TACOMA HOUSING AUTHORITY

RESOLUTION 2019-03-27 (2)

Date: March 27, 2019

To: THA Board of Commissioners

From: Michael Mirra
Executive Director

Re: Adoption of Capitalization Policy

This resolution would authorize the adoption of the Capitalization Policy to comply with a Department of Housing and Urban Development ("HUD") audit concern, as well as to document current Tacoma Housing Authority (THA) practice regarding capitalization of expenses and assets.

Background

In Accounting, Capitalization is when the costs to acquire an asset are expensed over the life of that asset rather than in the period it was incurred. It is a requirement of Housing and Urban Development (HUD) that every public housing authority has a policy for capitalization that complies with 2 CFR Part 200. This policy covers the capitalization of THA's assets. A copy of the Policy is attached (Attachment A).

Recommendation

Approve Resolution No.2019-03-27 (2).

TACOMA HOUSING AUTHORITY

RESOLUTION 2019-03-27 (2)
(Approval of Capitalization Policy)

A **RESOLUTION** of the Board of Commissioners of the Housing Authority of the City of Tacoma

WHEREAS, The Housing Authority of the City of Tacoma (the "Authority") is the recipient of Federal funding through various instruments issued by the Department of Housing and Urban Development ("HUD"); and

WHEREAS, HUD has adopted 2 CFR 200, which includes certain administrative requirements, cost principles, audit requirements, and requirements for procurements conducted by recipients of Federal funding; and

WHEREAS, Public Housing Authorities, including the Authority, are required to adopt policies that meet the requirements of 2 CFR §200; and

WHEREAS, Following an audit that HUD conducted between July 31 and August 4, 2017, HUD raised a concern about the lack of a capitalization policy; and

WHEREAS, A proposed Capitalization policy that satisfies and adopts the requirements of 2 CFR §200 is attached as Attachment A; now, therefore be it

Resolved by the Board of Commissioners of the Housing Authority of the City of Tacoma, Washington as follows:

1. The THA Capitalization Policy F-40 dated March 27, 2019, as provided in Attachment A, is hereby adopted by the Authority.

2. This resolution shall be in full force and effect from and after its adoption and approval.

Approved: March 27, 2019

Dr. Minh-Anh Hodge, Chair

CERTIFICATE

I, the undersigned, the duly chosen, qualified and acting Executive Director of the Housing Authority of the City of Tacoma (the "Authority") and keeper of the records of the Authority, CERTIFY:

1. That the attached Resolution No. 2019-03-27 (2) (the "Resolution") is a true and correct copy of the resolution of the Board of Commissioners of the Authority as adopted at a meeting of the Authority held on the 27th day of March, 2019, and duly recorded in the minute books of the Authority.

2. That such meeting was duly convened and held in all respects in accordance with law, and, to the extent required by law, due and proper notice of such meeting was given; that a quorum was present throughout the meeting and a majority of the members of the Board of Commissioners of the Authority present at the meeting voted in the proper manner for the adoption of the Resolution; that all other requirements and proceedings incident to the proper adoption of the Resolution have been duly fulfilled, carried out and otherwise observed, and that I am authorized to execute this Certificate.

IN WITNESS WHEREOF, I have hereunto set my hand this 27th day of March, 2019.

HOUSING AUTHORITY OF THE CITY OF TACOMA

By: Michael Mirra

Michael Mirra, Executive Director

TACOMA HOUSING AUTHORITY

Policy No. F-40
Policy Capitalization Policy
Date March 27, 2019

Table of Contents

1. PURPOSE

To provide a clear and consistent understanding of the Tacoma Housing Authority's (THA's) policy on capitalization and depreciation of capital assets.

To ensure consistent and accurate application of capitalization and depreciation required for internal, external, and regulatory reporting for federal agencies.

2. SOURCES FOR POLICY

2 CFR Part 200-Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards.

Generally Accepted Accounting Principles (GAAP)

3. SCOPE OF POLICY

This Policy affects the Finance Department

4. WHO IS RESPONSIBLE FOR IMPLEMENTING POLICY

Who	Responsibilities
Finance Department	Responsible for writing, updating, and interpreting this policy
Finance Director	Responsible for enforcing this policy and establishing adequate controls to ensure compliance with the guidelines outlined in this policy.
The Board of Commissioners	Responsible for approving appropriate capitalization thresholds.

