



Department of  
**Finance &  
Administration**

Division of  
Accounts

# CAPITAL ASSET GUIDE

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# STATE OF TENNESSEE CAPITAL ASSET GUIDE

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# STATE OF TENNESSEE CAPITAL ASSET GUIDE

## I. Introduction

The purpose of this guide is to assist agencies in completely and accurately recording and properly reporting capital assets in their respective funds. When appropriate, items acquired should be recorded in the state's accounting system as capital assets and depreciated or amortized over their useful lives. Items that do not meet the capitalization requirements may generally be expensed.

The state's financial statements report capital assets in accordance with standards established by the Governmental Accounting Standards Board (GASB). A capital asset means a tangible or intangible asset with a cost equal to or greater than an established capitalization threshold and having an estimated useful life of three years or more.

Capital asset reporting thresholds in this guide may be higher than thresholds for property control due to different objectives. The primary objectives of financial reporting generally pertain to valuation, allocation, presentation, and disclosures; whereas the primary objectives of property control generally pertain to efficiency, effectiveness, and safeguarding of assets.

This guide is not intended to address all matters that require consideration when establishing internal controls or assessing risk for capital assets, particularly in the area of property control. Each agency is responsible for reviewing their business practices and processes to determine where risks exist and where and how controls can be established to mitigate these risks.

### **Accounting Overview**

Capital assets used in fiduciary or proprietary (enterprise and internal service) funds are reported in each of the respective funds. All other capital assets are reported as expenditures in the governmental fund financial statements, but are reclassified to capital assets in the government-wide financial statements through fiscal year-end adjustments for financial reporting in the state's Comprehensive Annual Financial Report (CAFR).

Capital assets are stated at historical cost or, in some instances, estimated historical cost. Donated capital assets are generally stated at acquisition value (AV) at the time of donation. Infrastructure assets are capitalized regardless of cost or useful life. Major outlays for capital assets and improvements are capitalized as projects are constructed. For internally generated computer software, only costs incurred during the application development stage are capitalized. The cost of normal maintenance and repairs that do not add to the value of an asset or materially extend the asset's life is not capitalized.

Certain assets such as works of art, historical documents, and artifacts are not capitalized or depreciated as long as they are held for the purpose of display or research, adequately maintained, and any proceeds from the sale of these items are applied to acquiring new items.

Capitalized assets, except for land, land improvements, intangible assets with an indefinite useful life, and infrastructure, are depreciated over their estimated useful lives. In addition, works of art,

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historical documents, and artifacts that qualify as a collection are also not depreciated. The state has elected to apply an alternative to depreciation for infrastructure. Under this alternative or modified approach, depreciation expense is not recorded for infrastructure capital assets that meet certain requirements. Instead, costs for both maintenance and preservation of these assets are expensed in the period incurred. Additions and improvements are capitalized.

### Capitalization Thresholds

Assets purchased, constructed, or received through capital lease or donation must be uniformly grouped into major classes. The following table summarizes the non-federal fund source capitalization thresholds for the state’s primary classifications of capital assets. Amounts are capitalized when the cost or value equals or exceeds the applicable threshold. Donations are subject to these capitalization thresholds, using the classifications most closely related to the donated assets.

#### Non-Federal Fund Source Capitalization Threshold Schedule

Class of Asset	Threshold*	CAFR Category
Land and land improvements, easements (indefinite useful life)	Capitalize all	Land
Buildings and building improvements	\$5,000	Structures and improvements
Improvements other than buildings	\$5,000	Structures and improvements
Machinery and equipment	\$5,000	Machinery and equipment
Infrastructure	Capitalize all	Infrastructure
Intangibles-Commercial Off the Shelf Software (COTS), licenses	\$5,000	Computer software
Intangibles-Software, internally generated	\$1,000,000 (est. total project costs)	Computer software
Intangibles-Other internally generated intangibles	\$1,000,000	Other capital assets
Intangibles-Easements (definite useful life), trademarks, copyrights, and patents	\$5,000	Other capital assets

\* See USC Title 2, Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* for assets acquired in whole or in part with federal funds.

### Trade-Ins

When the purchase of a new capital asset includes the trade-in of a similar old asset, the expenditure should be recorded for the amount paid to acquire the new asset (financial resources expended) and not the actual purchase price which includes the value of assets traded-in. For financial reporting

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purposes, the net book value of the old asset is added to the amount expended to reflect the full acquisition cost of the new asset in the capital asset system records. No gain or loss is recorded.

### Construction in Progress (CIP)

Construction in Progress (CIP) is an asset account that represents the temporary accumulation of costs, such as labor, materials, equipment, and any ancillary charges directly attributable to the construction of the project. The accumulation of costs continues in the CIP account until the project is complete. Once the asset is completed and placed into service, the CIP account is credited and the costs are capitalized to the appropriate capital asset account. This concept would be the same for buildings, infrastructure, or internally generated software.

### Installment Purchases

Some capital assets are acquired and owned by the state but the full acquisition price may not be immediately paid in full. The payments may occur over multiple years. For these types of purchases, an agency should contact someone in the Division of Accounts Asset Management (AM) team for the proper recording and accounting.

### Capitalized Interest

In general, the capitalization of interest for governmental funds and governmental activities of internal service funds is not allowed. For enterprise funds and internal service funds, reported as business type activities, interest incurred on debt during the construction period of the capital asset is considered part of the cost of the capital asset and may be capitalized.

### Recording Capital Asset Acquisitions

Capital asset purchases are recorded as expenditures at the time of purchase. Accruals are required at year-end for goods and services received but not processed through accounts payable.

The following expenditure account series should be used for all capital asset acquisitions except for infrastructure and intangible assets.

Account	Class of Asset	Category
7170xxxx	Land	LAND
72002000	Land improvements	LIMPR
71800000	Buildings	BLDGS
71802000	Building improvements	BIMPR
71810000	Improvements other than buildings	BOMPR
716xxxxx	Machinery and equipment*	See Section VI of this guide

*\*Refer to section IV of this guide for more detailed accounts in this series.*

### Depreciation/Amortization

Depreciation/amortization is the systematic and rational allocation of net cost (capitalized cost less estimated residual value) over the depreciable asset's estimated useful life. Residual value is the

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estimate of what an asset may be sold for at the end of its service life. Currently, vehicles are the only capital asset where residual value is estimated. Depreciation/amortization is calculated on a straight line basis over the estimated useful life of the asset. The following table exhibits the estimated useful lives for each major class of asset used by the state for calculating depreciation.

<b>Class of Asset</b>	<b>Years</b>
Buildings	50
Building improvements	20-50
Improvements other than buildings	5-50
Machinery and equipment	3-20
Intangibles, including commercial off the shelf software	3-10
Software, internally generated	3-10

The following assets are not depreciated/amortized: land, land improvements, infrastructure, and intangible assets with indefinite useful lives. In addition, works of art, historical documents, and artifacts that qualify as a collection are not depreciated.

### **Guidance by Major Asset Class**

The following guidance provides detailed descriptions for each major class of assets and examples of the types of expenditures which should be included in the capital acquisition cost. A capital asset should be recorded only if its total acquisition cost meets or exceeds the capitalization threshold for the asset class.

