CHAPTER 2

CAPITALIZATION POLICY AND CRITERIA FOR PLANT, PROPERTY, AND EQUIPMENT

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CHAPTER 2 – CAPITALIZATION POLICY AND CRITERIA FOR PLANT, PROPERTY, AND EQUIPMENT

2-1. **PURPOSE**. This chapter provides accounting guidance for the proper identification, classification, and accounting treatment of lifecycle costs for FAA PP&E. It prescribes the practices to be followed to provide adequate financial accountability for PP&E.

2-2. CRITERIA.

a. PP&E placed in service having an estimated service life of at least two years and a unit cost of $25,000 or more is a capital asset that is capitalized at its historical cost. A capitalizable PP&E item must be reasonably identifiable as an individual item and retain this identity throughout its expected life. It should be intended for or available for use by the FAA and not be intended for sale in the ordinary course of business. In the event that the $25,000 capitalization threshold would be raised, the change would be prospective and no prior period adjustment would be made.

b. Prior to the issuance of FASAB statements, there was no government accounting requirement to calculate depreciation and thus assets remained at cost until written off or disposed. Depreciation allocates the costs of capitalized assets to the periods expected to benefit from the asset. See Chapter 5, Depreciation. Matching resources (expenses) to the period of use (useful life) or benefit is a basic accounting principle.

2-3. CLASSIFICATION OF COSTS.

a. Capital Costs. The key to determining whether or not a cost is considered as capital or an expense is whether or not it was required to bring capital assets to a form and location suitable for their intended use or a cost that adds to the value of existing assets that (1) increase the

estimated service life of the asset, (2) increase the capacity of the asset, or (3) improve the performance of the asset. The costs of such capitalized assets are allocated to the periods expected to benefit from the asset through the process of depreciation.

b. Expense. In general, costs that do not meet the requirements for capitalization are expensed and charged to the accounting period in which the costs were incurred. An example of a GL account for a charge to operating expenses is # 61006600, "Operating Expenses/Program Costs Non-Governmental, Production." Appendix B lists various 6000 series of DELPHI general ledger expense accounts.

Example: *The FAA incurs the following costs in connection with a Facilities and Equipment (F&E) project:*

	FY-01	*FY-02*	*FY-03*	*GL Account*
Equipment FY-01 (Construction in progress)	*$150,000*			*Construction-In-Progress - 17206000*
Equipment FY-02 (Construction in progress)		*$150,000*		*Construction –In-Progress - 17206000*
Termination FY - 03 - Equipment is scrapped and will never be used			*$300,000*	*Expense, current year - 61006000. Decision to abandon was not known in prior years.*

To expense FY 01 and FY 02 CIP costs,

Debit (DR)			
GL 61006000	*$300,000*		
		Credit (CR)	
		GL 17206000	*$300,000*

Remember, the rule is to match the resources with the benefit. In this case, the first two years were included in the CIP account (fully expecting to eventually have an asset to use and recognize the benefit of that asset over its useful life). However, due to unforeseen events, the project is terminated in the third year and there are no benefits to be received. That event is recorded as an operating expense (GL account # 61006000) in the year of termination - there are no prior period adjustments made.

Expense items that are known at the on-set should not be accumulated in the CIP account. Expense items should be expensed when they are received without waiting for project completion or close-out. Waiting to expense items at project completion will charge operating expenses to the wrong fiscal year.

c. Technological Feasibility Study. Expense these costs when incurred in a program before its technological feasibility has been established. These costs are typically research costs and include concept demonstration, prototyping, breadboarding, etc., to prove the operational or economic benefits and technological feasibility. Technological feasibility is established when the FAA has completed all activities necessary to determine that the acquisition project is feasible and will be deployed. Normally, for FAA National Airspace System (NAS) projects, this occurs when the Joint Resources Council (JRC) approves the investment decision for the program, documented by a memorandum from the Director of Acquisition. Program costs incurred after technological feasibility has been proven are eligible for capitalization.

2-4. **RELATIONSHIP BETWEEN FUNDING SOURCE AND CAPITALIZATION**.

a. The FAA uses several appropriations to procure equipment and services that form tangible PP&E, as follows:

- Research, Engineering & Development (RE&D).
- Facilities and Equipment (F&E).
- Operations (OPS).

b. While the majority of PP&E is procured using the F&E appropriation, the type of appropriation used is not a determinant of whether a cost will be capitalized or expensed. Congress appropriates F&E funds only to distinguish between FAA's capital budget and its day-to-day operating budget, which is funded from OPS. The use of F&E funds alone does not determine that costs should be capitalized or recorded in the CIP account.

