LOWER RIO GRANDE PUBLIC WATER WORKS AUTHORITY (LRGPWWA)
CAPITAL ASSETS POLICY

TABLE OF CONTENTS

1. DEFINITIONS

State Procurement Statute-CHAPTER 13 Public Purchases and Property; Article: 1; Procurement: 13-1-1 through 13-1-199. NMSA 1978

Capital Asset Definition (aka, Fixed Asset) - An asset definition was established for the asset management plan (see definition below). To be considered a capital asset, it must meet at least one of the following criteria:

- Has a value greater than $5,000
- Has a useful life greater than one year
- Is critical to the delivery of process, compliance of regulatory standards, and/or provision of staff safety

All of the Authority's capital assets were identified using the above criteria. These criteria helped to distinguish an asset from a component (See definition below). Only those assets that fulfill these criteria will be included in the capital assets register.

Capital Asset Hierarchy - An asset hierarchy helps to efficiently and effectively organize a large volume of assets in the capital asset register. It provides a parent and child relationship between asset records and allows information (i.e. cost and asset valuation) to be presented at all levels of the hierarchy. At the higher level, the Authority's assets are grouped into Water System, Sewer System and General. Water System is further classified into Linear Assets (e.g. pipes, hydrants, valves) and Facility Assets (i.e. wells, pump stations, pressure reducing stations. Sewer System is classified into linear assets (e.g., pipes, manholes, lift stations). General Assets are assets that cannot be allocated to strictly Water System or Sewer System (i.e., office buildings, vehicles, etc.)

Components - A Component is an essential part of an asset which may be removed and replaced to extend the life of the asset. Components are usually an expensive piece of equipment with a separate, depreciable life. A Component is a part of an asset that needs to be identified separately from its parent asset. Reasons for identifying the component separately may include a different useful life, maintenance regime or the risk and criticality of the component.

> ***Example**: Water System (Parent)>Well (Child)>Pump/Motor (Component) - A well could have a useful life of 80 years but the pump and motor required to draw the water up from the well may only last for 5 years. You wouldn't abandon the well and drill a new one just because the motor went out. You would replace the motor and continue using the well. Therefore, the motor would be a component and would be added to the parent asset as the child with a separate, depreciable life.*

Asset Management Plan - An Asset Management Plan is a tactical plan for managing an organizations infrastructure and other assets to foster more efficient use of financial and physical resources.

Note: Asset management plans have only recently become a requirement to obtain funding and meet reporting requirements with state agencies. The Authority has developed an Asset Management Plan. The Plan is in a transitional phase due to the recentness of the requirement. Mutual Domestics were not required to keep detailed records so in many cases none exist. The Authority was formed through the merger of many small Mutual Domestic Water systems that were run by volunteers and lacked records. After the formation of the Authority in 2009 newly acquired assets and maintenance records have been documented. In 2016, in an effort to establish an accurate Fixed Asset Inventory, the Authority with the assistance of a third-party (RPC CPA's), has verified and documented the existence of all Fixed Assets owned by the Authority that are still in use and has established values for items that lacked documentation. Fully depreciated items and items that have been disposed of or replaced have been removed from the Fixed Assets listing and the accounting records. Appropriate entries have been made into the accounting records to reflect the changes and a detailed Fixed Assets inventory has been entered into the accounting system.

Where records were available, the Fixed Assets have been broken down into parent, child, and component sections to form the basis of the Asset Management Plan. Where records were not available, the Fixed Assets were recorded based on the information on hand and the professional judgment of the General Manager and other experts. Any new items will be added using current record keeping requirements, and as old items are depreciated and disposed of they will be removed, improving the usefulness of the Asset Management Plan.

Acquisition Cost – Capital assets should be recorded and reported at their historical costs, which include the vendor's invoice (plus the value of any trade-in or allowance, if reflected on the invoice), plus sales tax, initial installation cost (excluding in-house labor), modifications, attachments, accessories or apparatus necessary to make the asset usable and render it into service. Historical costs also include ancillary charges such as freight and transportation charges, site preparation costs and professional fees.

Merger Asset – A Merger Asset acquired through a merger shall be recorded at cost with accumulated depreciation. If there is no supporting documentation available at the time of merger the merger asset will be assessed for age and condition and be recorded at fair market value. A remaining useful life will be established and the asset will be depreciated accordingly.