## **II. Land, Buildings, and Improvements Other than Buildings**

Capital assets in these classes are acquired by purchase, construction, or donation. Those acquired by purchase or construction should be reported at historical costs. Historical cost is the cash or cash equivalent price paid at the time of purchase or acquisition. The cost should include ancillary charges necessary to place the asset into its intended location and condition for use such as site-preparation costs and professional fees. Capital assets acquired by donation should be capitalized based on an appraisal of the estimated acquisition value at the date of acquisition. See the Donated Capital Assets section (Section VII) of this guide for specific guidance. Except for the classification of land and land improvements, the state has set a standard capitalization threshold of \$5,000 for buildings, building improvements and improvements other than buildings. The state capitalizes all costs classified as land and land improvements. An addition or improvement, unlike a repair, either enhances a capital asset's functionality (effectiveness or efficiency) or it materially extends a capital asset's expected useful life. Additions represent a new asset (e.g., a new wing to a building) and must equal or exceed the standard threshold. Improvements represent a substitution of a better asset (e.g., a concrete floor for a wooden floor) and must equal or exceed the standard threshold. Acquisitions, deletions (e.g., disposals, casualty losses, and donations) and

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modifications meeting the guidelines for capitalization as described should be reported to the Division of Accounts (DOA) on a Real Property Capitalization form (Appendix F).

### **A. Land and land improvements**

Land is the surface or crust of the earth, which may be used to support structures. Land is characterized as having an indefinite useful life. Land improvements consist of betterments, site preparation and site improvements (other than buildings) of a permanent nature that ready the land for its intended use. The costs associated with improvements to land are added to the cost of the land. Land and land improvements are inexhaustible assets and do not depreciate over time.

Examples of expenditures to be capitalized as land and land improvements include:

- Original purchase price or estimated acquisition value at time of donation
- Professional fees (closing fees, title searches, architect, legal, engineering, appraisal, surveying, environmental assessments, etc.)
- Land excavation, fill, grading, drainage, and clearing
- Demolition of existing buildings and improvements (less salvage)
- Removal, relocation, or reconstruction of property of others (railroad, telephone and power lines)
- Water wells (including the initial cost for drilling, the pump and its casing)
- Accrued and unpaid taxes at date of acquisition

### **B. Buildings and building improvements**

A building is a structure that is permanently attached to the land and is not intended to be transportable or moveable. Building improvements are capital events that materially extend the useful life of a building, increase the value of a building or both. A building improvement should be capitalized and recorded as an increase to the value of the existing building if the cost of the improvement meets or exceeds the capitalization threshold and increases the estimated useful life.

Examples of costs to be capitalized as buildings and building improvements (not all inclusive):

#### **PURCHASED BUILDINGS**

- Original purchase price
- Expenses for remodeling, reconditioning or altering the structure of a purchased building to make it ready to use for the purpose for which it was acquired (including internal payroll and payroll-related costs of employees directly involved in the activity)
- Environmental compliance costs (i.e., asbestos abatement)
- Professional fees (legal, architect, inspections, title searches, etc.)
- Payment of unpaid or accrued taxes on the building to date of purchase
- Cancellation or buyout costs of existing leases
- Other costs required to place the asset into operation



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### CONSTRUCTED BUILDINGS

- Completed structure costs
- Expenses incurred for the preparation of plans, specifications, blueprints, etc.
- Cost of building permits
- Professional fees (architectural, engineering, legal, management fees for design and supervision, etc.)
- Cost of permanently attached fixtures or machinery that cannot be removed without impairing the use of the building

### BUILDING ADDITIONS

- Similar costs included above in constructed buildings but rather associated with additions to buildings (expansions, extensions, or enlargements)

### BUILDING IMPROVEMENTS

- Conversion of attics, basements, etc., to usable office, clinic, research or classroom space
- Structures attached to the building such as covered patios, sunrooms, garages, carports, enclosed stairwells, etc.
- Installation or upgrade of heating and cooling systems
- Installation/upgrade of wall or ceiling covering such as carpeting, tiles, paneling, or parquet
- Structural changes such as reinforcement of floors or walls, installation or replacement of beams, rafters, joists, steel grids, or other interior framing
- Installation or upgrade of window or door frames, upgrading of windows or doors, built-in closet and cabinets
- Interior renovation associated with casings, baseboards, light fixtures, ceiling trim, etc.
- Installation or upgrade of plumbing and electrical wiring
- Installation or upgrade of phone or closed circuit television systems, networks, fiber optic cable or wiring required in the installation of equipment (that will remain in the building)

Care should be taken to distinguish capitalizable improvements from non-capitalizable maintenance costs. Repairs or replacements that are merely costs to retain an asset in its normal state are not to be capitalized. Repairs or replacements that have an effect on a capital asset's functionality (effectiveness or efficiency) or materially extends a capital asset's expected useful life should be capitalized. The following items must not be capitalized as improvements to buildings. Instead, these items must be recorded as building maintenance expenditures/expenses:

- Adding, removing and/or moving walls in conjunction with renovation projects that are not considered major rehabilitation projects and that do not increase the value of the building
- Improvement projects of minimal or no added life expectancy and/or value to the building
- Plumbing or electrical repairs
- Cleaning, pest extermination, or other periodic maintenance

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- Interior decoration, such as draperies, blinds, curtain rods, wallpaper
- Exterior decoration, such as detachable awnings, uncovered porches, decorative fences, etc.
- Maintenance-type interior renovation, such as repainting, touch-up plastering, replacement of carpet, tile, or panel sections, sink and fixture refinishing, etc.
- Maintenance-type exterior renovation such as repainting, replacement of deteriorated siding, roof, or masonry sections
- Replacement of a part or component of a building with a new part of the same type and performance capabilities, such as replacement of an old boiler with a new one of the same type and performance capabilities
- Any other maintenance-related expenditure which does not increase the value or useful life of the building

### C. Improvements other than buildings

Improvements other than buildings include depreciable improvements and betterments made to land of a permanent nature, other than buildings that add value to land, but do not have an indefinite useful life.

The following are examples of costs to be capitalized as improvements other than buildings:

- Fencing and gates
- Parking lots, driveways, parking barriers (would not include restriping or resurfacing of existing lots and driveways)
- Outside sprinkler systems
- Recreation areas and athletic fields (including bleachers)
- Golf courses
- Paths and trails
- Septic systems
- Swimming pools, tennis courts, basketball courts
- Fountains
- Plazas and pavilions
- Retaining walls

## III. Infrastructure

Infrastructure assets (right-of-way acres, roads and bridges) are capitalized regardless of cost or useful life. The state has elected to apply the modified approach to accounting for roadways and bridges infrastructure. Under the modified approach, depreciation expense is not recorded for these assets. Instead, costs for both maintenance and preservation of these assets are expensed in the period incurred. Additions and improvements to existing infrastructure assets that increase capacity or efficiency are capitalized. Examples of additions and improvements that increase capacity or

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efficiency include adding a new lane or widening the lanes of an existing road, or alignment improvements. For financial reporting, infrastructure right-of-way (ROW) is capitalized in the land classification and infrastructure (roads and bridges) construction in progress is included in the construction in progress.