5. DEFINITIONS

Definition and Classification of Capital Costs	The basis for accounting for capital assets is cost. All normal expenditures of readying an asset for its intended use are capitalized. The information below identifies specific costs that can be capitalized for individual categories of assets.

Land	The following costs related to the acquisition of land should be capitalized: • Purchase price • Closing related costs (e.g. appraisals, attorney fees, recording fees, title insurance, land rights) • Cost to get land in condition for intended use (e.g. grading, draining, filling) • Cost of demolishing existing building(s) Land (site) improvements such as fences, retaining walls, driveways, sidewalks, and parking lots are also capitalized but unlike the above costs are depreciated over their useful lives.
Buildings	Costs that are related to the acquisition, construction, or improvement of a building should be capitalized in the fiscal year those costs are incurred. See below for definition of building improvements. Acquisition costs include: • Purchase price • Closing related costs (e.g. appraisals, professional services, title insurance) Construction costs include: • Professional services and appraisals • Site preparation • Materials, Labor, and Overhead
Building Improvements	Building improvements are significant alterations, renovations, or structural changes, and: • Meet the capitalization threshold and increase the usefulness of the asset • Enhance its efficiency • Prolong its useful life The Housing Authority will record Building Improvements as "buildings" in the general ledger (but account for them separately from the building in the capital asset records).

	When the Housing Authority records building improvements, the Housing Authority will estimate the original cost of the portion of the building, which is removed as a result of an alteration (or renovation), The Housing Authority will deduct this original cost from the recorded valuation of the building, along with the appropriate amount of accumulated depreciation.
Construction in Progress	The cost of buildings or other real property assets (capital projects) that are under construction at a balance sheet date are included on the balance sheet as Construction in Progress (CIP). CIP represents a temporary capitalization of labor, materials, and fixed equipment of a construction project for financial reporting purposes. Depreciation is not calculated for assets under construction. When the constructed asset is put into use, accumulated CIP costs are capitalized and depreciated within their respective component categories. Construction should be accounted for by project. Separate accounting should be used to record separate projects. The costs included in CIP are the total direct project-to-date expenditures together with the related accounts payable, insurance premiums, interest, and other related accrued costs.
Interest Costs during Construction	The capitalized costs of interest during construction for debt-financed projects are the costs of interest related to the acquisition or construction of an asset. The interest costs are capitalized during the period of time that is required to complete and prepare the asset for its intended use. Interest cost to be capitalized for qualifying assets is intended to be the portion of the interest cost incurred during the assets' acquisition periods, that theoretically, could have been avoided if expenditures for the assets had not been made. For example, by avoiding additional borrowings or by using the funds expended for the assets to repay existing borrowings.

	For assets funded by specific borrowings, the capitalization rate is the interest rate for the period. For assets funded by general borrowings, the capitalization rate is the aggregate average borrowing rate on general debt of the Housing Authority. If the Housing Authority uses a mixture of specific borrowings and cash contributions and has other general debt, the Housing Authority should capitalize both the interest for the specific borrowings, as well as the lesser of the weighted average interest rate of the other general borrowings applied to the cash contribution and the actual interest paid on other general borrowings. To determine the net increase allowed to be capitalized on certain tax-exempt borrowings , interest earned on the temporary investments of the proceeds of those borrowings should be deducted from the interest cost of restricted tax-exempt borrowings... Assets are qualified for interest capitalization when they are constructed or otherwise produced for the Housing Authority's own use. Assets are also qualified when they are constructed or produced by others and deposits or progress payments have been made. Also, assets intended for sale or lease that are constructed or otherwise produced as discrete projects, are qualified. Land that is not undergoing activities necessary to get it ready for its intended use is not a qualifying asset. The capitalization of interest costs is accomplished by debiting (increasing) the CIP account.
Leased Real Property or Equipment	Leased real property is capitalized if the total cost of the property exceeds the $5,000 capitalization threshold and it meets one of the four capital lease requirements listed below. Leased equipment is capitalized if the total cost of the property exceeds the $5,000 capitalization threshold and it meets one of the four capital lease requirements listed below.