Donated Asset – Donations are defined as voluntary contributions of resources to a government entity by a non-governmental entity. Donations should be reported at fair value at the time of acquisition plus ancillary charges, if any. Fair value equals the amount at which an asset could be exchanged in a current transaction between willing parties.

Donations must be recorded and reported at fair value on the date of acquisition based on a reasonable market study. Recipients of donated capital assets will recognize the donation and related revenue when the transaction is complete and the assets are received, providing all eligibility requirements have been met. Promises of capital asset donations should be recognized as receivables and revenues (net of estimated uncollectible amounts) when all applicable eligibility requirements have been met, providing that the promise is verifiable and the resources are measurable, with the probability of collection.

In some cases, donated capital assets are given with the stipulation (time requirement) that the assets cannot be sold, disbursed or consumed until a specified number of years have passed or a specific event has occurred.
For such cases, the capital asset should be reported in the statement of Net Assets as "Net Assets—Restricted" as long as the restrictions or time requirements remain in effect.

Additions and Improvements - Capital outlays that increase the capacity or efficiency of the asset should be recorded as additions and improvements. A change in capacity increases the level of service provided by an asset.

> ***Example:*** *a new pump can be added to a well. A change in efficiency maintains the same service level, but at a reduced cost, or a SCADA system could be reengineered so that it monitors the tank's changes at reduced cost.*

Maintenance Costs – Costs that allow an asset to continue to be used during its originally established useful life. Maintenance costs should be expensed in the period incurred.

Preservation Costs – Costs that are generally considered to be those outlays that extend the useful life of a capital asset beyond its original estimated useful life, but do not increase the capacity of efficiency of an asset. Preservation costs should be capitalized.

Land - The surface or crust of the earth, which can be used to support structures, and may be used to grow crops, grass, shrubs, and trees. Land is characterized as having an unlimited life (indefinite) and is not depreciated. Donated land should be treated like donated assets and is not depreciated.

Land Improvements – Betterments, site preparation, and site improvements (other than buildings) that ready land for its intended use. The costs associated with improvements to land are added to the cost of the land and are not depreciated.

Building - A structure that is permanently attached to the land with a foundation, has a roof, is partially or completely enclosed by at least three walls, and has one utility other than electricity. It is not intended to be transportable or moveable and is used for housing people, animals, plants, or equipment.

Building Improvements - Capital events that increase the value of a building. A building improvement should be capitalized as a betterment and recorded as an addition of value to the existing building if the expenditure for the improvement is at the capitalization threshold (i.e. adding square footage, or any improvements that decrease the age of the structure such as new windows).

Computation of Gain or Loss from Sale Assets - To compute a gain or loss, proceeds received must be subtracted from the asset's net book value and in accordance with federal regulations.

Example*:*

Asset's Historical Cost	*$10,000*
Less Accumulated Depreciation	*(7,000)*
Net Book Value	*3,000*
Subtract Proceeds Received	*(2,000)*
Loss from Sale of Asset	*1,000*

Net Book Value - Asset's historical cost less the accumulated depreciation

Computer Software – Software developed or obtained for Internal Use (SOP 98-1). Minor software purchases are defined as purchases between the cost of $5,000 and $50,000, and are depreciated over five years. Major software purchases are defined as purchases over $50,000 and are depreciated over 10 years.

Capitalization of Software Cost – Software implementation generally involves three phases. These phases and their characteristics are as follows:

- Preliminary Project – when conceptual formulation of alternatives, the evaluation of alternatives, determination of existence of needed technologies and final selection from among the alternatives is made.
- Application Development/Implementation Phase – Design of chosen path including software configuration and software interfaces, coding, installation of computer hardware, testing, including parallel processing phase, costs of training, employee and consultant travel expenses and consultant fees.
- Post-Implementation/Operation Phase – training and application maintenance activities incurred after phase two is complete.

Costs associated with the Preliminary Project and the Post-Implementation/Operating Phases should be expensed as incurred. Internal and external costs associated with the application development phase should be capitalized. Costs to develop or obtain software that allows for access or conversion of old data by new information systems should also be capitalized. General and administrative costs and overhead expenditures associated with software development should not be capitalized as costs of internal use software.