For purposes of infrastructure accounting and reporting, our state has determined that roads will not only consist of lane miles of roadways, but other dissimilar assets as well. These dissimilar assets include, but are not limited to drainage systems, lighting, signalization, and Intelligent Transportation Systems (ITS). ITS includes management centers, cameras, dynamic message boards, traffic sensors, congestion monitoring stations, 511 information, TDOT SmartWay Mobile, Incident Management, fog detection, and other safety items. All of these components increase the capacity and/or efficiency of the transportation system and are thus capitalized.

Infrastructure is managed and recorded by the Tennessee Department of Transportation (TDOT). Financial reporting entries are recorded by the Division of Accounts (DOA).

### **IV. Machinery and Equipment**

Machinery and equipment is an apparatus, tool, or conglomeration of pieces to form a tool, or purchased equipment, used in operations. These items can be fixed or movable tangible assets. They will stand alone and not become a part of a basic structure or building.

Machinery and equipment with an acquisition cost greater than or equal to \$5,000 and an estimated useful life of three years or more must be capitalized and tagged. Acquisition cost is considered to be the net invoice price of the equipment including the cost of modifications, site preparation, assembly, attachments, accessories, or auxiliary apparatus necessary to make the equipment operable. Separately invoiced associated charges such as the cost of installation, transportation, or protective in-transit insurance, must also be included in determining the acquisition cost. If a group of smaller items is acquired, and all items are needed to make the equipment operational for its intended purpose, all must be included when determining whether the purchase is classified as a capital asset or not. (See the tables below for the detailed information on account codes and asset profiles.)

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### A. Machinery & equipment account code and asset profile tables

Machinery and equipment purchases that are correctly determined to meet the capitalization threshold for the state must be recorded in the accounting system with an account code beginning with 716XXXXX and an asset profile beginning with an 'E'. The appropriate account codes and asset profiles are listed below:

#### Machinery & Equipment Account Codes

Account	Description
71600000	Computer Equipment
71601000	Lab & Scientific Equipment
71602000	Medical Equipment
71603000	Training & Educational Equipment
71604000	Photo/Duplicating/Printing Equipment
71605000	Video & Telecom Equipment
71606000	Airplanes & Helicopters
71607000	Marine Equipment
71608000	Passenger Vehicles/Titled Equipment
71609000	Shop Equipment
71610000	Textile Equipment
71611000	Building & Electric Systems Equipment
71612000	Construction & Land Maintenance Equipment
71613000	Food Service Equipment
71614000	Furniture & Office Equipment
71615000	Parks & Recreation Equipment
71616000	Agricultural Equipment & Livestock
71617000	Weapon
71618000	Art Objects
71620000	Computer Software

#### Machinery and Equipment Profiles

Profiles	Description
EAIRPxxx	Equipment, Airplanes & Helicopters
EARTxxx	Equipment, Art Objects
EBULDxxx	Equipment, Building and Electric Systems
ECOMPxxx	Equipment, Computer
ECONStxxx	Equipment, Construction & Land Maintenance
EDATAxxx	Equipment, Data Collection/Measuring
EEDUCxxx	Equipment, Training & Educational
EFARMxxx	Equipment, Farm & Agricultural
EFIRE xxx	Equipment, Fire Protection/Training
EFOODxxx	Equipment, Food Service
EFRFXxxx	Equipment, Furniture & Office
EGUNxxx	Equipment, Weapons

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<b>Profiles</b>	<b>Description</b>
ELABS <sub>xxx</sub>	Equipment, Lab & Scientific
EMARN <sub>xxx</sub>	Equipment, Marine
EMEDL <sub>xxx</sub>	Equipment, Medical
EPHOT <sub>xxx</sub>	Equipment, Photo/Duplicating/Printing
EPKRC <sub>xxx</sub>	Equipment, Parks & Recreation
EPOLC <sub>xxx</sub>	Equipment, Police Protection/Training
ESHOP <sub>xxx</sub>	Equipment, Shop
ESOFT <sub>xxx</sub>	Equipment, Computer Software
ETECH <sub>xxx</sub>	Equipment, Non computerized Technical
ETELC <sub>xxx</sub>	Equipment, Video & Telecommunication
ETEXL <sub>xxx</sub>	Equipment, Textile
EVGNR <sub>xxx</sub>	Equipment, Licensed Vehicles

*NOTE: The 'xxx' indicates the depreciable life.*

### **B. Special considerations for machinery and equipment**

#### **1. Asset purchasing process**

When purchasing a capital asset, the purchase must be started at the requisition stage because an Edison item number must be used. The use of an item number is required so that the purchase can be serialized and tagged. For receipt lines with a quantity greater than one, serialization allows the user to enter multiple tag numbers and serial IDs. Without the serialization, the user could not enter more than one tag per line. The item number also specifies the asset profile that will be attached to the asset which will define the useful, depreciable life of the asset.

#### **2. Computer hardware systems**

All computer hardware systems with an acquisition cost greater than or equal to \$5,000 and an estimated useful life of three years or more must be capitalized and tagged. Systems consist of a central processing unit (CPU), operating and utility (versus application) software, and all accessories necessary to make the system operable. External peripherals purchased at the same time, but not needed to make the equipment operable, are to be evaluated separately. The determination of the acquisition cost must also include installation, consultation services, and the transportation charges associated with the purchase.

#### **3. Operating system software**

Software that allows the parts of a computer to work together by performing needed tasks or provides a platform to run application software. Utility software helps analyze, configure, optimize, and maintain the computer. This software is considered part of the hardware purchase when determining whether the equipment should be classified as a capital asset.

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### 4. Application software

Software designed to help people perform an activity (e.g. an accounting application) is considered separately from the hardware purchased when determining whether the hardware and software should be classified as capital assets (see Section VI.A.5 for further guidance).

### 5. Ancillary equipment

The cost of an ancillary piece of equipment, not required to make the associated asset operable, will be treated and evaluated for capitalization and tagging purposes as a separate item of equipment.

### 6. Repairs, replacements, modifications, and upgrades:

- a) **Repairs and maintenance**—retain value rather than provide additional value to an asset. The cost of normal maintenance and repairs that do not add to the value of an asset or materially extend the asset's life is not capitalized.
- b) **Replacement machinery and equipment**—must be evaluated as a stand-alone purchase using the capital asset criteria provided in this guidance and reported accordingly.
- c) **Modifications and upgrades of existing machinery and equipment**—should be evaluated on a case-by-case basis. Equipment modification and upgrade costs will be capitalized when they materially extend the useful life, increase the capacity, or improve the efficiency of the original asset and meet, or exceed the state's capitalization threshold. The expenditures are capitalized and reported as a child asset of the existing machinery and equipment. The asset value and useful life of the original piece of equipment are not modified.

### 7. Transfers of machinery & equipment

Transfers of machinery and equipment are recorded within the asset module and processed by the Division of Accounts (DOA). Requests must be submitted by the transferring business unit on the Interdepartmental Capital Asset Ownership Transfer form (Appendix G). The transfers will not be recorded until the information associated with the asset has been verified by the accepting business unit and they have acknowledged receipt of the asset.

### 8. Warranties

Costs of extended warranties and/or maintenance agreements, which can be separately identified from the cost of the equipment, should not be capitalized.

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### 9. Training

Training costs, which can be separately identified from the cost of the equipment, should not be capitalized.