Example: *The FAA incurs the following costs in connection with a project:*

Funding Source	*Expenditure Description*	*Value*	*Eligible for Capitalization?**
RE&D	*Engineering Services*	*200,000*	*Yes*
OPS	*Construction of Radar*	*200,000*	*Yes*
F&E	*Equipment (radar dish)*	*250,000*	*Yes*
F&E	*Spare parts*	*15,000*	*Yes*
OPS	*FAA Employee Labor - inspection*	*22,000*	*Yes*
OPS	*FAA Employee Travel - inspection*	*15,000*	*Yes*
OPS	*Contractor Labor – inspection*	*12,000*	*Yes*
OPS	*Contractor Travel - inspection*	*10,000*	*Yes*
OPS	*Develop Training materials*	*24,000*	*Yes*
OPS	*Initial Training for staff*	*17,000*	*No*
OPS	*Ongoing Training after Commissioning*	*25,000*	*No*

**Costs eligible for capitalization would be charged to an asset task*

Per Appendix A, nine items in the above example are eligible for capitalization. These include engineering services, construction, and equipment costs, as they were incurred to bring the PP&E to a form and location suitable for its intended use.

Costs associated with site spares are also eligible for capitalization as PP&E, and are accounted for in the Logistics and Inventory System (LIS), in the Field Spares Inventory module. Spares destined for the FAA Logistics Center (FAALC) are considered OM&S, until issued to the field. This example assumes that these spares were shipped to the field with the initial system.

Training development and travel costs (incurred either by F&E personnel or contractors, (example Technical Support Service Contract, TSSC) in connection with installation and testing of new equipment are also eligible for capitalization.

Training services (both initial and ongoing) are expensed as a cost of operations and are not accumulated in the CIP account.

The funding source (column 1) does not influence whether the costs are eligible for capitalization.

Design costs in this example were incurred after technological feasibility of the project had been determined. See 2-3.c. on page 2-5 for clarification of this topic.

2-5. **WHEN TO CAPITALIZE AN ASSET**. It is FAA policy to capitalize an asset within 30 days of either the date it is placed in service, or the occupancy date. In accordance with SFFAS No. 6, self constructed PP&E shall be recorded as CIP until it is placed in service, at which time the balance shall be transferred to real or personal property accounts in the FA module. All capital assets are recorded at actual historical cost, not market or other value.

a. Real property.

1. The in-service date for owned land and land rights is the date the title is acquired.

2. The in-service date for owned buildings is:

(a) If purchasing a building, when title is taken.

(b) If the building is new construction, the date of acceptance as shown on the Contract Acceptance Inspection (CAI).

3. The in-service date for owned other structures is the date of acceptance as shown on the CAI or the date the structure is placed in service, if there is no CAI.

4. The in-service date for assets under capital lease is when the asset has been accepted or when beneficial occupancy has taken place.

5. The in-service date for leasehold improvements is when the improvement is accepted, or beneficial occupancy has taken place, as shown on the CAI.

b. Personal property.

1. The in-service date for installed F&E and related installation charges (asset class 61) is when the facility, system, or equipment is commissioned and/or placed in service.

2. The in-service date for line-item accountable property, e.g., computers, portable test, and communications equipment, is when it is accepted.

3. The in-service date for aircraft and aircraft engines is at the time the airframe or engine is placed in service.

4. Administrative information systems are eligible for capitalization once placed in use.

c. Cost adjustments can be added to the original cost of an asset up to a maximum of one year from the asset's in-service date. After one year, only AFM-320 or the NCT can make corrections to the original asset cost. No corrections will be made for adjustments after a year if the amount is less than $25,000. This control is necessary to prevent routine processing of cost additions to the value of the original assets, years after it became functional.