	The capital lease is recorded by debiting (increasing) the appropriate capital asset (real property or equipment) and crediting (increasing) the installments/leaseholds payable account at an amount equal to the lesser of the fair value and the present value at the beginning of the lease term of minimum lease payments during the lease term excluding that portion of the payments representing executory costs (such as insurance and maintenance to be paid by the lessor, together with any profit thereon). Capital lease requirements are any one of the following: 1. Property Ownership. The lease transfers ownership of the property to the Housing Authority by the end of the lease term; or 2. Purchase Option. The lease contains a bargain purchase option (option to purchase at lower than fair value when the option is exercised); or 3. Lease Term. The lease term is 75% or more of the estimated economic life of the leased property; or 4. Rental Payments. At the beginning of the lease term, the present value of the minimum lease payments (excluding executory costs) equals or exceeds 90% of the excess fair value of the leased property. If the recorded capital lease meets either capital lease requirement 1 or 2, the asset should be depreciated in accordance with depreciation (useful life) periods described in Schedule D. If the capital lease does not meet either capital lease requirement 1 or 2, the asset depreciation period should be the lease term. Any lease that does not meet the capitalization threshold requirements or does not meet any one of the four listed lease requirements should be classified as an operating lease (no asset or payable is recorded).
Leasehold Improvements	The capitalized costs of leasehold improvements are all costs associated with structural alterations, renovation, or improvements made by the lessee to leased real property.

Tangible Personal Property	Capitalized costs of tangible personal property are those costs associated with the acquisition or construction of tangible personal property. The property has to have a useful life of one year or more and cost in excess of $5,000 per individual unit. Tangible personal property includes equipment, computers, furniture, fixtures, and vehicles. Acquisition costs for Tangible personal property include: • Invoice price • Transportation • Installation • In-transit insurance • Any modifications, attachments, or accessories needed to make property usable for its intended purpose One exception to the capitalization threshold of $5,000 per individual unit of property exists. As part of a building acquisition or construction project, costs may be incurred to fit out space with new furnishings and equipment. When such purchases are made as part of an acquisition/construction project, if the aggregate cost of these expenditures exceeds $5,000 and each item in this purchase grouping has a useful life of one year or more, the costs may be capitalized even though some of the individual items cost less than $5,000.
Software and Other Intangible Assets	Intangible assets lack a physical substance, are of non-monetary or non-financial nature, and have an expected useful life beyond one year. To be capitalizable an intangible asset should be identifiable, meaning that either: 1. This asset is capable of being separated or divided from the Housing Authority and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability; <u>or</u> 2. The asset arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the Housing Authority or from other rights and obligations.

	All costs related to the external purchase of software applications in excess of $5,000 with a useful life of one year or more should be capitalized as intangible assets and amortized over the useful life. The external costs of upgrades and enhancements that enable the software to perform tasks it was previously incapable of performing should also be capitalized; otherwise such costs are not capitalizable and should be expensed. Fees paid for training, conversion costs and software maintenance may not be capitalized and should be expensed. Software site/user licenses also should be expensed. Internally-generated computer software, created or produced by THA employees or a third party contractor with an estimated useful life of one year or greater with development cost that meets or exceeds the capitalization threshold of $5,000. Trademarks, brands, and goodwill will not be recognized as intangible assets and therefore not capitalized.
Donated Assets	Donated assets should be reported at their estimated value to acquire at the time of acquisition, plus any ancillary charges, if any. Donated assets that will be resold should not to be capitalized.
Non-Capitalizable Expenses	Costs that neither significantly add to the permanent value of a property nor prolong its intended useful life are expensed. The following type of capital asset related costs are expensed: 1. **Costs Below Capitalization Thresholds** Items that do not meet the monetary thresholds listed in Schedule C should be expensed in the period incurred. 2. **Maintenance and Repairs** The costs associated with recurring work required to preserve or immediately restore a capital asset to such condition that it can be effectively used for its designed purpose. Maintenance includes work done to prevent damage to a capital asset.

