



September 03, 2020

TO: LOCSD Board of Directors

FROM: Ron Munds, General Manager

SUBJECT: Agenda Item 6F – 09/03/2020 Board Meeting
Adopt a Resolution Updating the Capitalization Policy

DESCRIPTION

President

Charles L. Cesena

Vice President

Christine M. Womack

Directors

Matthew D. Fourcroy
Vicki L. Milledge
Marshall E. Ochylski

General Manager

Ron Munds

District Accountant

Robert Stilts, CPA

Unit Chief

Scott M. Jalbert

Battalion Chief

Paul Provence

Staff is uncertain when the current Capitalization Policy (attached) was adopted since there is no record of a report or resolution in the District's files. It appears it could be from 2016 based on dates in our electronic files. This report summarizes the purpose of the policy and its importance to guiding the District's financial procedures in regards to capital assets.

STAFF RECOMMENDATION

This item will be approved along with the Consent Calendar unless it is pulled by a Director for separate consideration. If so, Staff recommends that the Board adopt the following motion:

Motion: I move that the Board adopt Resolution 2020-20 Amending and Updating the District's Capitalization Policy.

DISCUSSION

The term capital assets is used to describe assets that are used in operations and that have initial lives extending beyond a single reporting period. Capital assets may be either intangible (e.g., easements, water rights, licenses, leases) or tangible (e.g., land, buildings, building improvements, vehicles, machinery, equipment and infrastructure).

As a practical application of the materiality principle, not all tangible capital-type items with useful lives extending beyond a single reporting period are required to be reported in the District's statement of net position. Items with extremely short useful lives (e.g., less than 2-3 years) and/or of small monetary value are properly reported as an "expense" or "expenditure" in the period in which they are acquired.

When outlays for capital-type items are reported on the statement of net position, they are said to be capitalized. The monetary criterion used to determine whether a given capital asset should be reported on the statement of net position is known as the capitalization threshold. The District may establish a single capitalization threshold for all of its capital assets, or it may establish different capitalization thresholds for different classes of capital assets which is recommended in the draft policy. In selecting different capitalization thresholds, the District will be able to report and depreciate substantially all capital asset value while eliminating the cost of tracking a large number of small-value items.

The proposed capitalization policy is intended to provide guidance for the capitalization and depreciation of capital assets to comply with the requirements of Governmental Accounting Standards Board Statement (GASB) 34, Basic

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Financial Statements and Management's Discussion and Analysis for State and Local Governments. This Statement requires the reporting of the District's capital assets and depreciation in their annual audited financial statements.

The 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.

FINANCIAL IMPACT

There is no financial impact with the adoption of the bid protest rules. The policy will provide clear direction to the General Manager and financial support staff on how to account for and depreciate the District's assets.

Attachment – Resolution 2020-20
Exhibit A
Current Capitalization Policy

RESOLUTION NO. 2020-20

A RESOLUTION OF THE BOARD OF DIRECTORS OF THE LOS OSOS COMMUNITY SERVICES DISTRICT AMENDING THE DISTRICT'S CAPITALIZATION POLICY

WHEREAS, The District Board of Directors finds it desirable to adopt a comprehensive set of financial management policies for the District; and

WHEREAS, the Governmental Accounting Standards Board (GASB) adopted Standard No. 34 states that purchased or district constructed capital asset should be reported at historical cost; and

WHEREAS, the Governmental Accounting Standards Board (GASB) adopted Standard No. 34 also requires fixed assets to be depreciated based on estimated their useful life; and

WHEREAS, the District Board of Directors desires to provide guidance for the capitalization and depreciation of capital assets to comply with the requirements of Governmental Accounting Standard Board Statement (GASB) 34, Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments.

NOW, THEREFORE, THE BOARD OF DIRECTORS OF THE LOS OSOS COMMUNITY SERVICES DISTRICT DOES HEREBY RESOLVE, DECLARE, DETERMINE AND ORDER AS FOLLOWS:

1. The Capitalization Policy is hereby amended as specified in Exhibit A and incorporated by reference herein.

On the motion of Director _____, seconded by Director _____, and on the following roll call vote, to wit:

Ayes: _____
Noes: _____
Abstain: _____
Absent: _____

The foregoing resolution is hereby passed, approved, and adopted by the Board of Directors of the Los Osos Community Services District this 3rd day of September, 2020.

Charles L. Cesena
President, Board of Directors
Los Osos Community Services District

ATTEST:

APPROVED AS TO FORM:

Ron Munds
General Manager and Secretary to the Board

Jeffrey A. Minnery
District Legal Counsel

**Los Osos Community Services District
Capitalization Policy**

1. 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 Standards Board Statement (GASB) 34, Basic Financial Statements and Management’s Discussion and Analysis for State and Local Governments. This Statement requires the reporting of Los Osos Community Services District’s (“District”) capital assets and depreciation in their annual audited financial statements.

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.

2. 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, software programs, 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 3 years.
- Or
- A group of same type assets has a cost of \$5,000 or more, and;
 - Useful life of at least 3 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 vehicles, equipment, land, land improvement, buildings, building improvements, facilities, facility improvements and renovations, water system, pipelines, pump stations, meters, and other major components that are used in the water distribution and/or water treatment.

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, 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 \$5,000 or more, and;
- Useful life of at least 5 years.

Exception:

Service connections (pipelines) are capitalized as capital assets and are not subject to the \$5,000 limitation. However, it still has to meet the useful life limitation of at least five 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 \$5,000 or more, and;
- Useful life of at least 5 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 \$5,000 or more, and;
- Useful life of at least 5 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 \$5,000 or more, and;
- After the repair or refurbishment, the remaining useful life of the existing asset must be extended by at least 5 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 \$5,000 or more, and;
- Useful life of at least 5 years

3. 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.

4. 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.

5. Depreciation Method

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

6. 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	Fences, landscape shrubbery, driveways	\$5,000	20
BUILDING & IMPROVEMENT	Buildings	\$5,000	40
INFRASTRUCTURE	Pipelines, pump station, well, motors, vaults, pump, storage tank, meters, compressor,	\$5,000	3-50
VEHICLES	Truck, tractor, trailer	\$5,000	10

* The above descriptions are not limited to those described.

Glossary of Terms:

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, in the case of the District, vehicles, equipment, buildings and improvements, water supply, water treatment, flood management systems, telecommunications (SCADA), emergency services equipment 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: $(\text{Cost-Salvage value}) / \text{Estimated useful life} = \text{Depreciation per period}$.

LOCSD CAPITALIZATION -ASSET RETIREMENT POLICY

A PURCHASED ITEM WILL BE CAPITALIZED WHEN

- The cost of the item is greater than \$5,000.00
- The line item for its expense will be in the 9000 series and identified by fund
- The asset will have an expected life length of at least 5 years. Exceptions to this rule would be high-tech items with a very short "service" life.
- It is not a repair or maintenance of an existing asset.
- The item is included in the Asset Records and adds to the value of the LOCSD Infrastructure.
- Assets purchased, valued over \$5000.00 that are attached to an already owned asset, should be listed and tracked as a separate asset. For example, a fire truck accessory is purchased and its value is over \$5000.00. It is attached to an existing fire truck. If the vehicle is salvaged, the asset is removed and attached to another vehicle.

ITEMS TO BE RETIRED WILL BE DECLARED SURPLUS WHEN

- The original purchase price of the item was greater than \$5,000.00
- The Board authorizes retirement