2-6. **CONSTRUCTION IN PROCESS BACKLOG**. If an eligible asset is not capitalized within 30 days of being placed in service, the cost associated with that asset is considered "backlog."

a. AFM-320 sends out a "Construction in Process Summary Report" to regional and national capitalization points of contact. Regional points of contact and accounting managers are also provided a detailed report of projects completed within the last 30 days and those in backlog status. This report is identical to the former work-in-process summary report.

b. Accounting, logistics, and Implementation Center (IC) employees must monitor and correct expected commissioning dates and status codes. Accounting employees will correct and update project status codes and the IC employees are responsible for correcting commissioning dates in the Resource Tracking Program (RTP). Blank commissioning dates in the RTP will automatically trigger a "backlog status." These should be corrected immediately. Outdated or incorrect commissioning dates could lead to erroneous reporting of backlog or premature capitalization of systems that are not completed.

2-7. **FIRST ARTICLES AND PROTOTYPES**.

a. A first article or prototype represents the first unit constructed for a system. It's costs may be higher than for subsequent units because production efficiencies have not yet been realized. Excessive cost of the first article is not to be pro-rated across all similar articles.

b. Expense any costs incurred on a first article or prototype before technological feasibility has been established. After technological feasibility is established, the subsequent costs of constructing and installing a first article are eligible for capitalization and depreciation.

c. If the first article is placed in service at a site, then depreciate it over its estimated useful life at that site. While the costs incurred for its production may be higher than those incurred for later production units of the same or similar type, these actual costs become the true historical costs of placing that unit in service and therefore are capitalized as that unit's historical cost.

d. Some first articles or prototypes are not intended to be placed in operational service. Instead they are intended to be used solely for testing (both initial testing and recurring testing throughout the service life). Such an item may be kept at the contractor's facility, or may be located at the FAALC, William J. Hughes Technical Center, or even installed in a region. If the first article is to be used strictly for testing, then capitalize and depreciate it over the estimated service life of the

entire program. This treatment is parallel to how project common costs are treated.

e. If a system is destroyed during testing, expense the asset at that time.

2-8. **CLEANUP AND DECOMMISSIONING COSTS.**

a. Cleanup - Existing FAA Properties. SFFAS No. 6 provides two options for accounting for cleanup costs. Option 1 is required if the agency intends to obtain its resources primarily through the collection of user fees. FAA has chosen to utilize Option 2, which recognizes the cleanup cost of an in-use asset as a current expense. For financial statement purposes, cleanup costs are recognized in the fiscal year of the cleanup. Do not capitalize or depreciate cleanup costs.

b. Decommissioning - Existing FAA Properties. FAA has chosen to utilize SFFAS No. 6 Option 2, which recognizes as a current expense the cost of decommissioning an asset that was in-use but is being taken out of service. For financial statement purposes, the decommissioning costs are recognized as an expense in the fiscal year that the asset is taken out of service. Decommissioning costs are not capitalized as a cost of placing any replacement system in service since they do not add any value to the replacement system.

c. Cleanup, Decommissioning, or Environmental Cost. If user fees become the primary funding source of the agency; and if these costs become material to the calculation of those fees, FAA will convert to SFFAS No. 6 Option 1.

d. Cleanup Costs – New Properties.

1. When the FAA acquires new property, it may remove an existing structure on that property in order to ready the property for the FAA's purpose. In this situation, the cost of removing the existing structure is considered a site preparation cost, eligible for capitalization.

2. The FAA also may incur cleanup costs in the context of developing a new property that it has not previously been occupied. In such an instance, the FAA has not recognized any previous liability. Cleanup costs incurred in connection with bringing such a property to a form and location suitable for its intended use are eligible for capitalization along with the other site development costs.

2-9. **TECHNOLOGY REFRESHMENT**. This refers to a NAS strategy in which major components of a NAS system (personal property) are periodically replaced during the system's service life with new COTS components to assure continued supportability. The accounting treatment of technology refreshment depends upon the manner in which the original asset was recorded in the detail property records.

a. If the original asset was recorded in the detail property records on a component basis, remove the original component from the detail property records (with associated adjustments to book value and accumulated depreciation) when replaced. Record the replacement component as a new detail property record, capitalize it if it meets the capitalization criteria, and then depreciate it over its expected service life. Refer to Chapter 5 for guidance regarding depreciation.

b. If the original asset was recorded in the detail property records as part of the entire system, and not specifically posted as a separate record, then a determination must be made as to whether the replacement component increases the capacity or extends the service life of the system (two or more years).

1. If the new component does not add functionality or extend the service life of the overall system, then expense it as a maintenance cost.

