Type Items

A physical inventory should be completed biennially (every 2 years) at the close of the fiscal year for all tangible capital assets and controlled capital-type items. Due to the stationary nature of certain assets (land, infrastructure, buildings, and improvements other than buildings) performing a physical inventory is not required. In order to ensure objective reporting of inventory items, employees having no direct responsibility (custody and receipt issue authority) should perform the physical inventory.

Every individual assigned responsibility for capital asset and controlled capital-type items records should prepare a report to be maintained within the department that provides a complete list of those items, along with an explanation of changes from the previous year. Any changes requested from the inventory made to the capital asset records will require approval from the City Treasurer/Deputy Treasurer. The changes should consist of:

1. Recording unrecorded capital assets noted during the physical inventory.
2. Conduct a search for missing assets, if they are not found, follow the procedure in the lost disposition of assets above.
3. Differences found by the department between the actual useful lives of their assets and the useful life assigned. The purpose is to ensure assets are being property depreciated.

Each department should designate an individual to be responsible for verifying that lists of all capital asset and controlled capital-type items have been filed each year, as required. The responsible manager in the department should then certify to the Treasury Department that those lists are 1) on file and available for inspection and 2) reliable and complete.

The GFOA recommends that every state and local government periodically inventory its tangible capital assets and controlled capital-type items so that all such assets are accounted for, at least on a test basis, no less than once every five years to be conducted by the Financial Analyst/Compliance Officer.

Responsibility of Department Managers

It is the responsibility of the Department Manager to act as or designate a steward for each piece of property. The steward will become the focal point for questions regarding the availability, condition and usage of the asset, as well as the contact during the physical inventory process.

Someone should be designated to record the receipt of the asset, to examine the asset to make sure that no damage was incurred during shipment and to make sure that the asset was received and working order.

The steward is also responsible for arranging the necessary preventative maintenance and any needed repairs to keep the asset in working condition. It is necessary to have a responsible person available for questions that arise during a physical inventory or when someone wants to borrow the asset. The steward ensures that the asset is used for the purpose for which it was acquired and that here is no personal or unauthorized use. In addition, the steward should report any property damage or theft.

Record Keeping Requirements

The capital asset record system shall contain the following data elements:

1. In-service date: the date the agency takes title to or places the capital asset in service.
2. Ass class: the general category code that the asset will roll up to, such as land, poles, buildings, improvements, and etc.
3. Cost: the total cost assigned to the capital asset.
4. Amount: the number of assets being capitalized.
5. Accumulated depreciation: the total depreciation expense incurred to date for the capital asset.
6. Depreciation expense: the total depreciation expense incurred fiscal year to date for the capital asset.
7. Disposal date: the date the agency officially relinquishes the capital asset.
8. Fund number: record the number of the fund utilizing/purchasing the capital asset.

9. Inventory property tag number: the serial number on the Department property tag affixed to the capital asset. This is not required for land, buildings, and other capital assets that cannot be reasonably tagged; however, an identifying number will be needed.
10. Location: an identification code to indicate where the capital asset is located.
11. Useful life: the estimated number of years of use to be received from the capital asset. This is not required for non-depreciable capital assets.
12. Serial number: the sequential identification number assigned by the manufacturer.
13. Description: a word explanation of what the capital asset it.
14. Model year: for applicable equipment. This can be included in the description.
15. Parcel: a legal description of a specific real property.
16. Reference number: to assist in tracing to City Commission minutes, etc.

I hereby certify that the above policy was adopted by the City Commission of the City of Traverse City at its regular meeting of August 16, 2010, held in the Commission Chambers, Governmental Center, 400 Boardman Avenue, Traverse City, Michigan.

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Benjamin C. Marentette, CMC, City Clerk