	<u>Examples</u>: Custodial services; paint jobs; plumbing, electrical, air conditioning repairs; lawn and landscaping; roof repairs (to include roof replacement if it does not extend the useful life of the building). **3. Preservation/ Restoration** The costs associated with maintaining special assets in, or returning them to a level of quality as close to the original as possible. <u>Examples</u>: Stained glass restoration and protection; door, portico and porch repair; cast iron work; wood replacement and repair. (Note: restoration of a building, if it extends the useful life of the building, should be capitalized. The same generally does not hold for building components.)

6. FORMS ASSOCIATED WITH THIS POLICY

7. CFR's FOR POLICY

2 CFR 200.439 Equipment and other capital expenditures

(a) **See §200.13 Capital expenditures.** *Capital expenditures means expenditures to acquire capital assets or expenditures to make additions, improvements, modifications, replacements, rearrangements, reinstallations, renovations, or alterations to capital assets that materially increase their value or useful life.* **200.33 Equipment**. *Equipment means tangible personal property (including information technology systems) having a useful life of more than one year and a per-unit acquisition cost which equals or exceeds the lesser of the capitalization level established by the non-Federal entity for financial statement purposes, or $5,000.* **200.89 Special purpose equipment.** *Special purpose equipment means equipment which is used only for research, medical, scientific, or other technical activities. Examples of special purpose equipment include microscopes, x-ray machines, surgical instruments, and spectrometers.*

200.48 General purpose equipment. *General purpose equipment. General purpose equipment means equipment which is not limited to research, medical, scientific or other technical activities. Examples include office equipment and furnishings, modular offices, telephone networks, information technology equipment and systems, air conditioning equipment, reproduction and printing equipment, and motor vehicles. See also Equipment and Special Purpose Equipment.* **200.2 Acquisition cost.** *Acquisition cost means the cost of the asset including the cost to ready the asset for its intended use. Acquisition cost for equipment, for example, means the net invoice price of the equipment, including the cost of any modifications, attachments, accessories, or auxiliary apparatus necessary to make it usable for the purpose for which it is acquired. Acquisition costs for software includes those development costs capitalized in accordance with generally accepted accounting principles (GAAP). Ancillary charges, such as taxes, duty, protective in transit insurance, freight, and installation may be included in or excluded from the acquisition cost in accordance with the non-Federal entity's regular accounting practices.* **200.12 Capital assets.** *Capital assets means tangible or intangible assets used in operations having a useful life of more than one year which are capitalized in accordance with GAAP. Capital assets include:* ***(a)*** *Land, buildings (facilities), equipment, and intellectual property (including software) whether acquired by purchase, construction, manufacture, lease-purchase, exchange, or through capital leases; and* ***(b)*** *Additions, improvements, modifications, replacements, rearrangements, reinstallations, renovations or alterations to capital assets that materially increase their value or useful life (not ordinary repairs and maintenance).*

(b) The following rules of allowability must apply to equipment and other capital expenditures:

(1) Capital expenditures for general purpose equipment, buildings, and land are unallowable as direct charges, except with the prior written approval of the Federal awarding agency or passthrough entity.

(2) Capital expenditures for special purpose equipment are allowable as direct costs, provided that items with a unit cost of $5,000 or more have the prior written approval of the Federal awarding agency or pass-through entity.

(3) Capital expenditures for improvements to land, buildings, or equipment which materially increase their value or useful life are unallowable as a direct cost except with the prior written approval of the Federal awarding agency, or pass-through entity. See §200.436 Depreciation, for rules on the allowability of depreciation on buildings, capital improvements, and equipment. See also §200.465 Rental costs of real property and equipment.

(4) When approved as a direct charge pursuant to paragraphs (b)(1) through (3) of this section, capital expenditures will be charged in the period in which the expenditure is incurred, or as otherwise determined appropriate and negotiated with the Federal awarding agency.

(5) The unamortized portion of any equipment written off as a result of a change in capitalization levels may be recovered by continuing to claim the otherwise allowable depreciation on the equipment, or by amortizing the amount to be written off over a period of years negotiated with the Federal cognizant agency for indirect cost.

