THIS STAFF REPORT COVERS CALENDAR ITEM NO.: 12
FOR THE MEETING OF: October 17, 2008

TRANSBAY JOINT POWERS AUTHORITY

BRIEF DESCRIPTION:

Presentation of Capitalization Policy for Capital Assets for adoption by the Board of Directors.

SUMMARY:

Staff proposes that the Board of Directors adopt a Capitalization Policy that will guide the development of the Authority's financial statements in accordance with Generally Accepted Accounting Principles.

EXPLANATION:

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). Adoption of a Capitalization Policy for Capital Assets is advisable in order to ensure that the TJPA appropriately tracks the cost of its capital assets, and records those assets in its financial statements in compliance with GAAP, and the requirements of GASB's guidance on capital asset reporting, known as GASB Statement Number 34 (GASB 34).

The proposed Capitalization Policy for Capital Assets was developed by staff, in consultation with the TJPA's external auditors, based on a review of the requirements for capital cost financial reporting established by GASB 34, by the Federal Transit Administration and Office of Management and Budget for federal grantees, and by the bond rating agencies, as well as based on a review of the capitalization policies used by other public entities. The proposed Policy contains the following major principles:

- Capital assets should be capitalized when the following criteria are met:
    - The asset is complete in itself, and is not a component of another item;
    - The asset is used in the operation of the TJPA's activities;
    - The asset has a useful life of more than one year or more and provides a benefit throughout that period; and
    - An individual asset is of significant value, that is, it has a unit cost of $5,000 or more.

- Examples of capital assets are land, improvements to land, easements buildings, building improvements, vehicles, machinery, equipment, works of art, and various intangible assets.

- Typically, the TJPA's capital assets should be reported in its financial statements at their historical cost, including all ancillary costs associated with the procurement or construction of an asset, and should be depreciated on a "straight line" basis over their expected useful lives. However, in conformance with GAAP and GASB 34, "inexhaustible" capital assets, such as land and land improvements, easements and right-of-ways, and intangibles (for example, goodwill), will not be depreciated.

- GASB establishes parameters for the development of government agency financial statements, and within the parameters, there are alternative approaches that agencies may choose from. This Policy establishes how the TJPA will account for its capital assets within those parameters, such as:

    - Establishing the level of detail that will be used for capital asset reporting;
    - Determining whether to treat some capital assets as infrastructure assets;
    - Determining whether infrastructure assets should be depreciated or whether they should be treated under a modified approach, and not depreciated; and
    - Establishing how demolition costs will be reported and identifying other costs that will be capitalized as "Land".

  This policy guidance will aid staff and the TJPA's external auditors in the completion of the TJPA's financial accounting system, and in the development of the TJPA's financial statements in the future.

RECOMMENDATION:

Staff recommends that the TJPA Board of Directors approve the proposed Capitalization Policy for Capital Assets.

ENCLOSURE:

1. Resolution
2. Proposed Capitalization Policy for Capital Assets

TRANSBAY JOINT POWERS AUTHORITY
BOARD OF DIRECTORS

Resolution No. ______________

WHEREAS, Government agencies must account for their capital assets in compliance with the requirements of Generally Accepted Accounting Principles, which are promulgated by the Governmental Accounting Standards Board; and

WHEREAS, It is advisable for the Transbay Joint Powers Authority (TJPA) to adopt a Capitalization Policy for Capital Assets that complies with Generally Accepted Accounting Principles, in order to guide TJPA staff and external auditors in the development of TJPA's financial statements; and

WHEREAS, Staff has developed a proposed Capitalization Policy for Capital Assets, in consultation with TJPA's external auditors; now, therefore, be it

RESOLVED, That the TJPA Board of Directors adopts the attached Capitalization Policy for Capital Assets identified as Board Policy No. 014, Category: Financial Matters.

I hereby certify that the foregoing resolution was adopted by the Transbay Joint Powers Authority Board of Directors at its meeting of October 17, 2008.

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Secretary, Transbay Joint Powers Authority

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 and Right-of-Ways;
- Intangibles;
- Transbay Transit Center;
- Downtown Extension; and
- Furniture and Equipment.

The Transbay Transit Center Underground Station, the Temporary Terminal, the Bus Storage facility, Ramps, and the roof top Park and Art, 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 weighted average useful lives unless they are inexhaustible. Inexhaustible capital assets, such as land and land improvements, easements and right-of-ways, and intangibles, such as goodwill, will not be depreciated. Depreciation expense will be measured by allocating the historical cost over their estimated weighted average 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 and uses the weighted average as the composite useful life. 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 weighted average 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 weighted average useful lives unless they are inexhaustible. For the Transit Center asset, which is comprised of several components, a composite weighted average 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 weighted average useful life at the date the asset is placed into service.

V. TREATMENT OF DEMOLITON 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, those demolition costs would be expensed as direct expenses, e.g. the demolition of the Temporary Terminal.

Policy: **TJPA will capitalize demolition costs incurred for newly acquired property as improvement to land. TJPA will expense 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 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.**

- Interest costs related to debt issuance
- Freight costs
- Installation costs to put asset into service
- Internal costs such as salaries, benefits, administrative

VII. CAPITALIZATION THRESHOLD

- Equipment and Other Capital Expenditures not part of the network or subsystem of assets

Equipment means an article of nonexpendable, tangible personal property having a useful life of more than one year and an acquisition cost which equals or exceeds the capitalization threshold level established at $5,000.

IX. CAPITALIZATION OF STATE CONVEYED LAND – ASSIGNING VALUE

Donated capital assets should 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 does not require a formal appraisal of the donated property to obtain the fair value. There is no prescribed guidance by GASB in determining the fair value for reporting of donated land and other real estate. GASB notes that there are many factors that can be considered when estimating the fair value of land, making the estimation of fair value 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. TJPA will assign a fair value at the time of conveyance based on a rational and systematic method.

X. 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, to be classified as capital assets. TJPA will acquire easements for the Downtown Extension project, which will be valued based on the easement agreements and right-of-way acquisition costs and reported on the financial statements as non-depreciable capital assets.

Date Approved: ________________

Resolution No.: ________________