Capitalization Policy

I. Purpose

To establish accounting policies for the capitalization and depreciation of capital assets belonging to the University of Kentucky and its affiliated corporations as defined in Business Procedure E-1-0.

II. Definitions

- *Betterments and improvements:* changes to a capital asset, such as additions, renovations and alterations, which increase its expected life or enhance its performance. Examples include building enlargements, installation of air conditioning in a building that was not air conditioned, partitioning of a classroom into offices, expansion of a paved parking lot, addition of a hoist or crane to a vehicle or a zoom lens to a camera*.*
- *Building:* roofed structure for permanent or temporary shelter of persons, animals, plants or equipment. Costs to be included are foundations, walls, frame, roof, etc.
- *Capital asset:* any physical resource that benefits a University program for more than one year, including buildings, fixed equipment, land, land improvements, infrastructure, moveable equipment, library books, works of art and historical treasures, computer software, and vehicles.
- *Capitalization:* recording in the financial records the cost or value of a capital asset belonging to the University, regardless of the source of funds used in acquisition of the property.
- *Control:* protecting and safeguarding a capital asset while under the supervision or in the possession of a University department or personnel, whether or not it is recorded in the space, equipment and vehicle inventory system.
- *Depreciation:* the allocation of the cost of a capital asset over the useful life of the asset rather than expensing the entire cost in the year of acquisition.
- *eBARS:* the University’s space, equipment and vehicle inventory system.
- *Equipment*: moveable property having a useful life of two (2) years or longer, and which retains its identity as a separate and identifiable item. An item loses specific identity when attached to another item as a component part or when attached as a permanent part of a building. Moveable equipment, whether leased or purchased, will include equipment, furniture, furnishings, fixtures, machinery, instruments, and vehicles.
- *Fixed equipment*: service equipment permanently attached to a structure. Costs included are electrical lighting and power fixtures, elevators, heating and ventilation, air conditioning, sprinkling and fire protection systems, casework, etc. Communications and network equipment are a special category of fixed equipment. The University does not capitalize equipment purchased to replace existing fixed equipment.
- *Infrastructur*e: long-lived capital assets typically preserved for a significantly greater number of years than most capital assets and normally stationary in nature. Examples include roads, bridges, tunnels, drainage systems, water and sewer systems, and dams. Infrastructure assets do **not** include buildings, driveways, parking lots or any other items that are incidental to the property or access to the property.

- *Land improvements:* enhancements to land other than buildings, such as fencing, paving, roadways, walks, parking facilities, retaining walls, shrubs, underground sewers, water lines, yard lighting, etc. Land improvements are further categorized as inexhaustible and exhaustible, as follows:
  - Inexhaustible: land improvements that do not deteriorate with use or the passage of time or do not require maintenance or replacement, such as those made to bring land into condition to commence erection of structures
  - Exhaustible: Other land improvements that are part of a site, but which require maintenance or replacement, such as parking lots, landscaping and fencing

  Maintenance and repairs: the recurrent, day-to-day work required to preserve a capital asset in its original condition (excluding normal deterioration) without materially increasing its usefulness or life. Costs include cleaning, lubrication, parts, material and labor. Charge such costs to current expenses.

  Reference materials: information sources, other than books, which include journals, periodicals, microforms, audio/visual media, computer-based information, manuscripts, maps, documents and similar items which provide information essential to the learning process or which enhance the quality of academic, professional or research libraries.

- *Works of art and historical treasures*: collections of rare books and manuscripts; maps, documents and recordings; paintings, sculptures and designs; artifacts, memorabilia, exhibits; unique and significant structures.

  Works of art and historical treasures are further categorized as inexhaustible and exhaustible, as follows:
  - Inexhaustible: Collections and individual items of significance not held for financial gain, but rather for public exhibition, education or research in furtherance of public service. The period of economic benefit or service potential for inexhaustible works of art and historical treasures is extraordinarily long due to efforts of the University to protect and preserve the asset in a manner greater than that for similar assets without such cultural, aesthetic or historical value.
  - Exhaustible: Collections and individual items of significance whose useful lives diminish by display or educational or research applications and no effort is made to protect and preserve the artwork.

III. Policy

A. The University capitalizes assets in its financial records as follows:
   1. Land – at cost; gifts capitalized at fair market value at the time of donation.
   2. Buildings, building improvements, fixed equipment (other than communications and network equipment), infrastructure assets and land improvements costing $100,000 or more and which increase its expected life or enhance its performance.
   3. Repairs and maintenance – not capitalized; job order work charges a departmental cost center on appropriate general ledger accounts (533010 through 533060).
   4. Moveable equipment purchased from vendors or fabricated by the University costing $5,000 or more – recorded in eBARS at historical cost, or fair market value in the case of gifts, and tagged with a UK property tag.

a) Expenses incurred for additions, improvements, or betterment to movable equipment – recorded in eBARS at cost
b) Equipment meeting all the criteria for equipment but costing less than the capitalization limits – controlled by the department and not included in the University's capital inventory. However, departments are encouraged to track noncapital equipment through eBARS. Refer to E-12-3 Equipment Inventory for procedures.
c) Any item required to be tracked in a Sponsored Project Agreement should have a UK property tag.
d) Leased equipment – capitalize if the lease arrangements meet any one of the requirements of Governmental Accounting Standards Board (GASB) Statement No. 62, paragraph 212, as follows:
   1) The lease transfers ownership of the property to the lessee by the end of the lease term.
   2) The lease contains a bargain purchase option.
   3) The lease term is equal to 75 percent or more of the estimated economic life of the leased property.
   4) The present value of the minimum lease payments at the inception of the lease, excluding executory costs, equals at least 90 percent of the fair value of the leased property.
e) Accessories to the equipment, installation costs and freight charges must be included in the cost of the equipment. Maintenance agreements and software licenses are not considered part of the cost of the equipment.
f) Maintenance or repair costs to equipment – not capitalized and must not charge a capital outlay GL account.
g) Capital equipment purchases must use capital outlay GL accounts. Refer to Business Procedure E-12-3.