(6) Cost of equipment disposal. If the non-Federal entity is instructed by the Federal awarding agency to otherwise dispose of or transfer the equipment the costs of such disposal or transfer are allowable.

8. POLICY

8.1 Capitalization Requirements

It is necessary to maintain accurate and complete records pertaining to the cost of each asset to properly capitalize the costs associated with an asset; both acquisitions and subsequent improvements should be completely documented for each asset.

8.1.1 Expenditures at Acquisition

To be considered for capitalization (and subject to depreciation, where applicable) an asset should fulfill three characteristics:

(a) an estimated useful life of more than one year; and

(b) a value greater than the capitalization threshold for the particular classification of asset, as defined in 7.3 below; and

(c) been purchased, constructed, or donated.

8.1.2 Expenditures Subsequent to Acquisition

Expenditures subsequent to the acquisition of a capital asset include the costs for renovations, betterments, or improvements that add to the permanent value of the asset, make the asset better than it was when it was purchased, or extend its life beyond the original useful life. To capitalize these costs, the improvements should fulfill at least one of the following criteria:

(a) the useful life of the asset is increased; or

(b) the productive capacity of the asset is improved; or

(c) the quality of units or services produced from the asset is enhanced.

8.2 Asset Capitalization Thresholds

Thresholds for asset capitalization represent the dollar value at which an asset is capitalized. Purchases and expenditures less than the dollar values listed below should be treated as an expense.

Asset Category	Capitalization Threshold *
Land	$ 5,000
Land Improvements	$ 5,000
Buildings	$ 5,000
Building Improvements	$ 5,000

Construction in Progress	$ 5,000
Interest Costs during Construction	$ 1
Tangible Personal Property (equipment, computers, furniture, vehicles)	$ 5,000 **
Leased Real Property (buildings & land) – capital lease	$ 5,000
Leasehold Improvements	$ 5,000
Leased Personal Property (machinery & equipment) – capital lease	$ 5,000
Software	$ 5,000

Notes: * Thresholds apply to costs at purchase or construction and the acquisition value of donated assets to be used in operations at the time of donation.

** When related to building acquisition or construction the threshold can be met by aggregate total of equipment purchases.

8.3 Asset Depreciation Methods

With the exception of Land and CIP, all capitalized assets should be depreciated using the straight-line method over the useful life of the asset class. An asset's useful life is a period of time over which services are expected to be rendered by the asset. The calculation of depreciation should be based on historical cost (capitalized costs).

In the year that the asset is placed in service and in the year that it is disposed of depreciation will be calculated using the half-year convention.

Periodically, the estimated useful lives of depreciable capital assets should be re-evaluated for reasonableness. An estimated useful life is not reasonable if the associated capital asset is near full depreciation but will remain in use significantly longer than originally estimated. If the balances of fully depreciated capital assets that remain in use are material, the related estimated useful lives should be changed and the beginning accumulated depreciation balances should be restated.

Salvage value should generally not be utilized in calculating depreciation, unless the salvage value is specifically known.
General guidelines for expected useful lives are the following:

Asset Category	Useful Life
Buildings	40 years
Building Improvements	5 – 40 years
Leasehold Improvements	20 years (or the term of the lease, whichever is shorter)
Land Improvements	5 – 40 years
Equipment	3 – 7 years
Computer Equipment	4 years
Residential Furnishings	3 years
Office Furnishings	7 years
Vehicles	5 years
Software	4 – 7 years

Expected Useful Life Table

Guidelines for the expected useful life of the building and site sub-components, as published by HUD, can be found here:

https://www.hud.gov/sites/documents/EUL_FOR_CNA_E_TOOL.PDF

9. PROCEDURES

Procedures

Determine Appropriate Cost of Capital Asset →	**Determine Non-Capitalizable Expenses** →	**Capitalize Capital Assets for GAAP & Tax Reporting** →	**Record Depreciation for Each Capital Asset Category**
Refer to Definition and Classification of Capitalized Costs (Definitions)	Refer to Non-Capitalizable Expenses (Definitions)	Refer to Asset Capitalizations Thresholds (8.2)	Refer to Depreciation Methods (8.3)