TRANSBAY JOINT POWERS AUTHORITY

Board Policy No. 014 Category: Financial Matters

CAPITALIZATION POLICY FOR CAPITAL ASSETS

The Transbay Joint Powers Authority ("TJPA") is a joint powers agency organized and existing under the laws of the State of California. Pursuant to the Joint Powers Agreement creating the TJPA, dated April 4, 2001 (the "Agreement"), the TJPA has the authority to exercise all powers necessary and proper to carry out the provisions of the Agreement. This Capitalization Policy will be a comprehensive policy which will address the capitalization of assets and infrastructure; the established threshold for reporting a capital asset; the determination of the useful life and depreciation of a capital asset; and all other ancillary costs necessary to place the capital assets into service.

I. BACKGROUND

For government agencies, the ways in which capital assets are defined and accounted for are set forth in "Generally Accepted Accounting Principles" (GAAP), which are promulgated by the Governmental Accounting Standards Board (GASB). Within the parameters established by GASB, there are alternative approaches that agencies may choose from. This Policy will establish how the TJPA will account for its capital assets within those parameters. Specifically, this Policy will: (1) Establish the level of detail that will be used for capital asset reporting (individual assets versus networks of assets); (2) Determine whether to treat some capital assets as infrastructure assets; and, (3) Determine whether to depreciate infrastructure assets, or to treat those assets under a modified approach, and not depreciate them. Also, this Policy will establish how demolition costs will be reported and identify other costs that will be capitalized as "Land." Assets that are categorized as land are not depreciated. Typically, capital assets are recorded in an agency's financial records at their historical cost, and are depreciated over their estimated useful lives. Contributed assets will be valued at "fair value."

II. LEVEL OF DETAIL OF CAPITAL ASSET FINANCIAL REPORTING

GASB Statement Number 34 (GASB 34) defines "capital assets" as including land, improvements to land, easements, buildings, building improvements, vehicles, machinery, equipment, works of art and historical treasures, infrastructure, and all other tangible or intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period. GASB 34 provides public agencies with the option of reporting their capital assets at the "network, subsystem, or individual asset level". GASB defines "network" as a group of assets where the individual members either provide similar services or work together to provide one service. A network can range from one asset that is made up of many components to a collection of assets that are roughly the same.

The TJPA cannot identify a business need to classify each component individually for financial reporting purposes, although the TJPA will maintain subsidiary records which provide additional detail. As a result, the following six capital asset categories will be delineated in the Authority's financial statements:

- Land;
- Easements (Intangible Assets);
- Information Technology (Intangible Assets);
- Transbay Transit Center;
- Downtown Extension; and
- Furniture and Equipment.

The Transbay Transit Center Underground Station, the Temporary Terminal, the Bus Storage Facility, Bus Ramp, the rooftop park, and artworks that are incorporated into the building design, will be considered components of the Transbay Transit Center and thus part of the "network" of assets.

Policy: **TJPA will categorize its capital assets at the network level, as such, all components of the Transit Center will be considered a single asset for financial reporting purposes. Furniture, Fixtures and Equipment will be depreciated as a separate asset category using a composite rate.**

III. DEPRECIATION AND COMPOSITE USEFUL LIFE

Capital asset categories will be depreciated over their estimated useful lives unless they are inexhaustible. Inexhaustible capital assets, such as land and land improvements, intangibles, such as easements, and artwork will not be depreciated. Land improvements that have determinable useful lives and deteriorate with use or passage of time (e.g., walking paths, landscaping, sprinklers) will be depreciated. Depreciation expense will be measured by allocating the historical cost over their estimated useful lives in a systematic and rational manner. TJPA assigns useful life of the asset based on the engineering design estimation of the useful life of the core assets. Depreciation will be calculated for the network of assets at the completion of the Construction in Progress phase and the value of the capital asset will be depreciated annually using the straight-line method.

