

This document reflects the result of analyses, discussions and review by UCOP staff and PricewaterhouseCoopers (PwC) to date. The document is subject to change pending additional discussions with PwC; however, it represents the best information available to date.

University of California GASB 35 Depreciation Reporting

Issues Resolution Memo No. 14

Recording Buildings & Structures Values by Three Basic Components

Define Issues

Tracking prospective additions to Buildings & Structures by components will alleviate some of the administrative burden and expense required by campuses to implement Methods 3A, 3B, and 4 (IRM No. 1). In addition, it may provide the means, over the long-term, for the University to shift to Method 5 (component by component depreciation).

Background

Much of the discussions at the April and June North/South meetings centered on the issues set forth in IRM No. 1, as well as Addenda A, B, and C. The issues have included:

- *Consistency in calculating depreciation*—The depreciation policies established by the University must meet the consistency requirements of all applicable rules and regulations (e.g., GASB Statements 34 and 35, Generally Accepted Accounting Principles, Generally Accepted Accounting Standards, OMB Circular A-21, IRS Tax Code, Medicare costing rules). The consistency requirements have defined the choices available to the University's multi-campus system. Methods 1 through 4 in IRM No. 1 are all variations of straight-line depreciation and, therefore, campuses may select independently among them. However, Method 5 (component by component depreciation) is considered a different depreciation method from Methods 1 through 4. Method 5 requires that all campuses elect building componentization for calculating building depreciation for a given class of buildings in order to achieve consistency within the University for financial reporting purposes.
- *Building survey requirements*—The building survey requirements that are necessary for Methods 3A, 3B, 4, and 5 add to campus' administrative burden and expense. These methods require that building surveys be conducted annually, at least for new buildings, in order to develop the weighted average useful lives or the for annual increments.

- *Facilities and administrative costs recovery*—OMB Circular A-21 currently limits administrative overhead rate to 26 points, although facilities overhead (of which depreciation is a part) remains uncapped. As such, the depreciation method selected by campuses impacts their indirect cost recovery. Several campuses have expressed concerns about selecting Methods 1 through 4 because, compared to Method 5, these methods do not demonstrate the optimal indirect cost rates allowable under the regulations. OP has demonstrated that Method 4, coupled with a depreciation allocation algorithm, can approximate the recovery provided using Method 5. However, the University needs to examine the effect Methods 4 and 5 have on indirect cost recovery.
- *Accumulated depreciation*—Although Method 5 may increase indirect cost recovery in a particular year, implementation of Method 5 also increases accumulated depreciation from past years that will permanently be lost.
- *Campus proposal*—UCSD provided a proposal to prospectively track building, renovation and modification costs by three basic components.

As a result of the discussions at the North/South meetings and OP’s weekly depreciation meetings with PricewaterhouseCoopers, we have developed an approach that addresses some of the primary campus concerns and provides additional options to the campuses.

Prospective Componentization Approach for Consideration

- Beginning January 1, 2002, campuses are encouraged to track new buildings, renovations or modifications by the following three components only (with corresponding useful lives):

<i>Asset Group</i>	<i>Useful Life</i>
▪ Fixed Equipment	15 years
▪ Systems	25 years
▪ Shell and Other	40 years

Note: These useful lives are used as placeholders for discussion purposes, pending completion of useful lives analysis by OP.

- Tracking three components prospectively provides the University with two options (to be further developed based on weekly meeting with PwC and OP workgroup):

- *Developing Weighted Average Useful Lives*

Campuses may elect to track by the three components in order to develop the weighted average useful lives for each annual increment per building required for Methods 3A, 3B, and 4, as outlined in IRM No. 1. This will ease the administrative burden of adopting one of these methods by reducing the need to engage independent appraisal firms to provide weighted average useful lives for future annual increments. This option allows campuses to choose independently,

and does not require all campuses to track prospective additions by the three components.

- *Depreciating by Component on a Prospective Basis*

All campuses must elect to track future additions to all buildings and structures by the three components in order to adopt Method 5 (IRM No. 1) on a prospective basis. This option requires all campuses to employ this approach for all buildings (i.e., laboratory and all other) based upon mutual agreement among the campuses.

Depreciating by component on a prospective basis has several benefits:

- Implementation beginning January 1, 2002, for future new buildings, additions and renovations will not interfere with the University's ability to implement the depreciation reporting requirements for FY 2001-02.
- Although prospective depreciation by component does technically constitute a change in accounting method, it will not require a retroactive restatement of accumulated depreciation for prior years since it will not be applied to items capitalized in prior years. However, it will require disclosure of the effect of the change on depreciation expense in the year of the change (i.e., in FY 2002-03).
- It may not require a comment in the auditor's report if the effect of the change is immaterial.

Next Steps—Required Actions

- OP and PwC will continue to discuss the viability and details of the approach outlined above.
- OP to seek campus comments on the approach, including option preferences, if any.
- OP to finalize the approach based on discussions with campuses and PwC.
- Systems may need to be reviewed in order to accommodate the additional level of detail required to be tracked.
- Decision would need to be reached by November 1, 2000, in order to implement.