2. If the replacement component does increase the capacity and/or extend the service life of the system, it is considered an improvement to the original asset. Evaluate the cost of the replacement

component to determine if it meets the capitalization criteria (if the component exceeds $25,000 and has more than two years expected service life). Post the new component as a separate detail property record, and if it is eligible for capitalization, capitalize and depreciate it over its expected service life. Do not modify the service life of the original asset. Capitalization of the component does not depend on the value of the original system.

2-10. **ADVANCE PAYMENTS AND PREPAYMENTS**. These are payments made to contractors before completion of the related task or delivery of the item. Record these payments as prepaid assets. Reduce prepaid assets and increase the CIP account when work is performed or services delivered. Charge the total invoice cost of the progress payments based on a percentage of contract completion to the CIP account. Charge reductions of progress payments resulting from the contract holdback to GL account # 21306200, "Contract Holdback Liability Account." Once the final invoice has been certified for payment, release the approved contract holdback amount.

2-11. **LABOR COSTS**. Labor costs can be incurred on a construction project from FAA headquarters, regions, centers, or contractor sources. Where practical, allocate these labor costs to the appropriate project/task. However current system limitations preclude headquarters, regions, or centers from identifying and allocating many of these labor costs. When this is the case, such costs should be expensed.

2-12. **SOFTWARE**. Consider software embedded in a system to be a part of the system's total cost. Other software costs (both internally and externally incurred) procured independently of the hardware on which it is resident may be capitalizable costs. Examples of capitalizable costs are the costs to purchase or develop the software, including design, coding, testing, installation, and any enhancements to existing software that result in significant additional capabilities of the software. Examples of software costs that are not eligible for capitalization include evaluation of alternatives, data conversion costs, costs incurred after final acceptance,

software maintenance, or enhancements that merely correct a design flaw or extend the useful life of the software.

2-13. **HAZARDOUS MATERIALS/OSHA**. Hazardous materials and OSHA related acquisitions should be expensed as the cost is incurred. They still may be properly funded with a F&E appropriation. The use of F&E funds as a source of funding does not preclude the appropriate expensing of the cost.

a. For projects/tasks that do not include equipment or materiel, expense all costs to the expense "00" project task so the items are not recorded in CIP and are expensed to the proper fiscal year.

b. Line item accountable equipment purchased to accomplish hazardous materials/OSHA projects at a cost that exceeds the capitalization dollar threshold, should be capitalized. Charge line item equipment to the Administrative Equipment "AE" project/task. This will transfer the items to the DELPHI Mass Additions Table where it can be determined if the equipment meets either the capitalization or property accountability definition. If it does not, it should be expensed.

2-14. **ENVIRONMENTAL CLEAN UP.** Agency liabilities for environmental clean up are recorded as a future liability as a potential cost to the agency, and appear in the liabilities section of the Consolidated Balance Sheet. A detailed footnote on this liability is contained each year in the FAA Financial Statements.

2-15. **WARRANTY COST**. If the FAA purchases an extended warranty for an item, it is expensed when the invoice is paid.

2-16. **PROPERTY ACQUIRED UNDER REIMBURSABLE AGREEMENTS**.[1] The general rule is to expense property that is acquired under reimbursable agreements, since this property does not belong to the FAA. In some cases, equipment may be purchased for use

[1] Reimbursable Agreements are set up in the DELPHI projects module as contract projects.

by FAA on a reimbursable agreement. This equipment should be returned to the sponsoring organization and therefore does not belong in FAA capital assets. If the equipment were to revert back to the FAA upon project completion, then this equipment would become a donated asset. In another circumstance, if a reimbursable agreement calls for FAA reimbursement to reestablish an asset or build a new asset at the expense of an airport sponsor or other agency, then capitalize the asset. For example, the FAA was reimbursed for costs associated with tearing down one air traffic control tower and building a new one in another location for the benefit of the airport. The asset is part of the FAA, and the costs should be capitalized, even if paid for by reimbursable funds.

2-17. **DISPOSAL AND REMOVAL OF NON-EXISTENT ASSETS**.

a. SFFAS No. 6 provides that general PP&E shall be removed from PP&E accounts along with associated accumulated depreciation/amortization in the period of disposal (i.e., same fiscal year).

b. FAA policy is to remove assets from the FA module within 30 days from the removal or discovery that the asset no longer exists. The FA module will generate the necessary general ledger accounts to recognize gain or loss on disposition, and remove the asset and accumulated depreciation that goes along with it.