Capitalization of costs should begin when the Preliminary Project Phase is complete and the Authority's management has implicitly or explicitly authorized or commits to funding the software project with the intent it will be completed and used to perform its planned functions. Capitalization should cease no later than the time at which substantial testing is complete and the software is ready for its intended purpose or rendered in service.

Vehicles – anything with a VIN number or that is drivable or towable, or that has to be registered with the State Motor Vehicle Department or Department of Transportation to be driven on public road ways (i.e. trucks, cars, trailers, backhoes, sewer jetter).

Machinery & Equipment – Equipment used out in the field such as trenchers, power washers, saws, power and hand tools, compressors, generators, riding lawn mowers (Not drivable or towable on public roadways).

Furniture & Fixtures- Equipment used in an office setting such as copy machines, printers, appliances, computer equipment, security systems, etc.

Equipment – Movable tangible assets to be used for operations, the benefits of which extend beyond one year from the date of acquisition and rendered into service. Improvements or additions to existing equipment that constitute a capital outlay or increase the value or life of the asset, and which have an acquisition cost of $5,000 or more, should be capitalized as betterments and recorded as additions of value to the existing assets. (Office equipment should be recorded as part of Furniture and Fixtures)

This $5,000 threshold is mandated by New Mexico State Statute. The Authority also elects to change the threshold to reflect the State Auditor's mandated threshold changes. Equipment with a short service life, such as personal computers, which will be technologically obsolete within a short period of time, is depreciated over five years. Equipment with a long service life, between 6 and 7 years, and not subject to technological obsolescence is depreciated over 7 years.

Leased Equipment - Leased equipment should be capitalized if the lease agreement meets any one of the following criteria:

- The lease transfers ownership of the property to the lessee at the end of the lease term.
- The lease contains a bargain purchase option.
- The lease term is equal to 75 percent or more of the estimated economic life of the leased property.
- 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.

Leases that do not meet any of the above requirements should be recorded as an operating lease.

Infrastructure – Assets that are long-lived capital assets that are normally stationary in nature and can be preserved for a significantly greater number of years than most capital assets. Infrastructure assets are often linear and continuous in nature. The Authority's two infrastructure subsystems are:

1. Water System
2. Sewer System

Infrastructure Improvements – Improvements are events that materially extend the useful life or increase the value of the infrastructure, or both. Infrastructure improvements should be capitalized as a betterment and recorded as an addition of value to the infrastructure if the improvement or addition of value is at the capitalization threshold ($5,000) or increases the life or value of the assets by 25 percent of the original cost or life period.

Infrastructure Modified Approach - The modified approach is an alternative to reporting depreciation for infrastructure assets that requires an asset management system, documentation that assets are being preserved at or above a condition level established by the government and depreciation is not reported.

Jointly Funded Infrastructure – Infrastructure paid for jointly by the State and other governmental entities should be capitalized by the entity responsible for future maintenance.

Leasehold Improvements – Construction of new buildings or improvements made to existing structures by the lessee, who has the right to use these leasehold improvements over the term of the lease. These improvements will revert to the lessor at the expiration of the lease. Moveable equipment or office furniture that is not attached to the leased property is not considered a leasehold improvement. Refer to section 6 for *Leasehold Improvements Depreciation Methodology*.

Other Improvements – Depreciable improvements made to a facility or to land that should be capitalized as betterments if the improvement is at the capitalization threshold or the expenditure increases the life or value of the asset by 25% of the original cost or life period.

Construction in Progress – The economic construction activity status of buildings and other structures, infrastructure (water and sewer systems, pipelines, etc.), additions, alterations, reconstruction, installation, and maintenance and repairs, which are substantially incomplete. Once construction is complete the Asset should be moved from CIP to the appropriate Fixed Assets category.

Disposal of an asset – An asset which is obsolete or unusable may be disposed of by selling or donating as per State Statute-CHAPTER 13 Public Purchases and Property; Article: 6; Sale of Public Property: 13-6-1 through 13-6.8. NMSA 1978. See Section 5 below for procedure.

