Prepared by Property and Fund Management Office
This replaces Administrative Procedure A8.550 dated May 2003.

A8.550 Capitalization

1. Purpose

To provide policies for capitalization of University of Hawaii assets.

2. Objectives

To establish capitalization policies to ensure conformity with Federal and State regulations, generally accepted accounting principles, and applicable laws.

3. Definitions

Equipment - Tangible non-expendable personal property having a useful life of more than one year, and an acquisition cost of $5,000 or more per unit.

Controlled Property - Tangible non-expendable personal property less than $5,000 per unit which is not capitalized and meets either of the following criteria: 1) Any firearms/weapons and 2) property which is Federal or agency owned under the provisions of an extramural award and is accountable to the University.

Real Property - Land including certain improvements thereto, infrastructure assets, and buildings including appurtenances but excluding moveable equipment. (APM A8.552)

Capital Lease - Lease of a capital property where a material equity interest in the property is created as a result of significant cost incurred under that lease. A material equity interest in the property exists when the lease:

a. is non-cancelable or is cancelable only upon the occurrence of some remote contingency, and;

b. has one or more of the following characteristics:

(1) Title to the property passes to the University at

some time during or after the lease period.

(2) The term of the lease corresponds substantially to the estimated useful life of the property (i.e., the period of economic usefulness to the legal owner of the property).

(3) The initial term is less than the useful life of the property and the University has the option to renew the lease for the remaining useful life at substantially less than the fair rental value.

(4) The property was acquired by the lessor to meet the special needs of the University and will probably be usable only for that purpose and only by the University.

(5) The University has the right, during or at the expiration of the lease, to purchase the property at a price which at the inception of the lease appears to be substantially less than the probable fair market value at the time it is permitted to purchase the property (commonly called a lease with a bargain purchase option), except for any discount normally given to educational institutions.

Leases under "sales and lease back" arrangements or "less-than-arms-length" transactions shall be considered capital leases.

<u>Lease Improvement</u> - Improvement made to leased property.

<u>Library Books</u> - Collections maintained by the libraries. Library collections shall include, but not limited to books, bound volumes, periodicals, photographs, manuscripts, magazine subscriptions (except e-subscriptions), journals, non-print collections, newspapers, audio-visual materials, etc. that are identified, cataloged, shelved, and stored by the libraries.

4. <u>Works of Art</u>

For works of art, estimated current market value in lieu of reporting a cost-based amount is acceptable. Works of art may be excluded from inclusion in the financial reports if all of the following criteria are met:

a. they are held for exhibition, education, or research in furtherance of public service rather than financial gain;

b. they are protected, kept unencumbered (i.e., not pledged as collateral), cared for and preserved.

5. <u>Software</u>

Purchased software with a unit acquisition cost of $25,000 or more per unit shall be capitalized. Software developed or obtained for internal use with a unit acquisition cost of $25,000 or more shall be capitalized. Costs of software developed or obtained for internal use shall include:

a. payroll and payroll-related costs for employees who are directly associated with developing the internal use software. Eligible employees, for example, are programmers and end users who are directly involved with the development or testing of the software.

b. external direct costs of materials and services consumed in developing or obtaining the internal use software such as fees paid to third party consultants, costs of developing or acquiring coding, and testing.

Costs for training, maintenance associated with an existing system where no substantive new functionality is being added, and data conversion shall be expensed as incurred.

Software developed for internal use with unit acquisition cost of $25,000 or more shall be reported to the Inventory Management Section via FMIS Form 73, <u>Fabricated Equipment</u>. Capitalization shall cease when the software has completed testing and ready for its intended use. Upon completion of software development, the fiscal officer or property custodian shall inform Inventory Management via memorandum of the 1) completion of the project, 2) in-service date, and 3) percentage cost allocation involving multiple AAUs.

Software with unit acquisition cost of less than $25,000 shall be treated as an expense of the current period.

6. <u>Maintenance and Warranty</u>

The cost of maintenance, whether purchased with the property or purchased separately, shall not be capitalized for financial reporting since the cost of maintenance or warranty are not considered tangible, i.e., it is a guarantee against defects or poor workmanship under normal use.

7. Applicability

These policies and procedures pertain to all purchases, transfers, and gifts to the University.

Equipment and controlled property shall be inventoried.

Subcodes shall be used to distinguish equipment from controlled property. Controlled property shall be coded with subcode 7759 for Federal/agency owned property less than $5,000.00 per unit and subcode 7789 for firearms/weapons less than $5,000.00 per unit.

Acquisitions defined as equipment shall be coded in the 77X0 subcode format.

Acquisitions defined as library books shall be coded in the capital asset subcode 776X format as appropriate.

Acquisitions of software with unit acquisition cost of $25,000 or more shall be coded in the 77X0 subcode format.