Composite depreciation refers to calculating depreciation for a collection of dissimilar assets, such as all assets composing a transportation network as long as they do not cross over asset classifications, e.g. buildings, buildings improvements, or equipment. A composite useful life will be used for the Transit Center "network" of assets, which work together to provide one service. Composite depreciation assumes that all assets are retired at the end of their useful lives, and therefore no gain or loss is recorded when the assets are removed or replaced.

The composite of the network of assets for the Transit Center will include the following types of assets:

Non-Infrastructure

- Temporary Terminal

- Transit Center Building
- Park Landscaping
- Concrete Pavement/Ramps
- Underground Station
- Bus Storage
- Foundation
- Art integrated as building components
- HVAC Systems
- Elevator and Escalator
- Engineering and costs for Utility Relocation

Policy: **Capital asset categories will be depreciated over their estimated useful lives unless they are inexhaustible. For the Transit Center asset, which is comprised of several components, a composite useful life will be developed at the time the asset is placed into services. Equipment and Furniture will be depreciated based on a composite rate for the classification.**

IV. INFRASTRUCTURE ASSETS AND DEPRECIATION

Infrastructure assets, as a subset of capital assets, are long-lived capital assets that normally are stationary in nature, and can normally be preserved for a significantly greater number of years than most capital assets. The Downtown Extension can be considered an infrastructure asset because it has rails and tunnels, and will utilize easements that are inexhaustible.

The traditional accounting approach for a capital asset, including infrastructure assets, is to depreciate the asset over its useful life, based on an asset's historical cost, thereby decreasing the book value of the asset as shown on the TJPA's financial statements by a given amount each year. An alternative is known as the "Modified Approach", under which an infrastructure asset is not depreciated, but continues to be reported at its original historical cost indefinitely. Using this financial reporting approach requires public agencies to meet several assessment, maintenance, investment and annual disclosure reporting requirements, which demonstrate the preservation and renewing of the asset as an annual budgeted operating expense.

TJPA cannot identify a compelling business reason for using the Modified Approach for infrastructure reporting, which would tie the TJPA's maintenance and preservation plans to the preparation of its financial statements. As a result, TJPA will depreciate its infrastructure assets.

Policy: **The Downtown Extension (DTX), which consists of the rails and tunnels, electric train power source, safety and cooling electrical systems will be recorded as capital asset/infrastructure and will be considered a single asset subsystem that will be assigned a useful life at the date the asset is placed into service.**

V. TREATMENT OF DEMOLITION COSTS

GASB 34 gives no specific guidance concerning how to treat demolition costs for financial reporting purposes, but based on the approaches utilized by several other public agencies, demolition expenses incurred to prepare an acquired property for its intended use are categorized as improvement to land. TJPA will use this approach. However, demolition costs have been and will continue to be categorized as a construction expense for budget development purposes. It is entirely acceptable to treat demolition costs differently for budget versus financial reporting purposes. Once the project's construction-in-progress has been capitalized, if the TJPA should tear down any structures related to the Transit Center project (e.g. the demolition of the Temporary Terminal), those demolition costs would be capitalized as land improvements, as these costs will prepare the land for its intended use.

Policy: **TJPA will capitalize demolition costs incurred for newly acquired property as improvement to land. TJPA will capitalize demolition of the Temporary Terminal costs incurred on existing property.**

VI. CAPITALIZATION OF LAND IMPROVEMENTS

Policy: **TJPA will capitalize the following costs as Land Improvements:**

- Title and Closing Costs
- Relocation Services, Consultation and Assistance
- Appraisal Services
- Environmental Consulting – Soil Hazardous Materials
- American Land Title Association Design Surveys
- Cost to remove or demolish a building or structure existing at the time of acquisition
- Site Preparation (betterment that prepares land for its intended use)
- Reconstruction of Property of Others: Rails, Utilities, Parking Lots, Fencing and Landscaping

There may be similar costs that will be categorized by the Chief Financial Officer as "land improvements" in the future. Utility relocation will not be classified as land improvements, but rather as "Transit Center" costs, because the relocation of utilities takes place on property not owned by TJPA and is being performed for the purpose of the building of the Transit Center.

