TOPIC: Revision to Board Policy VIII-1.10—Policy for Capitalization and Inventory Control

COMMITTEE: Finance

DATE OF COMMITTEE MEETING: June 19, 2014

SUMMARY: The Policy for Capitalization and Inventory Control establishes System-wide standards for recognition of capitalizable assets, and establishes minimum requirements for the processes that institutions must follow to ensure safeguarding of important, high value, and long-lived assets. The policy was last updated in 1999, following an increase in the threshold the Federal government uses for cost recovery for capital assets from $500 to $5,000.

At the time of the last revision, the nature, extent and cost of computers and data processing equipment warranted a System-wide requirement that those types of assets be controlled in a traditional manner of affixing a tag or asset identifier, maintaining a central or departmental listing of those assets, and inventorying the list once every three years. Over the past 15 years, the requirements associated with computer and data processing equipment have gotten increasingly unmanageable, particularly at the larger, more decentralized institutions, where considerable institutional resources are being expended to achieve what amounts to a poor or weak level of internal control. Further, the requirement to inventory computers and data processing equipment once every three years results in a situation where many of the items will have reached the later portions of their useful life, further complicating and increasing the effort and cost to perform an inventory, and investigate or reconcile results.

The proposed revision enables institutions to adopt alternative processes and institutional practices to control long-lived—more than 1 year life—assets with a cost less than $5,000. Requirements for capital equipment—long-lived personal property assets costing more than $5,000—remain unchanged.

Institutions have given considerable thought to the appropriate set of controls and procedures to apply to computers and data processing equipment. For example, UMB is formalizing an institutional process that requires tracking of data processing equipment costing more than $200 on a master list of data processing equipment, and requires a written employee acknowledgement for the data processing equipment assigned. Non-data processing equipment with a cost more than $3,000 would also be tracked on a master list of non-capital assets.

ALTERNATIVE(S): The Finance Committee could reject the proposed revision to the policy.

FISCAL IMPACT: No fiscal impact is anticipated.

CHANCELLOR’S RECOMMENDATION: That the Finance Committee recommend approval of the proposed revision to the Policy for Capitalization and Inventory Control as presented.

COMMITTEE RECOMMENDATION: RECOMMEND APPROVAL

BOARD ACTION: DATE: 6/19/14

SUBMITTED BY: Joseph F. Vivona (301) 445-1923

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I. General

To ensure compliance with generally accepted accounting principles and prudent financial management, an asset valuation, property capitalization, and inventory control policy for the University System of Maryland has been developed.

Investment in property, plant and equipment comprises a substantial portion of the total assets of the University System of Maryland. It is essential for both financial statement and cost accounting purposes that all components of the System follow a uniform policy regarding capitalization, valuation, and control of plant, related assets, and inventory.

Capitalization of plant and related assets is the decision to report assets acquired or used under capital lease agreements as a long-lived (an asset which benefits more than a single year) asset within the Plant Fund fund group on the University System of Maryland financial records.

Valuation is the amount assigned in the financial records as the recorded value of a long-lived asset.

Control of plant and related assets are the procedures and policies in place to reduce to a reasonable level, the risk of loss or misappropriation of resources or assets.

This policy establishes asset valuation methods, and capitalization thresholds for property and related assets for financial reporting and cost accounting purposes. In addition, this policy sets forth guidelines for the minimal level of control for equipment, and requires institutions to establish a set of formal, written policies governing the control of plant and related assets, both capitalized and non-capitalized.

The System will value, capitalize and establish the necessary controls for the elements and values as described in Sections II and III.

II. Real Property

The elements of real property are land, building and building improvements, land improvements (other than buildings), infrastructure and construction in process. Valuation principles outlined for buildings and building improvements also apply to infrastructure, land improvements and construction in process.

A. Land

All land acquired by purchase is recorded at cost to include the amount paid for the land itself and all related acquisition costs.

Land acquired by gift or bequest is recorded at the fair market value at the date of acquisition.
When land is acquired with buildings erected thereon, total cost is allocated between the two in reasonable proportion at the date of acquisition. If the transfer document does not show the allocation, other sources of the information may be used such as an expert appraisal or the real estate tax assessment records.

B. Buildings and building improvements

This includes all buildings and permanent structures and all fixtures, machinery, and other appurtenances that cannot be readily moved without disrupting the basic building structure or services to the building.

When buildings are purchased or acquired by gift or bequest, the basis of valuation is similar to that used for land. The cost or fair market value is allocated between the buildings and the related land.

Significant additions, alterations, renovations or structural changes that extend the useful life or enhance the value of an existing building and which exceed $250,000 in cost, are added to the recorded valuation of the building at 100 percent of their identifiable cost. An estimate of the original cost of that portion of the building which is removed as a result of an alteration or renovation, for which the cost exceeds the $250,000 threshold, is deducted from the recorded valuation of the building.

C. Land Improvements (Other than Buildings)

These include fencing, athletic fields, landscaping, and other modifications to the land of a permanent nature requiring no or minimal upkeep. Only those components which exceed $250,000 in cost should be capitalized.

D. Infrastructure

These include roads, bridges, curbs, sidewalks, water, sewer and utility distribution systems. Only those components which exceed $250,000 in cost should be capitalized.

E. Construction in Process

This includes all costs associated with building, building improvement, or land improvement construction projects that are not complete at the end of the fiscal year.

When buildings are constructed, all identifiable costs are included such as (but not limited to) contract costs, insurance and interest costs during the period of construction. Only those projects which exceed $250,000 in cost should be capitalized.

