SECTION:	V	Expenditures	**EFFECTIVE DATE:**	July 1, 1996
SUB-SECTION:	12	Capital Expenditures	**REVISION DATE:**	July 1, 1996
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DEFINITION:

Capital Expenditures - Long-lived tangible assets obtained or controlled as a result of past transactions, events or circumstances.

BUDGETARY VS GAAP

This policy statement relates to the recording of capitalized expenditures in the State's accounting system, for budgetary purposes only. A separate policy statement will address capitalizing expenditures in accordance with Generally Accepted Accounting Principles or GAAP. The GAAP policy statement will be issued with the FY97 update to the GAAP manual.

It is important to note the differences, as well as the similarities, between the budgetary treatment of capitalized expenditures and the GAAP treatment. In budgetary accounting, nearly all disbursements, capitalized or not, are charged as expenditures against the appropriations (or budget). Therefore, the budgetary "capitalization" policy is useful only to identify the allotment line applicable to a given expenditure: i.e. line 4 (supplies and services) vs line 5 (capital items). In contrast, the GAAP capitalization policy for proprietary fund types requires that an agency report capital items as assets and depreciate them over their useful lives.

For example, a proprietary funds type must report the purchase of a capital item as an expenditure against the appropriation in the year the cash is paid. However, on a GAAP basis, the same item is capitalized in the year of purchase and only the amount of depreciation for the year is reported as an expense. What this means is that, for capitalized items in proprietary funds, the budgetary basis and GAAP basis of accounting will always differ. For now, this difference may not be apparent to non-GAAP accountants because the GAAP reporting is done "off book". However, in future years GAAP entries will be recorded in WiSMART at which time accounting personnel will be instructed on the entries to use to achieve the proper reporting under both the budgetary and GAAP bases of accounting.

GENERAL POLICY-Budgetary Basis

Equipment should be recorded as capital expenditures when the following criteria are met:
- The asset is tangible in nature, complete in itself, and is not a component of another item.
- The asset is used in the operation of the State's activities.
- The asset has a useful life of two (2) years or more and provides benefit throughout that period.
- The individual asset is of significant value, that is, it has a unit cost of $5,000.00 or more.

NOTE: The above dollar threshold policy change may be treated prospectively in the period of the change.

Agencies should keep inventory control records for all significant (i.e. with a value over $1,000.00) asset purchases, even those assets that are not capitalized. This asset inventory is useful for internal financial management purposes, most notably for insurance purposes and the recovery of lost, stolen or damaged items. A complete fixed asset inventory is important for performing revaluations for insurance purposes.

SYSTEM ASSETS

Asset components that have a unit cost under $5,000 should be capitalized if they are originally acquired as part of a system and the system cost equals or exceeds $5,000. Assets not capitalized should be recorded in fixed asset records, for insurance and control purposes. A system is defined as a group of interacting, interrelated, or interdependent components forming a whole. For example, the components of computer hardware would include the computer monitor, the keyboard, the central processing unit, the mouse, the printer, and the modem. The software should also be considered part of capitalized expenditures, however, costs associated with the purchase of upgrades for software already owned should be recorded as maintenance expenditures. These components should be considered part of the computer system and capitalized as a unit. Another example is modular furniture which includes the partitions, the work surface, and the shelves that comprise an office cubicle. While individual components may be immaterial, together all the components that comprise modular furniture constitute a system.

The logic behind capitalizing each individual component as part of the entire system is that the component, standing alone, cannot function or serve its intended purpose by itself.

COSTS SUBSEQUENT TO ACQUISITION

Costs incurred to achieve greater future benefits (e.g., improve efficiency, or materially extend the useful life of the asset, etc.) and which cost more than $5,000 should be recorded as capital expenditures, whereas expenditures that simply maintain a given level of service should be recorded as maintenance or repairs. Generally three major types of costs subsequent to original purchase or construction are incurred relative to existing capital assets.

1. <u>Additions</u> (extensions, enlargements or expansions). Any addition to a fixed asset should be recorded as capitalized expenditures since a new asset has been created. For example, the addition of an air conditioning system to an office building increases the service potential of that facility and should be capitalized.

   Other examples include the addition of a plow to a truck, the addition of book case to existing office furniture, or adding a sorter to owned copy equipment.

   However, costs related to changes occurring to the existing structure (e.g., removal of a wall to add a new wing) as the result of the addition will have to be evaluated to determine whether the change should be recorded as a capital expenditure or maintenance and repair. If the addition had been planned since acquisition of the asset, then the cost of removal of the wall is a proper cost to be included in the capital expenditures. However, if the addition had not been anticipated, the cost associated with the wall removal should be maintenance and repairs.

2. <u>Improvements and replacements</u>. The distinguishing feature between an improvement and a replacement is that an improvement is the substitution of a better asset-having superior performance capabilities - (e.g., a concrete floor for a wooden floor) for the one currently used, whereas a replacement is the substitution of a similar asset (a wooden floor for a wooden floor).

In both of these instances agencies should determine whether the expenditure increases the future service potential of the fixed assets, or merely maintains the existing level of service. When the determination is made that the future service level has been increased, the new cost is capital expenditure.

3. <u>Repairs</u> (Ordinary and Major). Repairs maintain the fixed asset in its original operating condition.

   Ordinary repairs are expenditures made to maintain assets in operating condition. Preventive maintenance, normal periodic repairs, replacement of parts, structural components, and other activities such as repainting, equipment adjustments, that are needed to maintain the asset so that it continues to provide normal services should not be capitalized but rather charged to maintenance or repairs account. Ordinary repairs should likewise be recorded with the appropriate maitenance and repair object code.

   Major repairs are relatively large expenditures that benefits more than one operating cycle or periods. If a major repair, e.g., an overhaul, occurs that benefits several periods and/or extends the useful life of the asset then the cost of the repair should be handled as an addition, improvement, or replacement, depending upon the type of repair made.

ACCOUNT CODES

Expenditure object codes in the 4000 series should be used to record capital expenditures in the State's accounting system, WiSMART.

CAPITAL EXPENDITURE INVENTORY REQUIREMENTS

Each state agency is responsible for maintaining a permanent record of all items classified as capital expenditures. Such records should be verified by physical count at least annually and appropriate actions should be taken to resolve any discrepancies.

Capital items and/or materials and supplies used to offset deficiencies in Program Revenue appropriations and corresponding segregated revenue appropriations from program receipts as provided under ss. 20.903 should be inventoried and valued at least annually. Book value should be based on methods outlined in the State's GAAP manual.