VII. CAPITALIZATION OF OTHER ANCILLARY COSTS

Only construction costs for betterment and improvements will be capitalized. The cost of repairs and maintenance will be expensed, as will replacements if the original useful life is not extended or the value of the asset significantly enhanced. As experience is generated with the assets, the useful life estimate will be evaluated and adjusted if necessary.

Policy: **The following ancillary costs will be capitalized as part of the "network of assets" of either the Transit Center or the Downtown Extension as costs necessary to place the asset in service.**

- Capitalizable interest costs related to debt (generally for the period during or shortly after construction)
- Installation costs to put asset into service
- Internal costs such as salaries, benefits, administration (until commencement of Transit Center operations)

VIII. CAPITALIZATION OF DONATED CAPITAL ASSETS

Prior to Fiscal Year 2015, donated capital assets were to be reported at their estimated fair value at the time of acquisition. Fair value is the amount at which the asset could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. GASB 72, implemented for periods beginning after June 15, 2015, (i.e., Fiscal Year 2016) prospectively requires donated capital assets to be reported at their estimated acquisition value. Acquisition value is the price that would be paid to acquire an asset with equivalent service potential. GASB does not require a formal appraisal of the donated property to obtain the acquisition price. There is no prescribed guidance by GASB in determining the acquisition price for reporting of donated land and other real estate. GASB notes that there are many factors that can be considered when estimating the acquisition price of donated capital assets, making the estimation of acquisition price dependent on the unique facts and circumstances of the specific land, such as the future cash flow from its intended use or assessed values of surrounding properties. For any capital assets donated in the future, TJPA will assign an estimated acquisition price at the time of conveyance based on a rational and systematic method.

IX. CAPITALIZATION OF INTANGIBLE ASSETS

GASB 51 requires the financial reporting of intangible assets, such as right-of-way easements, other types of easements, land use rights, licenses and permits, and certain types of information technology to be classified as capital assets. TJPA will acquire easements and certain types of information technology for the Transbay Transit Center and Downtown Extension projects, which will be valued based on the acquisition agreements and costs, and reported on the financial statements as non-depreciable capital assets.

X. CAPITALIZATION THRESHOLDS

- Artwork (stand-alone): $50,000

- Building or infrastructure improvements (significant structural alterations, material remodeling or renovation that increase the asset's usefulness, efficiency or Transit Center/Downtown Extension lives): $50,000

- Equipment (an article of nonexpendable, tangible personal property having a useful life of more than two years) and Furniture not part of the network or subsystem of assets: $5,000

- Information technology: $10,000 for initial purchase or application development

- Infrastructure assets (i.e., Downtown Extension): all

- Land and easements: all
- Land improvements (depreciable): $50,000

XI. IMPAIRMENTS AND DISPOSALS

A capital asset is considered to be impaired when its service utility has declined permanently, significantly and unexpectedly. Events or changes in circumstances that may be indicative of impairment include evidence of physical damage, changes in legal or environmental factors, technological changes or evidence of obsolescence, changes in manner or duration of use of the asset, or construction stoppage. Generally, an asset would be considered impaired if both:

- The expenses associated with the potentially impaired asset (i.e., continued operation and maintenance, including depreciation, or costs associated with restoration) are significant compared to its useable capacity, and
- The event or change in circumstances was outside the normal life cycle of the asset.

In the event a capital asset is impaired, there are two options for reporting the impairment:

- If the asset will no longer be used then the book value of the asset should be written down to the lower of carrying value or fair market value, or
- If the asset will continue to be used, then the book value of the asset should be adjusted by the net of the impairment loss and restoration costs.

Disposals may occur when an asset is no longer considered useful (e.g., is considered excess or surplus, or is to be traded-in on a new purchase). A disposed-of asset should be removed from inventory and financial accounting records.