### 10. Sensitive non-capital assets

Some machinery and equipment owned by the state does not meet the capital asset criteria but must be maintained and controlled by the owning agencies because, for example, it is susceptible to theft or easily converted to personal use. Machinery and equipment in this category is classified as sensitive non-capital assets. The Department of Finance and Administration issued Policy 32, *Maintaining Control Over Items That Are Not Capitalized*, to help ensure that adequate property controls are in place over 'sensitive' non-capital assets.

## V. Artifacts, Works of Art, and Collections

Artifacts and works of art should be capitalized unless they are part of a collection that meets **all** of the following criteria:

- It is held for public exhibition, education or research rather than financial gain,
- It is protected and preserved, and
- It is subject to an organizational policy that requires the proceeds from sales to be used to acquire other items for collections.

These are the types of collections generally held by museums, libraries, historic sites, etc.

If the above criteria are NOT met and the item(s) have an estimated useful life of three years or more and an initial cost of \$5,000 or more, then the item(s) must be capitalized.

Agencies should use account number 71618000 for all purchases for works of art and artifacts with an initial cost of \$5,000 or more regardless of whether the above criteria is met.

## VI. Intangible Assets

### Characteristics of Intangible Assets

An intangible asset possesses the following:

- Lack of physical substance,
- Nonfinancial nature, and
- Initial useful life extending beyond a single reporting period.

Examples of Intangible Assets:

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- Easements
- Land use rights (water, timber, mineral)
- Patents, trademarks, copyrights
- Computer software (purchased, licensed, internally generated)
- Websites

The following are not considered to meet the definition of an intangible asset and are outside the scope of this guide; please contact the Division of Accounts (DOA) for the proper recording of these types of transactions:

- Assets that are acquired or created primarily for the purpose of directly obtaining income or profit,
- Assets resulting from capital lease transactions reported by lessees,
- Goodwill created through the combination of a government and another entity, and
- Land use rights that are part of a “bundle of rights” purchased collectively with the underlying land.

There are several types of intangible assets. Computer software is the most commonly known type of intangible. The next few subsections discuss the specific issues related to computer software and the other less common intangibles.

### **Internally Generated Intangible Assets**

Intangible assets are considered internally generated if they are created or produced in house or by a contracted entity, or if they are acquired from a third party but require more than minimal incremental effort to reach service capacity.

#### **Criteria**

Expenditures associated with the development of an internally generated intangible asset (IGIA) should be capitalized when all three of the following criteria are met:

- 1) Determination of the objective of the project and the nature of the service capacity expected upon completion, i.e., the purpose and expectation of the project has been determined
- 2) Demonstration of the technological feasibility needed to complete the project, e.g., a plan of action that will result in the creation of the intangible asset
- 3) Demonstration of the current intention, ability, or presence needed to complete or continue development of the intangible asset, i.e., commitment to fund the project and/or commitments have been made to third parties to create or assist in the creation of the intangible.



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Only outlays incurred subsequent to meeting the above criteria should be capitalized. Outlays incurred prior to meeting those criteria should be expensed.

### A. Computer software

Computer software is an intangible asset that can be purchased, licensed, or “internally generated”. In general, the costs to purchase or license computer software should be capitalized if the capitalization threshold (discussed in Section I) is met and the software has a useful life of three years or more. For “internally generated” computer software (IGCS) that meets the applicable threshold and has a useful life of three years or more, only certain application development stage costs (described in item 3(a)(2) below) should be capitalized.

#### 1. Licenses, rights to use or subscriptions

In general, a software license grants the licensee the right to use a software program. Depending on the licensing agreement, some licenses are valid for a specific period of time and others are valid for the life of the software. Licenses are subject to the same capitalization requirements as other intangible assets. If the cost of a license is equal to or greater than \$5,000 and has a useful life of three years or more, then the cost of the license should be capitalized. Typically, the initial licensing cost is capitalized and subsequent annual renewals of the same license are expensed. Annual licensing and maintenance costs should be expensed since these type costs usually do not have a useful life greater than one year or add to the effectiveness or efficiency of the asset.

A licensing agreement could require periodic installment payments over the life of the agreement. In this situation, the sum of the periodic payments is capitalized and a long-term liability is also recognized for the same amount. This would include a situation in which the agency was obligated to renew any licenses, subscriptions or rights to use. Refer to *Installment Purchases* in Section I.

#### 2. Open source software

Generally refers to software which is publicly available in both source code and object code forms under a license which allows licensees to use, modify, reproduce, and distribute the software in both source code and object code forms without being required to make any payments to the licensor of the software. Open source code is typically created as a collaborative effort in which programmers improve upon the code and share the changes within a community. An agency should contact the DOA for the proper recording and accounting of open source software.

#### 3. Internally generated

Computer software should be considered “internally generated” if it is developed in-house or developed by a third party on the state’s behalf. In addition, commercially available

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software that is purchased or licensed and requires more than minimal incremental effort before being put into operation is also considered “internally generated”. An example of more than minimal incremental effort could be changing code or adding special reporting capabilities.

The activities involved in creating IGCS can be grouped into three stages as follows:

- a) Preliminary project stage—this stage includes the conceptual formulation and evaluation of alternatives, the determination of the existence of needed technology, and the final selection of alternatives. Common examples of activities in this stage include making strategic decisions to allocate resources, determining the performance and system requirements for the computer software, selecting a vendor for commercially available software and selecting a consultant for internally developed software.
- b) Application development stage—this stage includes the design of the chosen path, including software configuration and software interfaces, coding, installation to hardware, and testing, including parallel processing.
- c) Post implementation/operation stage—this stage includes training and software maintenance.

For IGCS, the three criteria previously discussed in the opening paragraphs of this section are considered met when the following occur:

- Activities in the preliminary project stage (described above) are complete, and
- Management has committed to funding the project.

Once these two conditions are met, capitalization of the application development stage can begin.

If the total estimated project costs of all stages equal or exceeds \$1,000,000 and the software has a useful life of three years or more then the application development stage costs should be capitalized. Capitalization should cease when the software is substantially complete and operational.

The following are examples of activities that occur during the application development stage that should be capitalized:

- costs to obtain the software,
- external direct costs of materials and services,
- travel costs of employees **directly** involved in the development of the software,
- internal payroll and payroll related costs of employees **directly** involved in designing, coding, installing or testing the software,
- data conversion activities needed to make the software operational.

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The following are examples of activities that occur during the application development stage that should **not** be capitalized:

- general and administrative costs,
- overhead costs,
- training costs,
- data conversion, unless the data is needed to make the software operational.

The activities in the preliminary project stage and post implementation stage should be expensed.

The decision to expense or capitalize an outlay should be based on the nature of the activity and not the timing of its occurrence. For example, training, which is considered an activity of the post implementation stage, could occur while the software is being developed. Since training is an activity of the post implementation stage, training costs should be expensed even though the training occurred during the application development stage.

An agency that is planning the purchase or development of internally generated computer software where the estimated project cost equals or exceeds the capitalization threshold, should complete and return the Computer Software form in Appendix C to the DOA. This form is used to describe the software project and document the methodology for capturing the project costs.

#### **4. Software modifications**

A modification of computer software that is already in operation, the cost of which equals or exceeds \$1,000,000, should be capitalized in the same manner as IGCS if the modification results in any of the following:

- Increase in functionality; i.e., the software is able to perform tasks that it was previously unable to perform
- Increase in efficiency; i.e., the level of service provided by the software has increased without the ability to perform additional tasks, or
- Extension of the estimated useful life. Modifications that only extend the useful life, without an increase in functionality or efficiency, are rare events.