2. CAPITALIZATION POLICY

A. <u>Personal Property</u>

1. All equipment and tangible personal property, either purchased or acquired through merger/acquisition by the Authority, regardless of funding source, are added to the Authority's permanent fixed assets inventory records as follows:

    - Items with a unit cost of $5,000.00 and over are capitalized for accounting purposes. Items costing $5,000.00 and over are subject to annual audit inspection and verification.

    - Items that are below the $5,000 threshold but meet any of the asset definitions above will be capitalized at the discretion of the General Manager and Finance Manager

    - Supplies and consumable items (useful life of less than one year) regardless of dollar amount should not be capitalized. Instead, these purchases should be charged to departmental Supplies and Expense accounts.

2. The following components are included in determining the cost of fixed asset items:

   - Actual purchase cost (net of any discounts)
   - Transportation and installation costs
   - Applicable taxes or transfer fees
   - Current fair market value (if received by donation or acquired through merger/acquisition)

3. If documentation is not available, the value of donated equipment or equipment acquired through a merger/ acquisition is determined by independent certified appraisal. In the absence of a certified appraisal, the value is determined by the General Manger. <u>All donated property must be received by the Inventory/Procurement department and entered into the accounting records and will then be issued to the receiving department.</u>

B. <u>Real Property and Infrastructure</u>

Purchased real property is recorded at cost basis.

In the case of improved property acquired, a reasonable cost allocation method is used in assigning the pro-rata amounts to the building, permanent improvement, and land.

The cost of construction of buildings and infrastructure includes: Architectural fees, legal fees, engineering fees, infrastructure costs, material costs, labor and other costs incurred in the construction process and should be capitalized in the Permanent Plant Fund upon completion of construction. Construction-in-progress is capitalized as of the last day of the fiscal year and is then transferred to Buildings upon completion of the project.

Building improvements are capitalized into the Building and Improvements account when the building's value is increased or its useful life is prolonged (i.e. permanently fixed shelving, and major renovations). Minor renovations, preventive maintenance and repairs are charged to operational supplies and expenses and are not considered capital improvements (i.e. painting, refinishing, damage repairs, etc.).

Permanent improvements to land that are capitalized into the Land Improvements account include, but are not limited to: parking lots, fencing, fixed lighting, major landscaping, surveying, etc.

Merger/ Acquisition - Assets acquired through a merger/acquisition shall be recorded at cost and supporting documentation should be obtained at the time of the merger/acquisition. For most cases, cost is equal to monetary value exchanged plus any associated cost to prepare the asset for its intended use. If there is no supporting documentation available, the asset shall be recorded at fair market value at the time of the transaction.

C. Repairs and Maintenance/ Betterments and Replacements

- Replacement of component parts that allow the asset to continue to be used or cost more than 25% of the total cost of the asset should be capitalized. Replacement costs should include all overhead costs incurred to replace the component.

  ***Example**: Replacement of the pump and motor in a well; the cost might not meet the 25% but without the replacement the asset would be useless.*

- Betterments to an asset should be capitalized if the component will improve the asset. The old component should be removed from the accounting records and the new component should be added to the appropriate asset account.

3. TAGGING AND INVENTORY CONTROL

All machinery, equipment, furniture and fixtures that are not permanently affixed to the Authority's land or buildings should be tagged and added to the inventory database. Items that are essential to daily operations that are moveable and likely to be lost or misplaced, regardless of the dollar value, should be tagged and issued to personnel for use at the General Manager's discretion. Note: The Authority has many items that don't meet the $5,000 threshold that are likely to disappear, so tagging them and issuing them to an employee will enable the Authority to be more accountable.

As part of the conversion to the new Accounting and Inventory system the Authority will review all items on hand and decided which items need to be tagged and included in the inventory database. After the items have been tagged they will be issued to employees. The employees will sign for receipt of the items and be responsible for the items until they are returned to the Inventory Specialist. The Inventory Specialist will sign a log or receipt when the items have been returned. Items should be inspected to make sure they are still in good, usable condition before being returned to the warehouse. The Inventory Specialist will make arrangements for repair or replacement if necessary. This information is then added to the inventory database; a unique identification number is assigned and a property tag is generated. The Inventory Control Clerk affixes the property tag to a visible area on each item.

