

WEST BASIN MUNICIPAL WATER DISTRICT

Capitalization Policy

Purpose

This capitalization policy is intended to provide guidance for the capitalization and depreciation of capital assets to comply with the requirements of Governmental Accounting Standard Board Statement 34, Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments. This Statement requires the reporting of West Basin Municipal Water District's ("District") capital assets and depreciation in their annual audited financial statement.

This policy includes capital asset classes, descriptions, capitalization threshold levels, estimated useful lives, methods of depreciation and the procedures to be used in effectively identifying, recording and reporting the District's capital assets.

Asset Classification

District capital assets are used to support two major criteria of the business:

- General Administration
- Infrastructure.

General Administration

General administration is the activity that District employees conduct to run the day to day business. Capital assets that support these activities can include but are not limited to office furniture, fixtures, equipment, information and computer systems, etc., where the following two (2) conditions are met:

- Each individual item has a cost of \$3,000 or more, and;
 - Useful life of at least Three years.
- Or
- A group of same type assets has a cost of \$5,000 or more, and;
 - Useful life of at least Three years.

Infrastructure

Activities related to infrastructure include new construction, replacement due to expansion or new technology, replacement due to the end of normal life cycle, major repairs or refurbishment and acceptance of assets through the contribution by other agencies. Capital assets that are in this group can include but are not limited to land, land improvement, buildings, building improvements, facilities, facility improvements and renovations, water system, pipelines, pump stations, membranes, meters and other major components that are used in the water treatment plant facility.

1) New Construction:

New construction normally starts as a Construction-In-Progress project and may take more than one fiscal year to complete. At the completion of the project, the total costs of the project may be broken down by the major groups of assets such as distribution system, pumping system, reverse osmosis system, etc. Under each system, the component unit of the assets is listed based on the nature of the component and the length of the estimated useful life.

To be considered as a capital asset, these two conditions must be met:

- Each individual item or component unit has a cost of \$10,000 or more, and;
- Useful life of at least Three years.

Exception:

Service connections (pipelines) are capitalized as capital assets and are not subject to the \$10,000 limitation. However, it still has to meet the useful life limitation of at least three years. In the situation when the customers pays the cost of acquiring and installing service connections, but the District is responsible for the maintenance of the service connections, the District should include the connections as part of the District capital assets and record the customer contributions as revenue according to GASB Comprehensive Implementation Guide, footnote 64 to GASB-34.

2) Replacement due to expansion or new technology:

Replacement can take place when the District is expanding its facilities to increase production capacity, or as the result of new technology and equipment becoming available on the market that is more cost efficient than what is currently used. In this situation, the old systems or equipment will be replaced when they still have a remaining useful life and economic value.

To be considered as a capital asset, these two conditions must be met:

- Each individual item or component unit has a cost of \$10,000 or more, and;
- Useful life of at least Three years.

Also, because the retired equipment or systems still have a positive net book value, the District will calculate and record the appropriate loss of disposition.

3) Replacement due to the end of life cycle:

Replacement can also take place as a result of normal scheduled maintenance. The components can be purchased at the same time, but be installed simultaneously or within a planned short period time. In this situation, the old systems or equipment will be replaced when they have no useful life or economic value.

To be considered as a capital asset, these two conditions must be met:

- The aggregate total costs of the component units have a cost of \$10,000 or more, and;
- Useful life of at least Three years.

The estimated portion of the original asset that was replaced will be removed from the asset records of the District.

4) Repairs or refurbishments:

The District's existing infrastructure requires repairs and maintenance on a regular basis. Repair or refurbishment expenses to the existing capital assets under certain circumstances may be capitalized. The criteria for determining whether the expenditure is an expense or capital asset requires knowledge of the effect the repair will have on the capital asset.

To be considered as a capital asset, these conditions must be met:

- Total repair or refurbishment cost of one job has to be \$10,000 or more, and;
- After the repair or refurbishment, the remaining useful life of the existing asset must be extended by at least Three years.