If the modification does not result in any of the above outcomes then the modification should be considered maintenance and the outlays should be expensed as incurred. In addition, the cost of a maintenance contract that covers minor enhancements or unspecified upgrades should be expensed as incurred.

An agency, planning the modification of existing software that equals or exceeds the capitalization threshold, should complete and return the Computer Software form in

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Appendix C to the DOA. This form is used to describe the software project and document the methodology for capturing the project costs.

### **5. Purchased application software, other than internally generated**

Purchased application software that is not “internally generated”, as defined above, should be capitalized if the acquisition cost is equal to or greater than \$5,000 and the useful life is three years or more. In addition to the acquisition cost, other capitalizable cost should include any necessary installation, consultation, and transportation charges. An example of this type of software would be commercially available off the shelf software (COTS). COTS must be recorded with account code 71620000 and an asset profile of ESOFTXXX.

*For more guidance on capitalization of software, review the Computer Software Matrix in Appendix A and the Computer Software Decision Tree in Appendix B.*

### **B. Copyright, patents, and trademarks**

A copyright is a form of protection provided to the authors of original works, such as literary, dramatic, musical, artistic, and certain other intellectual works. Copyrights are registered by the United States Copyright Office.

A patent is a right granted by the United States government to an inventor to exclude others from making, using, offering for sale or selling the invention. Patents are issued by the United States Patent and Trademark Office.

A trademark is a symbol used by an entity to indicate that the word, phrase, symbol, design or service so marked is unique to that entity and to distinguish the marked good or service from those of other entities. Trademarks can be registered at the Tennessee Secretary of State and/or United States Patent and Trademark Office.

Copyrights, patents, and trademarks should be capitalized if all of the following criteria are met:

- The copyright, patent or trademark is owned by the state and used in operations, not for resale,
- The purchase price or the costs to create the copyright, patent or trademark equal or exceed the applicable capitalization threshold, and
- The useful life of the copyright, patent or trademark is three years or more.

If an agency has purchased or created a copyright, patent, or trademark that meets these criteria then the Copyrights, Patents, or Trademarks form in Appendix D should be completed and returned to the DOA. This form is to be used to describe the intangible asset and document the methodology for capturing the project costs.

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### C. Easements and land use rights

Easements and land use rights are usually considered intangible and include any of the following described assets:

***Easement/Right-of-Way*** – The right to use the land of another party for a particular purpose.

***Water Rights*** – The right to draw water from a particular source, such as a lake, irrigation canal, or stream.

***Timber Rights*** – The right to cut and remove trees from the property of another party.

***Mineral Rights*** – The right to draw minerals from a particular source, such as lake or stream.

All easements and land use rights should be tracked by the Department of General Services (DGS) State of Tennessee Real Estate Asset Management (STREAM) division. The DOA will identify and review expenditures related to these types of intangibles with an acquisition cost of \$5,000 or greater to determine the proper financial reporting treatment of these types of intangibles.

The length of the life of an easement or right-of-way may be limited by contract, law, or regulation. For those agreements or contracts that have a perpetual term, they will be considered to have an indefinite life. In order for any renewal options to be considered when estimating the useful life for amortization purposes, any renewal costs should be nominal in relation to the level of service capacity expected to be obtained through the renewal.

## VII. Donated Capital Assets

Donated capital assets (tangible and intangible) must be recorded at their estimated acquisition value plus ancillary charges on the date of acquisition, using a reasonable market study. The estimated acquisition value (entry/buy price) is the price that would be paid to acquire a similar asset with equivalent service potential in an orderly market transaction at the acquisition date had the agency actually purchased the asset. This differs from a fair value price (exit/sell price) which represents the price the agency could have sold the asset for in an arm's length exchange transaction.

The method used to determine the value computed for gifts and donations should be based on a reasonable assessment. This method must be fully documented and maintained on file to support the value.

A transfer of an asset between state agencies is not a donation.

All donations of land, buildings, easements and land use rights should be processed through the Department of General Services' State of Tennessee Real Estate Asset Management (STREAM) division.

Agencies should complete the Donated Capital Asset Reporting form in Appendix E to report all other donations (including equipment, artifacts, works of art, and other intangibles).

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### VIII. Impairments

A capital asset is considered to be impaired when its service utility has permanently declined significantly and unexpectedly. Events or changes in circumstances that may be indicative of impairment include evidence of physical damage, changes in legal or environmental factors, technological changes or evidence of obsolescence, changes in the manner or duration of use of a capital asset, and construction stoppage.

Generally, an asset would be considered impaired if both:

- The expenses associated with the potentially impaired asset (i.e., continued operation and maintenance, including depreciation, or cost associated with restoration) are significant compared to its useable capacity.
- The event or change in circumstances was outside the normal life cycle of the asset.

When a department learns of a capital asset impairment, or other type of loss (other than from sales) it should contact the Division of Accounts (DOA), Asset Management (AM) team.

In the event a capital asset is impaired, there are two options for reporting the impairment:

- If the asset will no longer be used then the book value of the asset should be written down to the lower of carrying value or fair market value
- If the asset will continue to be used then the book value of the asset should be adjusted by the net of the impairment loss and restoration costs.

Estimated impairment losses of \$5,000,000 or more will be evaluated and recorded based on the above considerations.

Losses should be recorded as a direct expense to the business function that owned the asset.

For impairments and other types of losses (other than losses from sales) estimated to be less than \$5,000,000, the recovery and repair costs will be evaluated to determine if the repairs qualify for capitalization in accordance with this guide. These costs must be recorded as expenditures/expenses when incurred. If recovery and repair costs qualify as capitalized costs, the write down of the carrying value on the impaired asset will occur in conjunction with the capitalization of the recovery and repair costs.

#### **Insurance proceeds (including from Risk Management-Internal Service Fund)**

Agencies should record proceeds from insurance including the state's Risk Management Fund at the time of receipt. Proceeds from the Risk management fund should be recorded as interdepartmental revenue. These revenues are identified and reclassified for financial statement purposes by the DOA as appropriate.

## **IX. Disposals of Capital Assets**

### **A. Disposals of land and buildings**

The Department of General Services' (DGS) State of Tennessee Real Estate Asset Management (STREAM) division oversees the acquisition and disposition of real property for state departments. When a property is no longer needed by the occupying state agency, alternate uses and the needs of other agencies are considered. The STREAM division disposes of real property for all state departments in accordance with state law. The Division of Accounts (DOA) accumulates the data and records the appropriate transactions in the general ledger. Any deletions or disposals of land and buildings should be reported to the Division of Accounts on a Real Property Capitalization form (Appendix F).

For real property acquired with federal grant funds that is no longer needed for the original authorized purpose, instructions for disposition must be obtained from the federal awarding agency or pass-through entity.

### **B. Disposal of machinery and equipment**

#### **1. Equipment retirements due to disposal or loss**

As a general rule, the initial determination as to who will be responsible for the retirement of an equipment asset record in the Edison Asset Module is based on whether the equipment is still in the possession of the owning state business unit.