F. Leased Real Property

Leased property is capitalized if the total cost of the property exceeds $250,000 and it meets the criteria outlined in the FASB Standard No. 13, subject to the provisions of other authoritative accounting guidance, which essentially provides that:
A lease is a capital lease if at inception it meets any one of the following criteria:

a. It transfers ownership of the property to the lessee by the end of the lease term;

b. It contains a bargain purchase option;

c. The lease term is 75 percent or more of the estimated economic life of the leased property; or

d. At the beginning of the lease term, the present value of the minimum lease payments (excluding executory costs), equals or exceeds 90 percent of the excess of the fair value of the leased property.

The leased property is recorded at the total cost net of interest expense (the present value at inception of the lease).

III. Personal Property

This includes those items identified below as moveable equipment, library books, book collections, museum and art collections, livestock and merchandise inventories.

A. Equipment (Unit Value of $5,000 or More - Capital Equipment)

This includes all equipment that is not permanently affixed to buildings, has a useful life greater than one year, and has a unit cost of $5,000 or more except for items predominantly composed of glass, rubber, cloth and equipment held for resale. Equipment held for resale should be valued and controlled in accordance with the guidelines for merchandise inventories.

A unit of equipment is defined for purposes of this policy as an individual item, or group of items, which is usable for its intended function and which cannot be separated without a diminishment in the usability of the item for its intended purpose.

1) For equipment purchased, the valuation is the net amount paid through accounts payable which is the invoice price less all discounts (except trade-in allowances). Trade-in allowance is included in the asset value. Freight and installation costs are also included if they are shown on the original invoice, or if they are readily available on related freight bills.

2) Equipment acquired by gift is recorded at fair market value at the date of acquisition.

3) Leased equipment is capitalized if it meets the criteria outlined in the FASB Standard No. 13, which essentially provides that:

   A lease is a capital lease if at inception it meets any one of the following criteria:

   a. It transfers ownership of the property to the lessee by the end of the lease term;
b. It contains a bargain purchase option;

c. The lease term is 75 percent or more of the estimated economic life of the leased property; or

d. At the beginning of the lease term, the present value of the minimum lease payments (excluding executory costs), equals or exceeds 90 percent of the excess of the fair value of the leased property

The leased equipment is recorded at the total cost net of interest expense (the present value at inception of the lease).

4) The valuation of fabricated equipment includes all identifiable costs such as drawings, blueprints, component parts, materials, and supplies consumed in fabrication, labor, and installation.

Each institution is responsible for maintaining inventory records for all capital equipment, performing or coordinating physical inventories, reconciling physical inventories to the related records at least once every two years, and reconciling equipment additions and deductions on the inventory system to the general accounting system.

Equipment inventory records should also include items of equipment that meet the above specifications except that the University System of Maryland is the custodian rather than owner. Items for which the University System of Maryland is the custodian rather than the owner, excluding items used under capital lease agreements, should not be reported in the financial statements.

B. Equipment (Unit Value of Less than $5,000 - Non-Capital)

Equipment that does not meet capital equipment specifications because its unit cost is less than $5,000 or because it is predominantly glass, rubber, or cloth is not reported for financial reporting purposes.

Each institution must develop a formal, written, institutional policy with respect to non-capital equipment geared towards loss prevention. The nature and extent of control processes and procedures relating to non-capital equipment are to be determined by each institution. Controls over data stored on equipment with a unit value of less than $5,000 must comply the University System of Maryland Guidelines In Response To The State IT Security Policy.

At a minimum, institutional policies and procedures need to ensure that there be written verification that related purchases have been reviewed and authorized appropriately, and that all responsibilities of each of the institutions’ departments, including central offices are clearly defined, with the overall intent being to maintain the integrity of the financial records and provide adequate internal control over all institutional assets.

Firearms are a unique and separate category of non-capital equipment, and must be identified, tracked, and accounted for periodically, in a manner and fashion determined by each institution.
C. Library Books

Purchases of books, bound periodicals, microfilm, or other library items are capitalized if they are part of a formal University catalogued library.

Library items acquired by gift are valued at fair market value. Deletions are valued at annually adjusted average cost per volume.

Each library should provide information to the institution comptroller/controller for annual entries to the records underlying the financial statements.

D. Museums and Art Collections

Each institution with a collection of art or of scientific or historical objects is required to maintain a detailed perpetual inventory with items valued at cost or market value at date of acquisition. For donated collections of substantial value, the appraised value should be the basis for the value recorded in the financial records. The institution must include this information in the financial statements.

E. Livestock

Animals used for instruction in agriculture or held for herd or flock perpetuation / improvement are capitalized at acquisition cost or fair market value.

The institutions are responsible for keeping records of livestock. Responsible units at all institutions must prepare annual inventories of capital livestock and report it to the institution comptroller / controller for inclusion in the financial statements.

F. Merchandise Inventories

Any functional unit involved in resale, either within the department or to other departments, institutions, or individuals, is required to maintain an inventory system appropriate to the value of items held for resale. The units involved in resale and the appropriate inventory system are to be determined by the institution. Additionally, the unit must take a physical inventory of these items at year-end and report it to the institution comptroller / controller.

G. Chemicals, Pharmaceuticals, and Radioactive Materials

Chemicals, pharmaceuticals, and radioactive materials present additional risks and responsibilities to the institution which must be acknowledged and accommodated in the institutions' control procedures, depending upon the institutions' situation. All state and federal regulatory requirements must be incorporated into institutional control procedures surrounding these items.

Replacement for: BOR VIII-1.10