FIXED ASSET ACCOUNTING AND MANAGEMENT PROCEDURES MANUAL

SECTION 9

Constructed Assets

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9 CONSTRUCTED ASSETS – SECTION 9

PURPOSE

The purpose of this section is to establish procedures for accumulating costs for Capital Improvement Program (CIP) construction projects and reporting these to Asset Management for recording in the SAP Fixed Asset Module. This includes calculating the amount of construction-related interest to be capitalized on an annual basis.

SCOPE

The asset under construction will be transferred from *Construction in Progress* to the appropriate fixed asset classification(s) when the construction project is completed, substantially complete, accepted by Council, or the asset is ready for its intended use or occupancy.

GUIDELINES

CAPITALIZED COSTS

All direct labor and material costs associated with the construction project will be capitalized as a cost of the new asset.

In addition, overhead costs, such as licenses, permits, and project management costs directly associated with the construction, will be capitalized. Other elements of City overhead that are difficult to measure, such as insurance and utilities, will be allocated and expensed as operating charges rather than added to the capitalized cost of the constructed asset.

CAPITALIZATION OF INTEREST

Interest costs incurred during the construction phase of projects undertaken on behalf of a proprietary (enterprise) fund will be capitalized as part of the cost of the fixed asset if the amount is considered material. Ordinarily, interest costs incurred during the construction of general government fixed assets are not subject to capitalization. Interest costs will not be capitalized on assets acquired through grants

or gifts unless the grant or gift permits such capitalization, and the funding is provided through the grant or gift.

> ***Note:*** *The calculation and accounting treatment of capitalized interest costs associated with the City's construction programs will be coordinated by the Controller's Office and the affected department.*

RESPONSIBILITIES

> ***Note:*** *The following departments, who manage their projects, are responsible for providing the information to capitalize:*

HOUSTON PUBLIC WORKS (HPW)

- HPW is responsible for capitalizing all the HPW projects when it reaches completion.

HOUSTON AIRPORT SYSTEM (HAS)

- Provides project status of completion in timely manner.
- Schedule of Value: Itemized costs associated with the projects including salary recovery.
- Request for Council Action (RCA)
- Certificate of Completion or In-Service Form
- Reviews and approves all cost documentation submitted, including review and approval of SAP final close-out package prepared and submitted by the HPW Resource Management Division

FINANCE DEPARTMENT

- Finance Department is responsible for General Government Fund project capitalization when GSD support documents are received.

> ***Note:*** *Costs to be capitalized for constructed assets are outlined in* ***Error! Reference source not found. (Error! Reference source not found.).***

1. Interest for capital projects will be capitalized during the construction period as indicated in this section.
2. All costs, either direct or indirect including salary recovery, which are associated with construction projects, will be capitalized into capital assets upon completion.

PROCEDURE FOR PLACING CONSTRUCTED ASSETS IN SERVICE

1. On an ongoing basis, but at least annually, regardless of project activity levels, the Finance Department will perform a review of all construction-in-progress ledgers to determine the percentage of completion for each project.
2. Projects that have reached completion or are occupied will be identified as ready to be placed in service. The Finance Department will perform the following tasks for these projects:
   - Analyze the project ledger data to determine the costs to be capitalized for each asset resulting from the project.
   - Determine if a single asset or multiple assets should be capitalized as a result of the project. This determination will include a decision on whether the project costs will be reported as asset systems or component assets, in accordance with **Error! Reference source not found.** (**Error! Reference source not found.**).
   - Identify the costs associated with each asset or asset system constructed or purchased.
3. Projects that have not reached the completion or occupied level will continue to be tracked by the HPW Resource Management Division as Construction in Progress.
4. Annually, the HPW Resource Management Division will provide the Controller's Office, Asset Management, and the benefiting departments with a Schedule of

Construction in Progress detailing accumulated costs and percent completion information for each project that is open and has not yet been placed into service.

Project costs that are not directly associated with a specific asset will be allocated to all assets resulting from the completed project using the apportionment method discussed in.

5. Once the actual cost of each asset resulting from the project has been determined, the HPW Resource Management Division will initiate a Request to Place Asset in Service.
6. The HPW General Accounting/Fiscal Section will approve the capitalization request and send a written notice to the Controller's Office detailing the capitalization and the transfer of the project from *Construction in Progress* to the appropriate fixed asset accounts. (The appropriate balance sheet asset accounts will be debited, and the *Construction in Progress* account will be credited for the total amount to be capitalized.)
7. The General Services Department will also forward a copy of the above notice, including cost and descriptive information, to the DFAC of the benefiting department so that the master SAP record(s) can be created. The SAP Final Close-Out Summary will be the official notice to the DFAC providing capitalization information, including costs to be recorded.
8. Upon receipt of the closing documents, the Finance Department will capitalize in accordance with Section 7 and complete the following requirements:
    - The acquisition date for the project can vary depending on the type of support provided by GSD. The following documents are acceptable dates that can be used as the acquisition date:
        - Certificate of Completion
        - Certificate of Substantial Completion – 90% or more completed
        - In-Service Form

- The unit or total cost will be the total inception-to-date expenditures associated with the project on the date used above.

> ***Note:*** *The unit or total cost will be amended through a financial adjustment in SAP at a future date when the final close-out costs are available.*

- The extended description of the asset will detail the basic construction of the asset (e.g., building specs, type of construction, square footage, components).
- The CIP project number will be recorded as SAP project number.
- The funding source(s) to be credited for the asset will be indicated.
- Required grant funding information, if applicable, will be included in Section 3 of the form.
- If the asset to be placed in service is being componentized (e.g., the individual building systems are being recorded separately), the appropriate parent/child relationships with sub-assets among the main assets will be noted. (For a building, the parent main asset is generally the building shell.) The parent main asset will carry the overall extended description for the conglomerate.