When a piece of equipment is still in the possession of a business unit, but is no longer considered useful (i.e. is considered surplus or excess, or is to be traded-in on a new purchase), the equipment is required to be declared surplus through the DGS Warehousing and Distribution division. Refer to the Warehousing and Distribution division's website for disposal guidelines. When the surplus equipment has been disposed of, either through sale or scrap, the Warehousing and Distribution division will retire the related tag numbers in the Edison Asset Module. Until the retirement has been entered into the Edison Asset Module, the asset will continue to be reported as In Service.

If for reasons outside the purview of the Warehousing and Distribution division, a piece of equipment is no longer in the possession of the owning business unit, the retirement transaction must be processed directly through the Division of Accounts Asset Management (AM) team through the completion of a Retirement Request form (see Appendix H).

Examples of these type situations include:

- When equipment has been lost or stolen, or has been destroyed by building demolition or in a fire or other casualty,

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- When a piece of equipment's retirement is necessitated as a result of specific TCA authorized disposition methods, that are not required to be processed through the DGS Warehousing and Distribution Division
- When a piece of equipment has been disposed of by the owning business unit using an unauthorized method.

The retirements requested through AM will be processed after all required documentation has been attached to the asset record in the Edison Asset Module by the owning business unit and a Retirement Request form has been sent to AM. The required documentation to be attached to the asset record is detailed below and must also include a copy of the Retirement Request form.

The following outlines the processes to be followed when requesting equipment retirements directly through AM:

A Retirement Request form should be sent to AM from the Departmental Property Officer, as an attachment to an email addressed to [AGAsset.Management@tn.gov](mailto:AGAsset.Management@tn.gov). A separate Retirement Request form must be submitted for each retirement method and the form must be signed by the agency's property officer and fiscal officer.

### The Retirement Request form must:

- a) Identify the "Retirement Method" and, depending on the denoted retirement method, carry as an attachment certain documentation supporting the retirement. This is the same documentation that must be attached to each of the respective asset records in the Edison Asset Module that are listed on the Retirement Request form. Allowed retirement methods and the required documentation are:
  - i. Missing/Lost – Comptroller report (required by TCA 8-19-501), includes unauthorized disposal of equipment
  - ii. Theft – Comptroller report (required by TCA 8-19-501); and, filed police report
  - iii. Casualty – Comptroller report (required by TCA 8-19-501); and, filed casualty loss report
  - iv. Donation to External Group - Explanatory memorandum signed by the Departmental Property Officer (includes equipment retirements necessitated as a result of specific TCA authorized disposition methods that are not required to be processed through the DGS Warehousing and Distribution Division).



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b) Include a listing of the individual tag numbers, using the Retirement Request form, included in the retirement request with the following detailed information:

- BU
- Asset ID
- Tag number
- Description
- Manufacturer
- Model
- Serial ID
- Tag Value (acquisition cost)

c) Include as an attachment any relevant documentation pertaining to the retirement request, including but not limited to, documentation required by department specific policies pertaining to equipment retirements.

### **2. Equipment retirements for reasons other than disposal or loss**

Certain retirement transactions must be processed within the Edison Asset Module that are not related to the actual disposal of equipment. The following retirement transactions must be processed directly through AM.

- a. When a piece of equipment has been tagged in error, for example, when multiple tags were issued for a piece of equipment that should be carrying one tag.
- b. When a piece of equipment has been returned to the supplying vendor, for example, through a warranty replacement program.

The retirements requested through AM will be processed after all required documentation has been attached to the asset record in the Edison Asset Module by the owning business unit; and, a Retirement Request form has been sent to AM. The required documentation to be attached to the asset record is detailed below and must also include a copy of the Retirement Request form.

The following outlines the processes to be followed when requesting equipment retirements directly through AM:

A Retirement Request form should be sent to AM from the Departmental Property Officer as an attachment to an email addressed to AGAsset.Management@tn.gov. The form must be signed by the agency property officer and fiscal officer.

The Retirement Request form must:

- 1) Identify the “Retirement Method” as SCRAPPED and carry as an attachment an explanatory memorandum signed by the agency property officer. Additionally, for

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returns to the supplying vendor, the attachments must include return shipping documentation and an acknowledgement of receipt from the vendor.

- 2) Include a listing of the individual tag numbers included in the retirement request, using the Retirement Request form to provide all required information on the asset.
- 3) Include as an attachment any relevant documentation pertaining to the retirement request, including but not limited to, documentation required by department specific policies pertaining to equipment retirements.

### **C. Disposals of purchased software & licenses, other than internally generated**

When capitalized purchased software meets the criteria listed in Section VI (a) and is no longer of use to a business unit, the item may be surplus. If the surplus request is submitted in accordance with requirements, the DGS Warehousing and Distribution Division will retire the asset in the asset module.

### **D. Disposals of other items**

For the disposal of items not listed in this section under subsections A-C, please contact the Division of Accounts for guidance on proper disposal guidance.

### **E. Trade-in of machinery and equipment**

A trade-in occurs when the owning business unit turns in a piece of equipment to a vendor as part of the purchase of new equipment. The trade-in is, in essence, the payment or partial payment for the new equipment. Trade-in transactions must be submitted to and approved by the Department of General Services, Warehousing and Distribution Division prior to any action between the business unit and the vendor. If a trade-in is approved, the Department of General Services, Warehousing and Distribution Division will retire the asset record in the asset module. Refer to Section I of this guide for a general discussion of the proper accounting treatment for trade-ins.

### **F. Cannibalized equipment**

A piece of tagged machinery or equipment can be cannibalized when the asset has been dismantled and the parts are reused within the business unit. Once the available parts have been used, there must be at least one piece left to surplus through the Department of General Services, Warehousing and Distribution Division. When the cannibalized equipment has been disposed of, in accordance with requirements, the Department of General Services, Warehousing and Distribution Division will retire the asset record in the asset module.

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### **X. Capital Leases**

A lease is an agreement that conveys the right to use property, plant or equipment usually for a stated period of time. Although actual title to the property may not be transferred to the lessee, a lease agreement must be evaluated to determine whether the transaction should be treated as an in-substance purchase. Leases may be classified as a capital lease or as an operating lease. The Division of Accounts collects documentation supporting any lease agreement where the state is the lessor or lessee and other similar arrangements for evaluation of the proper accounting, recording and disclosure of the state's leases.