When the above conditions are not met, the cost of repair or refurbishment will be considered as operations and maintenance expenses.

5) Contribution by other agency:

The District may enter into an agreement with other governmental agencies to co-build some infrastructure. At the completion of the project, a portion or the entire infrastructure may be contributed to the District regardless of which agency had paid for the costs and the District has the primary responsibility for maintaining the asset. In this situation, the capital asset is recorded at the time the asset is the sole property of the District. The total cost of the project must be broken down by operating system, and the major component units are to be listed under the operating systems depending on the nature and the length of the estimated useful life.

To be considered a capital asset, these two conditions must be met:

- Each individual item or component unit has a cost of \$10,000 or more, and;
- Useful life of at least Three years

Determination of Cost

GASB Statement 34 states that purchased or District-constructed capital assets should be reported at historical cost. The total cost of the capital asset is the cash outlay or its equivalent that is necessary to acquire the asset and put it in operating condition. These costs include contract price, freight, sales tax, licensing fees, handling and assembling, installation and testing, direct labor and material, indirect labor and materials, benefit and overhead allocations as well as any construction period interest cost as required by GASB Statement No. 34. In addition, it is the District's policy to capitalize any cost that is specifically identifiable with a planned capital project (or asset acquisition), including

public information costs and costs incurred to obtain financing for the project. Contributed capital assets will be recorded at their estimated fair market value at the date of the asset was contribution to the District.

Estimated Useful life

The District uses Internal Revenue Tax Law requirements, general guidelines obtained from professional or industry organizations and information for comparable assets of other governments as the guidelines when estimating the useful lives of the capital assets.

Depreciation Method

The District uses straight-line method with no salvage value for all depreciable capital assets.

Summary

The following table summarizes the criteria discussed above.

Asset Class	Description	Threshold	Useful life (years)
OFFICE FURNITURE, EQUIPMENT	Desk, chair, file cabinet, telephone printer	\$3,000	3-10
INFORMATION SYSTEMS	Computer, server, software, monitor	\$3,000	3-6
LAND	Land	N/A – capitalize all	N/A
LAND IMPROVEMENT	Sidewalks, fences, landscape shrubbery	\$10,000	20
BUILDING & IMPROVEMENT	Buildings	\$10,000	40
INFRASTRUCTURE	Pipelines, pump station, well, motors, vaults, membranes, pump, storage tank, meters, compressor,	\$10,000	3-40
VEHICLES	Car, truck, tractor, trailer	\$10,000	5

* The above descriptions are not limited to those described.

Glossary:

Capital Assets: Capital assets are acquired for use in operations and not for resale. They are long term in nature and subject to depreciation. They possess physical substance.

Component Unit: Individual identifiable pieces of a capital asset (or group of capital assets).

Depreciation: The systematic and rational allocation of the estimated historical cost of a capital asset, (or if donated, the fair value of the capital asset at the time of donation), over its estimated useful service life.

Estimated Useful life: The period of time over which an asset's cost will be depreciated.

Fair Market Value: An estimate of what a willing buyer would pay to a willing seller, both in a free market, for an asset or any piece of property.

GASB 34: The Governmental Accounting Standards Board's (GASB) Statement No. 34, Basic Financial Statements and Management's Discussion and Analysis require State and Local Governments depreciate their exhaustible capital asset, including infrastructure.

Historical Cost: The actual exchange value in dollars at the time the asset was acquired. It is measured by cash or cash equivalent price of obtaining the asset and charges necessary to bring it to its intended location and to place the asset in its intended condition for use.

Infrastructure: The structures that support a society, such as roads, water supply, wastewater, power grids, flood management systems, telecommunications (Internet, telephone lines, broadcasting), and so forth.

Replacement: The substitution of a new facility or component of an existing facility.

Salvage Value: An estimate of the amount that will be realized at the end of the useful life of a depreciable asset.

Straight-Line Depreciation Method: Is determined by the formula: $(\text{Cost-Salvage value}) / \text{Estimated useful life} = \text{Depreciation per period}$.