5. Library books, reference materials, works of art and historical treasures – capitalized at cost or, in the case of gifts, at fair market value at the time of donation.
6. Computer software developed or obtained for internal use – limited to institutionally significant systems developed or obtained for internal use with a cost of $400,000 or more.
   a) For software to be considered developed or obtained for internal use, both of the following tests must be met:
      1) The software must be acquired, internally developed, or modified solely to meet the University's needs, and
      2) During the software's development or modification, the University must not have a substantive plan to market the software externally to other organizations.
   b) Software development generally involves **three phases**, as follows:
      1) **Preliminary project phase:** Conceptual formulation of alternatives, the evaluation of alternatives, determination of existence of needed technologies and final selection of product
      2) **Application development phase:** Design of chosen alternative, including software configuration and interfaces, coding, installation of computer hardware and testing, including parallel processing phase
      3) **Post-implementation/operation phase:** Training and application maintenance activities
   c) Expense costs associated with the preliminary project and post-implementation/operation phases as incurred.

d) Capitalize costs (both internal and external) associated with the application development stage.
e) Capitalization of costs begins when the preliminary phase is complete and the University's management implicitly or explicitly commits to funding the software project with the intent to complete and use to perform the planned functions.
f) Capitalization ceases no later than the time at which substantial testing is complete and the software is ready for its intended purpose or placed into service.
g) Examples of expenditures that are capitalized during the application development stage include:
   1) External costs
   2) External direct costs of materials and services (third party fees such as external programmers and consultants)
   3) Costs to obtain software from third parties
   4) Internal Costs
      (a) Travel costs incurred by employees in their duties associated with development
      (b) Payroll and payroll-related costs of employees <u>directly</u> assigned to coding, installing or testing.
   5) Capitalization of computer software includes computer license fees if an individual license fee (determined as the total dollar amount of the fee paid divided by the number of units served/terminals) meets the capitalization dollar threshold.
h) Do not capitalize general and administrative costs, including training costs.
i) If it is anticipated that a computer software project will equal or exceed $400,000, a capital equipment WBS element must be established to track these costs. If it is anticipated that the capitalizable costs will be below $400,000, costs are expensed as incurred.
j) Define capital software projects and establish the WBS element and related budget authority prior to the start of the project. Charge all external and internal costs to this WBS element as incurred.

7. Property transferred from other entities
   a) Chairs or directors must notify Capital Assets Accounting of equipment brought by incoming faculty.
   b) Provide a list of the equipment and price (the original purchase price and acquisition date) so that the University insures the property and adds it to the eBARS inventory system. Incoming property falls into one of the following categories:
      1) Property for which the title transfers to the University;
      2) Government owned property (authority to transfer must be given by the federal government either by the terms of a grant or contract or by other transfer documents); and
      3) Property on temporary loan (title does not transfer to the University and property must be returned to a former institution according to stipulations of the Transfer Agreement).

B. Depreciation
Capital assets are depreciated over the following estimated useful lives:

Category	Depreciation Method	Useful Life
Land	Not depreciated	Unlimited
Land improvements – inexhaustible	Not depreciated	Unlimited
Land improvements – exhaustible	Straight line	10 years
Buildings and fixed equipment	Straight line	40 years
Building improvements	Straight line	20 years
Infrastructure assets	Straight line	25 years
Communications and network equipment	Straight line	5 – 15 years
Equipment and machinery, including vehicles	Straight line	3 – 20 years
Leased equipment	Straight line	Estimated useful life or lease period, whichever is shorter
Computer software	Straight line	10 years
Library books and reference materials	Straight line	10 years
Library books – special collections	Not depreciated	Not applicable
Works of art and historical treasures - inexhaustible	Not depreciated	Not applicable
Works of art and historical treasures – exhaustible	Straight line	10 years
Construction in progress	Not depreciated	Not applicable

IV. Responsibilities

A. *Accounting and Financial Reporting Services (AFRS) - Capital Assets Accounting*

1. Maintain an inventory of physical facilities and real property;
2. Conduct the annual verification of space assignments, room uses, and other applicable data to keep the physical facilities inventory current;
3. Conduct the university-wide equipment inventory annually;
4. Record the purchase, construction, capital renovation, or demolition of buildings;
5. Record the acquisition of capital equipment in the Equipment Inventory System and UK Financial Records;
6. Verify departments use the correct general ledger (GL) accounts on purchases and correct if necessary;
7. Provide the necessary property tags, forms, etc., for use in the inventory system;
8. Provide building and room inventory reports upon request.

B. *Department*

1. Verify the accuracy of the inventory records for equipment during the annual inventory process and throughout the year in accordance with E-12-3 Equipment Inventory;
2. Use the proper expenditure general ledger accounts when requisitioning equipment;
3. Control and record the location of property;
4. Report the following to Capital Assets Accounting:
    a) transfers of property between University departments
    b) surplus or obsolete property
    c) lost, stolen, or destroyed equipment items
5. Maintain reasonable precautions in protecting all property;
6. Report the acquisition of capital gifts to UK Philanthropy and Capital Assets Accounting.
7. Ensure compliance with capitalization and inventory requirements detailed in sponsored project agreements.