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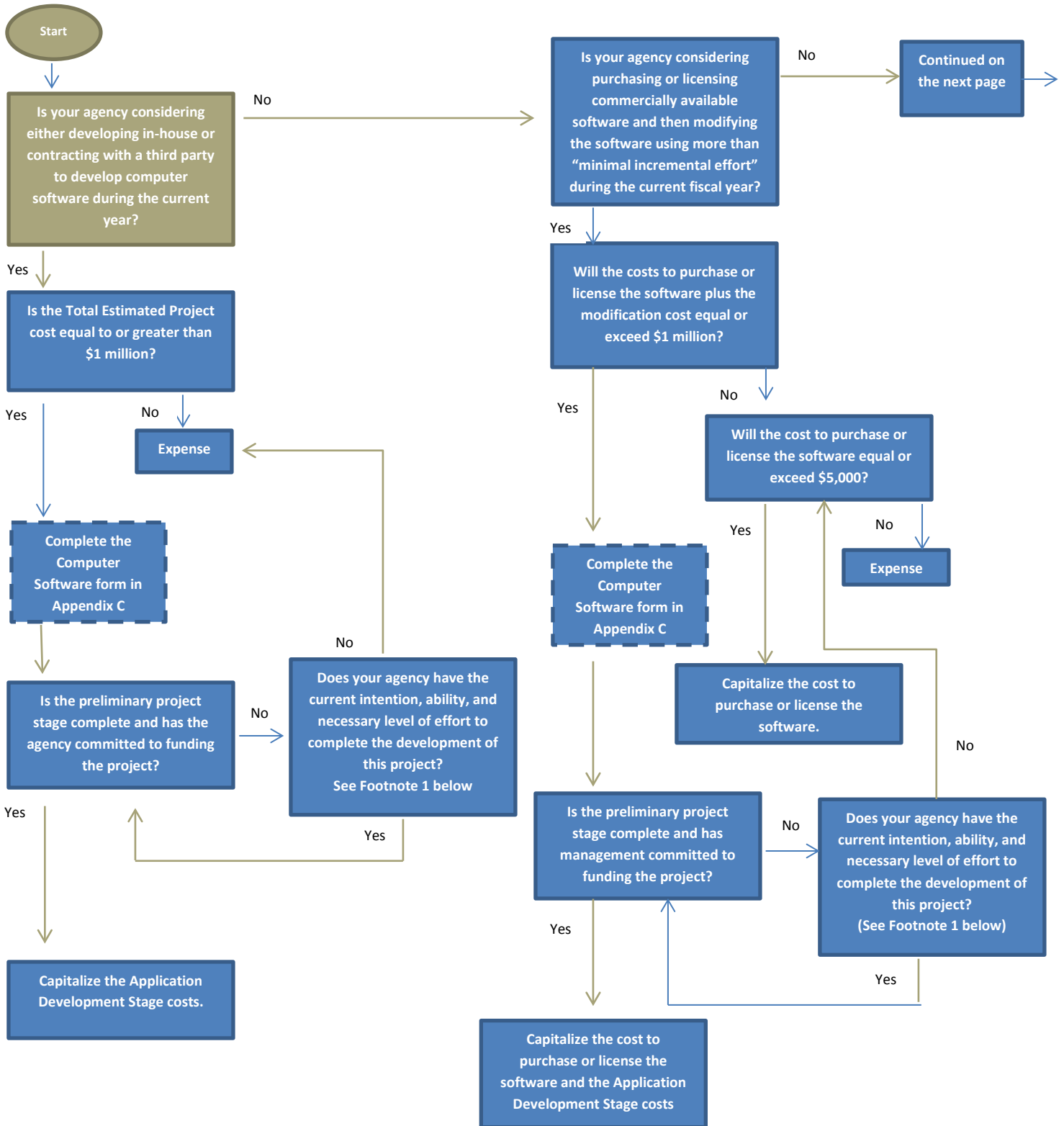
**Appendix A-Computer Software Matrix**

SCENARIO	RECORD AS:			
	<u>License</u>	<u>Internally Generated Computer Software</u>	<u>Modifications</u>	<u>Other</u>
Agency either develops in-house or hires third party to develop new software, total estimated project costs total \$1,000,000.		Complete Computer Software Form.		
Agency purchases <u>new</u> software and modifies with more than minimal incremental effort. Total acquisition cost of COTS, \$1,000,000; total modification cost \$1,000,000 (Total project cost greater than \$1,000,000 qualifies as IGCS, all eligible costs including COTS should be capitalized as one item).		Complete Computer Software Form.		
Agency purchases <u>new</u> software and modifies with more than minimal incremental effort. Total acquisition cost of COTS, \$4,000, total modification cost, \$1,500,000 (Total project cost greater than \$1,000,000 qualifies as IGCS, all eligible costs including COTS should be capitalized as one item).		Complete Computer Software Form.		
Agency purchases <u>new</u> software and modifies with more than minimal incremental effort. Total acquisition cost of COTS, \$1,000,000, total modification cost \$5,000,000 (All eligible costs should be capitalized as one item).		Complete Computer Software Form.		
Agency modifies existing software. Total cost of modification project \$1,000,000. (Not including existing software costs).			Complete Computer Software Form.	

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Agency purchases use of software license for five years for \$5,000.00.	Tag and record as 71620000 with asset profile ESOFTXXX			
Agency purchases license for use of new software for less than \$5,000.00.	Record as 72201000			
Agency enters into an agreement with an outside supplier for SPECIFIED upgrades and maintenance of existing software with total costs greater than \$2,000,000. Maintenance costs total \$1,000,000 and <u>specific</u> upgrades costs total \$1,000,000.			Complete Computer Software Form for specified upgrade costs only.	Record maintenance as 72203000.
Agency enters into an agreement for UNSPECIFIED upgrades and maintenance of existing software.				Expense unspecified upgrades regardless of cost.

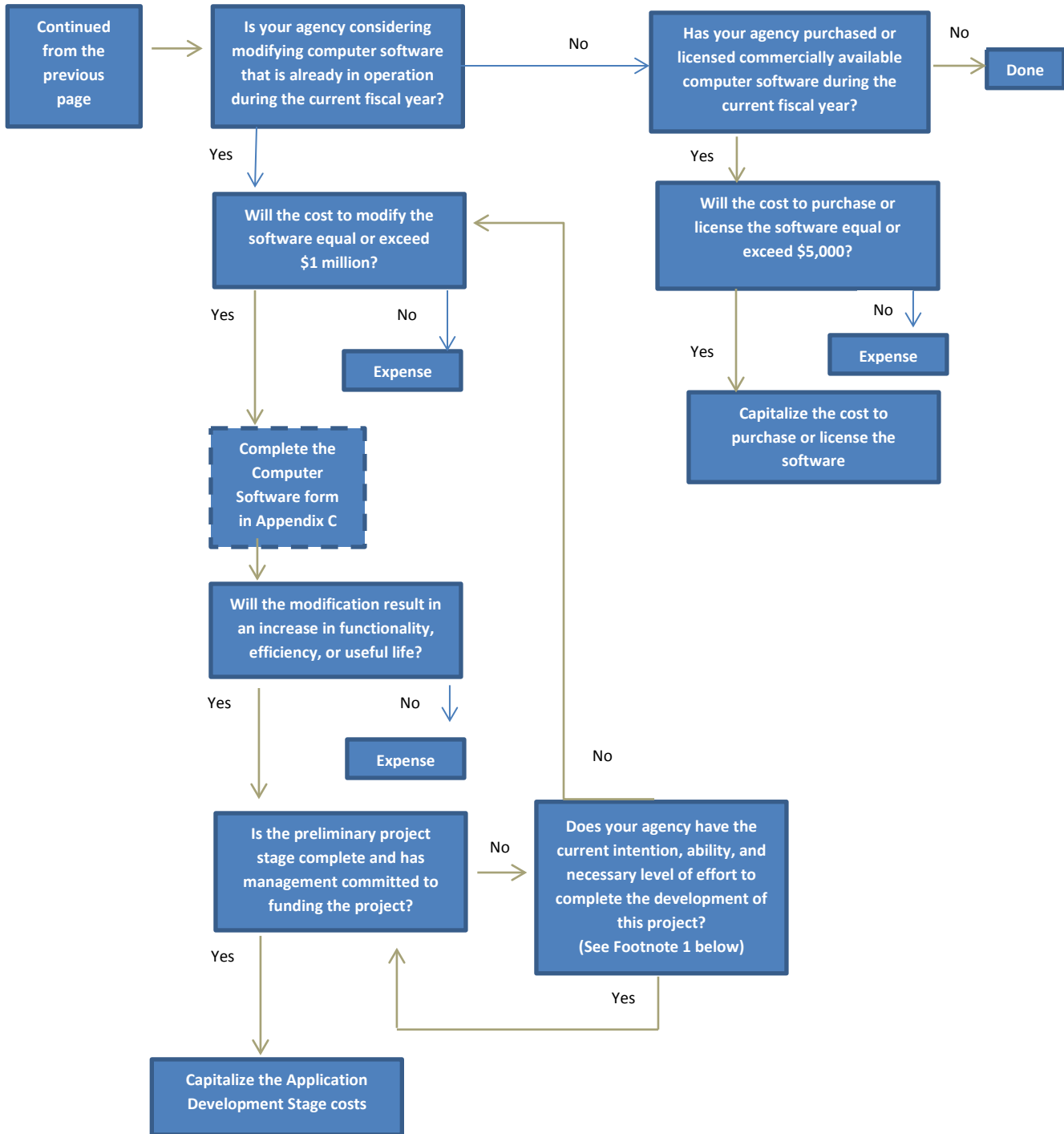
Appendix B-Decision Tree for Computer Software