4. PHYSICAL INVENTORY

The Finance Manager and Inventory Staff will perform an annual inventory working from a computer-generated report. The Inventory Staff meets with department heads to resolve discrepancies and to attempt to locate missing items.

5. DISPOSITIONS AND SALES OF THE AUTHORITY'S PROPERTY

Dispositions and sales of the Authority's property will follow these procedures:

- A detailed list of what is being disposed of will be prepared by the Inventory Control Clerk and reviewed by the Finance Manager.

- As the items are identified for sale or disposal the Authority inventory number will be noted and the Authority tag will be removed.

- A Designated Committee with at least one Authority board member will approve and oversee the disposition of property and recommend disposal to the Authority Board.

- Authority Board approval is needed for disposal of assets (in the case of auction this needs to be at least 30 days before the sale).

- All items being sold will be checked to make sure the Authority has clear title. In the case of inventory purchased by a grant, checks will be made to ensure no reimbursement is due to the grant or other regulations.

- The State Auditor and State Budget Division will be notified of the disposal in writing 30 days prior to the disposal.

- Dispositions whose fair market value is over $5,000 may be made through written approval by the State Budget Division.

After disposal, verification of receipts will be made and the assets removed from the Authority's inventory files.

There is an auction file in the vault where all supporting paperwork from an auction or sale is stored. The vault is kept in the General Manager's office.

When there are donations from the Authority to other entities, there must be a list of the items donated and a donation form signed by a representative from the entity receiving the items. When an item is determined to be obsolete or unusable it is transferred to the inventory warehouse via an inventory transfer form. These items, when identified for auction or sale, will then follow procedures found in Section 5.

6. DEPRECIATION METHODOLOGY

A. <u>Capital Assets Depreciation</u>

Capital assets should be depreciated over their estimated useful lives unless they are inexhaustible. The straight-line depreciation method (historical cost divided by useful life) will be used by the Authority. Accumulated depreciation will be summarized and posted to the accounting general ledger by Accounting and Financial Reporting personnel. See appendix A for estimated useful life.

B. <u>Leasehold Improvements Depreciation</u>

Leasehold improvements are capitalized by the lessee and are amortized over the shorter of (1) the remaining lease term, or (2) the useful life of the improvement. Improvements made in lieu of rent should be expensed in the period incurred. If the lease contains an option to renew and the likelihood of renewal is certain, the leasehold improvement should be written off over the life of the initial lease term or useful life of the improvement, whichever is shorter.

7. RECONCILIATION ENTRIES TO GENERAL LEDGER

After the close of each month, reports will be generated for inventory additions to the general ledger and inventory system. These reports will be used to manually reconcile the inventory system to the general ledger.

If a discrepancy exists in the inventory system, the Inventory Clerk will make the adjustment. If there is a discrepancy in the general ledger, a journal entry will be prepared.

After the approval of all adjustments, a journal entry will be made to capitalize inventory acquisitions.

APPENDIX A

Class of Asset	Useful Life	Threshold
Land *	N/A	N/A
Land Improvement **		$50,000
Fences	10	
Paving	20	
Drainage	40	
Buildings & Improvements		$100,000
Flooring	12	
Construction interior and Roofing	20	
Site Preparation	25	
Flooring Structure, Foundation, Roof Structure, Steel Frame	50	
Water/ Sewer System		$50,000
Well	40	
Piping	40	
Electrical Controls SCADA	10	
Booster	20	
Tank	40	
Meter	5	
Generators	10	
Lift Station	20	
Hydrants	40	
Pump/ Motor	5	
Machinery & Equipment ***		$5,000
Short Service Life	5	
Long Service Life	7	
Backhoes	15	
Trailers	10	
Vehicles		$5,000
Trucks/ Cars	5	
Construction Work in Progress	N/A	CAPITALIZE TO APPOPRIATE CATEGORY WHEN COMPLETED OR PLACED INTO SERVICE

* Capital assets considered inexhaustible and are not depreciated.

****** The useful life of improvements is determined by the economic useful life or term of lease, whichever is shorter**.**

******* This threshold is mandated by the NM State Auditor's Office. The Authority elects to change the threshold to reflect the State Auditor's mandated threshold changes.