9. The DFAC will set up the asset record in SAP following the same general approach as outlined in **Error! Reference source not found.** (**Error! Reference source not found.**).

FINAL CLOSE-OUT PROCESSING PROCEDURE

1. When the project is completed, the appropriate department will prepare a Request for Council Action (RCA) to accept final work for the project and notify the client or benefiting department of the project's completion. Copies of the RCA will be sent to the City Secretary and the HPW Resource Management Division.

2. Upon receipt of the RCA, the HPW Resource Management Division will enter the RCA information in its project close-out tracking system and analyze the project ledger data to determine the final costs to be capitalized for each asset resulting from the project, including cost recovery and final intra-governmental billings.
3. Once City Council has accepted work and the Council motion is received, the HPW Construction Division will compile and forward the Final Construction Pay Estimate to the HPW Fiscal Section.
4. The HPW Fiscal Section will proceed as follows:
   - Make final payment to the contractor(s).
   - Forward the estimate to the HPW Resource Management Division.
   - Enter the final payment voucher package into SAP.
   - Forward the documents for normal payment processing.
5. The HPW Resource Management Division will proceed as follows:
   - Verify that final payment has been processed and that all other project-related costs have cleared the SAP Suspense File.
   - Prepare SAP final close-out packet.
   - Forward SAP final close-out documents to the HPW Fiscal Section.
6. The HPW Fiscal Section will then proceed as follows:
   - Make adjustments if funds are needed to cover unbilled cost recovery due to insufficient funds.
   - Calculate and set aside an allowance for warranty inspection costs.
   - Determine the final close-out figure.
   - Return the completed SAP final close-out packet to the HPW Resource Management Division.
7. The HPW Resource Management Division will then proceed as follows:

- Accumulate all final project costs and request that the project be closed in SAP Capital Projects.
- Enter the close-out information into SAP Capital Projects module, thereby "closing" the project.
- Update their project close-out tracking systems.
- Forward the original close-out documents to the Controller's Office for final review and closure. (Audit exceptions will be returned to the HPW Resource Management Division for correction.)
- Forward a copy of the complete SAP final close-out packet, including cost and descriptive information, to the DFAC of the benefiting department so that the master SAP record(s) can be created. The SAP Final Close-Out Summary will be the official notice to the DFAC providing capitalization information, including costs to be recorded.

8. Upon receipt of the final close-out information, the DFAC will determine whether the asset record(s) have already been created in SAP because of the asset being occupied or placed in service at the completion point. If the record **has not yet been established**, the DFAC will follow the general capitalization procedure outlined in **Error! Reference source not found.** (**Error! Reference source not found.**) to place the project in service. If the record **has been established**, the DFAC will continue with step 9 below to record the asset in SAP.
9. **If necessary,** the DFAC will initiate an SAP Capitalization for each asset defined under the project to record the difference between the acquisition costs recorded at the time the asset was placed in service and the final close-out cost.
    - The adjustment transaction date will be the date of the City Council motion.
    - The reason for the adjustment will be *Final Project Close-Out Cost Adj.*
    - The unit or total cost currently recorded (as of the time the asset was placed in service) will be replaced with the **total inception-to-date expenditures associated with the final close-out of the project/asset**.

- The Other Changes section will be completed by changing the City Council motion number in the *Asset Master* screen (a user-defined field) from the motion number when the asset was placed in service to the motion number associated with the final project acceptance.

10. The DFAC will update the asset record in SAP.

CAPITALIZATION OF INTEREST

For construction projects (excluding projects funded by grants or gifts, unless the terms of the grant or gift permit such capitalization), interest charges on projects using proprietary funds during the construction period will be calculated and capitalized in accordance with guidelines coordinated by the Controller's Office and the affected department. General government projects will not capitalize interest, in accordance with Governmental Accounting Standards Board (GASB) *Statement* No. 37 (amendments to GASB *Statement* No. 34).

Capitalized interest costs will be included, as appropriate, in the information accumulated by the HPW Resource Management Division as outlined in this section.

In accordance with the *Statement of Financial Accounting Standards* (SFAS) No. 62 or SFAS No. 34 and the Controller's Office guidelines, the HPW Resource Management Division will calculate the interest expense, net of interest revenue earned on the bond proceeds, to be capitalized from the time of the borrowing until the completion of the project. Treatment of capitalized interest will be dependent on the actual funding source to determine which authoritative guideline to use.

DEFINITION OF CAPITAL PROJECT OR CONSTRUCTION IN PROGRESS (CIP)

The definition of a Capital Project for the SAP Project Systems module inclusion was agreed by the steering committee as projects that will ultimately become fixed assets. (12/06/05)

CONSTRUCTION IN PROGRESS

Construction in progress includes all partially completed projects for the construction of an asset. The cost of construction in progress will not be capitalized until the construction is complete and/or the constructed asset is placed into service.

For purposes of capitalization (placement into service or capitalization within the system), a constructed asset will be considered completed when occupied or upon acceptance by the City of the total project construction cost. Prior to capitalization, project expenditures should be charged to *Construction in Progress* in the appropriate capital project fund.

Internal labor charges and other administrative costs directly associated with a capital project may be charged to *Construction in Progress* and subsequently capitalized. The following criteria should be applied to determine whether such project-related costs should be capitalized or treated as normal periodic expenditures:

- Costs are chargeable to a capital project if they would not have been incurred during the specified time period in the absence of the project.
- Costs for dismantling, removal, or disposition of existing City-owned equipment and improvements in preparation for a new project may be capitalized by project. See the guidelines for land acquisitions and improvements.

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