**Footnote:**  
 1. If your agency doesn't currently have the intention, ability and necessary level of effort to complete the project but could at a later date then, at that later date, the project should be reevaluated from the top of the flowchart.

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Decision Tree for Computer Software (cont'd.)



**Footnotes:**

1. If your agency doesn't currently have the intention, ability and necessary level of effort to complete the project but could at a later date then, at that later date, the project should be reevaluated from the top of the flowchart.

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## Appendix C-Computer Software Form





## Computer Software Form

*This form should be used to provide a description of the planned Computer Software project and to document your agency's methodology for capturing the capitalizable costs.*

Business unit:

Name of project:

Total estimated project costs:

Is this project the development of a new system or a modification of an existing system?

Description of project:

Provide the applicable chartfield information that will be used (business unit, account, dept. id., project, user code, etc.):

Will the Edison project module be used to track the project costs?

If the Edison project module is not used, how will the project costs be tracked?

Estimated date (mm/yyyy) this project will begin development:

Estimated date (mm/yyyy) this project will become operational (Go Live Date):

Is this a multi-year project?

Is this project federally funded?

Will the project be implemented in modules?

Contact person/email:

Please complete form and return to the Division of Accounts

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**Appendix D–Copyrights, Patents, or Trademarks Form**



## Copyrights, Patents, or Trademarks Form

*This form should be used to provide a description of the Copyright, Patent or Trademark and to document your agency's methodology for capturing the capitalizable costs.*

Business unit:

Description of the copyright, patent or trademark:

Provide the applicable chartfield information that will be used (business unit, account, deptid. project, user code, etc.):

Estimated date this project will begin (mm/yyyy):

Estimated project costs:

Estimated date (mm/yyyy) of completion of the project:

Estimated useful life of copyright, patent or trademark  
(in years):

Is the copyright, patent or trademark federally funded? Yes      No

Does the copyright, patent or trademark have a matching requirement? Yes      No

Was the copyright, patent or trademark donated? Yes      No

Contact person/email:

Please complete form and return to the Division of Accounts

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**Appendix E-Donated Capital Assets Reporting Form**

## Donated Capital Assets Reporting

*Complete this form when an individual or organization is donating a capital equipment asset, artifact, works of art, intangible or other similar asset to your department. Donations of land, buildings, land or building improvements or improvements other than buildings should be reported on a Real Property Capitalization form.*

Receiving Department name:

GL business unit:

Fund:                      DeptID                      Is asset held for resale?    Yes    No

Date asset was received (mm/yyyy):

Asset description:                      Name of donor:

Estimated acquisition value:

Additional ancillary costs:

Describe method for appraising acquisition value:

Manufacturer:                      Location  
(Equipment Only):

Serial number:                      Model:

Details of donor-imposed restrictions accepted by the department if applicable:

Contact person/email:

Please complete form and return to the Division of Accounts

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**Appendix F-Real Property Capitalization Form**

## Real Property Capitalization

*This form should be used to provide capitalization information when acquiring, modifying or disposing of any real property such as land, buildings, land or building improvements or improvements other than buildings.*

<u>Business Unit*</u> :	<u>Update to* (check one):</u>
	Land
<u>Type of report* (check one):</u>	Land improvements
Add	Buildings
Change	Building improvements
Delete	Improvements other than buildings
<u>Description of property* :</u>	

Location of property\* (include physical address):

Deptid\*:

Name of county\*:

Total cost of report  
item\*\*:

Conveyance date\*:

Number of  
acres:

STREAM Transaction ID (if applicable):

---

---

COMPLETE THIS SECTION FOR DELETIONS

Disposition method (Sale, Donation, etc.)\*:

Sale price:

Conveyed to:

---

---

Contact person/email\*:

Please complete form and return to the Division of Accounts

\* *Required fields*

\*\**For donated items use acquisition value in this field and attach support that explains how acquisition value was determined.*

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**Appendix G- Interdepartmental Capital Asset Ownership Transfer Form**



**State Of Tennessee**  
**Interdepartmental Capital Asset Ownership Transfer**  
**(Both Agencies' Signatures Are Required for Form Completion)**

*Transferor Agency*

Business Unit Name \_\_\_\_\_

Business Unit Number \_\_\_\_\_

\_\_\_\_\_  
 Printed Name of Asset Custodian

\_\_\_\_\_  
 Signature/Date

Ownership of the capital asset(s) listed below has been transferred out of my department. All state and federal requirements applicable to this transfer have been followed and necessary general ledger accounting entries have been recorded, if applicable (e.g., billings, IUs). Note, in the case of most general equipment transfers no accounting entries are required to be processed. (TCA 12-2-420)

\_\_\_\_\_  
 Printed Name of Chief Fiscal Officer

\_\_\_\_\_  
 Signature/Date

Edison Asset ID	Asset Value	Asset Description

(attach additional listing if necessary)

*Transferee Agency*

Business Unit Name \_\_\_\_\_

Business Unit Number \_\_\_\_\_

The transfer of the capital asset(s) to my department should be recorded with the following information.

Fund \_\_\_\_\_

Department ID \_\_\_\_\_

Location Chartfield \_\_\_\_\_

Program \_\_\_\_\_

\_\_\_\_\_  
 Printed Name of Asset Custodian

\_\_\_\_\_  
 Signature/Date

Ownership of the capital asset(s) listed above has been transferred into my department. All state and federal requirements applicable to this transfer have been followed and necessary general ledger accounting entries have been recorded, if applicable (e.g., billings, IUs). Note, in the case of most general equipment transfers no accounting entries are required to be processed. (TCA 12-2-420)

\_\_\_\_\_  
 Printed Name of Chief Fiscal Officer

\_\_\_\_\_  
 Signature/Date

Electronically Send Completed Form To: Department of Finance and Administration, Division of Accounts, Asset Management Section  
 Email Address: (AGAssetManagement@tn.gov)

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**Appendix H- Retirement Request Form**



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