



## City of Sonoma Administrative Policy

### FIXED ASSET CAPITALIZATION AND INVENTORY CONTROL POLICY

#### 1. Purpose

The objectives of the City of Sonoma's fixed asset policy are as follows:

- **Accounting and Financial Reporting** - To accurately account for, and report, fixed assets in financial reports issued to external reporting agencies, granting agencies and the public.
- **Safeguarding of Assets** - To establish systems and procedures to protect the City's assets from loss or theft.

The Fixed Asset Capitalization and Inventory Control Policy provides specific guidance in determining which fixed assets are subject to capitalization (separate accounting and reporting), and which are subject to the inventory control (safeguarding) policies.

The Finance Department is responsible for implementing the systems and procedures through which both objectives are met.

#### 2. Categories of Assets

**Infrastructure Assets** are long-lived assets that normally are stationary in nature and normally can be preserved to a significantly greater number of years than most capital assets. Examples include buildings, roads, bridges, water and sewer systems, and drainage systems. The City's capitalization threshold for infrastructure assets is \$25,000.

**Capital Assets** are defined as tangible assets having an original unit cost of greater than or equal to the City's capitalization threshold of \$5,000, including ancillary costs, and with a useful life of at least two years. This capital asset threshold is applied to individual fixed assets rather than to groups or collections of fixed assets. Examples include vehicles, major equipment, and office furniture.

**Controlled Assets** have an original unit cost of between \$1,000 and \$5,000 and a useful life of at least two years. Examples of controlled assets include computer equipment, telecommunications equipment, and smaller items of office furniture and field equipment. Controlled assets also include items that do not meet the \$1,000 threshold but require a higher than ordinary level of accountability, such as items acquired with grant funds, and

items with heightened risk of theft (items which are easily transportable and readily marketable or easily diverted for personal use, such as cell phones, cameras, and tablets). Controlled assets will not be monitored in the City's capital asset records, but will be subject to departmental inventory control.

**Supplies** include any other item purchased for less than \$1,000. These items are expensed in the year that they are acquired.

### **3. Capitalization Policy**

Capital assets are capitalized and recorded as assets in the City's general ledger and fixed assets subsidiary ledger. Finance staff records depreciation transactions in its fixed assets subsidiary ledger for them over their estimated useful lives, and tracks each of these assets until they are disposed of. City staff perform periodic physical inventories of these items, and makes adjustments for and reports differences between what is reported in the fixed assets subsidiary ledger/general ledger and the physical inventory taken; and, these fixed assets are included in the total for fixed assets in the City's Comprehensive Annual Financial Report (CAFR).

### **4. Infrastructure Assets**

The purchase or construction of infrastructure assets is approved by the City Council, primarily through the adoption of the City budget. In addition, the donation of infrastructure assets (e.g. land, buildings) is approved by Council. It is the responsibility of the Finance Department to account for the infrastructure assets by class and fund. It is the responsibility of the Department Heads to ensure that infrastructure assets are adequately controlled and used for appropriate City purposes.

Capital projects will be capitalized as "construction in progress" until completed. Costs are reclassified from construction in progress to infrastructure assets, or another relevant description, the date the completion of the project is accepted by the City Council. Direct costs, ancillary costs, and construction period interest are included in the capitalized amount. Fair value at the date of donation will be capitalized for donated infrastructure assets.

The value of any infrastructure assets which are no longer in existence or service, will be estimated annually by the project engineers, and treated as infrastructure disposals.

City-owned land is capitalized but not depreciated. It is recorded at historical cost and remains at that cost until disposal.

### **5. Inventory Control Policy**

Department heads are responsible for safeguarding all fixed assets under their control. The Finance Department is responsible for establishing and managing the systems and procedures that enable the Department Heads to properly safeguard all fixed assets.

Controlled assets are not capitalized in the General Ledger nor are they depreciated, but are included along with Capital assets in inventory control. This allows the City to control these assets without affecting the City's financial status. This data can be used to determine the proper level of insurance and assist the City in providing proof of loss in an insurance claim.

Once every three years, an inventory of all City movable assets shall be conducted, including both capital and controlled assets (for stationary infrastructure assets, performing an annual physical inventory is not required). The purpose of this inventory is to assure that all City property is actually in the possession of the City and properly recorded. Department heads shall verify the inventory of all property belonging to the City in and under their control annually. A copy of the Department's Inventory Control Records is to be provided to the Finance Department.

## **6. Depreciation/Amortization of Fixed Assets**

Depreciation is the systematic and rational allocation of the estimated or actual historical cost (or the fair value at date of donation for donated assets) over the asset's estimated useful service life.

Estimated useful lives are based upon Governmental Accounting Standards Board recommendations unless a different life is determined by the City Manager, or his designee, based upon the facts and circumstances applicable to that asset or class of assets.

## **7. Intangible Assets**

Land easements will be recorded with land and not depreciated. Right of ways will be recorded separately and depreciated over useful life. Only easements and right of ways with a cost greater than \$5,000 will be capitalized.

## **8. Leased Assets**

Capital leases will be identified and capitalized according to criteria required by generally accepted accounting principles.

## **9. Impaired Capital Assets**

Governmental Accounting Standards Board (GASB) Statement No. 42, "Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries" (GASB 42) established accounting and financial reporting standards for impairment of capital assets. A capital asset is considered impaired when its service utility (design capacity or capability) has declined significantly and unexpectedly.

The requirements of GASB 42 only apply to capital assets with material carrying values. If the City has material capital assets that are impaired or potentially impaired, a determination needs to be made as to whether the impairment loss should be reported and disclosed. GASB 42 defines asset impairment as a *significant, unexpected decline in the service utility*

of a capital asset. The events or changes in circumstances that lead to impairments are not considered normal and ordinary. That is, at the time the capital asset was acquired, the event or change in circumstance would not have been expected to occur during the useful life of the capital asset.

### ***Assessment of Impairment***

The determination of whether a capital asset has been impaired is a two-step process of (a) identifying potential impairments and (b) testing for impairment. The events or changes in circumstances affecting a capital asset that may indicate impairment should be prominent (i.e., conspicuous or known to the agency). That is, the events or circumstances that may indicate impairment generally are expected to have already been the subject of discussion by the City Council or management or would otherwise have been the topic of press coverage.

#### **A. Identifying Potential Impairment**

The five most common indicators of potential impairment, as defined by GASB 42, are listed below. This list is not all-inclusive since it was not possible for the GASB to identify every potential indicator of asset impairment.

1. Evidence of physical damage to the capital asset that requires repair efforts to restore the asset's service utility. Examples would include a building damaged in a natural disaster or a building facing the costs associated with mold remediation or asbestos removal.
2. Enactment or approval of laws or regulations, or other changes in environmental factors, that limit or curtail the use of the capital asset because the asset does not meet and cannot be modified to meet the requirements of the new laws or regulations. The GASB requires these impairments to be reported when the change occurs and not when the change goes into effect. Examples would include underground storage tanks or water treatment plants that cannot meet new EPA requirements.
3. Technological development or evidence of obsolescence resulting in the capital asset being used much less frequently, or not at all. Examples would include magnetic resonance imaging (MRI) equipment of the enclosed type following the introduction of the more popular open models or other diagnostic or research equipment that is rarely used because newer equipment provides better service.
4. A change in the way an asset is used or in the length of time it is expected to be used. Examples would include a school building now used as a warehouse, the closure of a street prior to the end of its useful life for safety reasons, or the closure of a school prior to the end of its useful life because of a decline in enrollment.
5. A permanent construction stoppage prior to the completion of an asset. Examples include the halting of building construction due to a lack of funding or a stoppage following the discovery of an endangered species at a construction site.

## B. Impairment Test

Once a capital asset has been identified as being potentially impaired, the agency needs to apply the following two impairment tests, both of which must be met for assets to be considered impaired:

1. The magnitude of the decline in service utility is significant. The expenses associated with continued operation and maintenance (including depreciation) or costs associated with restoration of the capital asset are significant in relation to the current service utility. This modifier would limit testing to only those capital assets that have experienced significant events or changes in circumstances.

2. The decline in service utility is unexpected. The restoration cost or other impairment circumstance is not a part of the normal life cycle of the capital asset. This modifier would limit testing to only those capital assets that have experienced events or circumstances other than a normal decline in utility during the capital asset's expected useful life and normal changes in estimated useful lives.

If the above impairment tests are met, the capital asset is considered to be impaired. Only losses from permanent impairments of capital assets should be recognized in the financial statements.

## 10. Disposal of Fixed Assets

Property shall not be transferred, turned-in or disposed of without prior approval of the City Manager or designee. For property valued more than \$5,000 (except vehicles) disposal will require Council approval. Disposal of fixed assets shall follow any applicable provisions of the City's Purchasing Policy.

11. **Transfer of Assets Between Funds** Transfers of assets between proprietary accounting funds will be recorded as a loss on disposal, in the amount of the net book value, in the transferring fund, and other revenue, in the amount of the net book value, in the recipient fund.

Transfers of assets between governmental funds or departments will be done on the fixed assets schedule only. No entry will be made to the general ledger as these are only reported at the government-wide level in the City's financial statements.

Transfers of assets between proprietary funds and governmental funds will be recorded as contributions to/from City/proprietary funds.

Transfers of assets purchased with grant funds will be recorded as a sale between funds, including a transfer of cash.

## 12. Policy Review

The Finance Department will review this policy at least bi-annually and make recommendations for change, as needed.

Reviewed by the City of Sonoma's Finance Committee –  
Mayor Agrimonti and Vice Mayor Ding  
February 9, 2021.