



Item No. 11e

AGENDA ITEM MEMORADUM

Finance

Tony Bryan, Finance Director

Department

Department Director

COMMISSION MEETING DATE (*) - 7:00 PM	Deadline to Town Clerk
<input checked="" type="checkbox"/> Oct 11, 2011	Sept 30 th
<input type="checkbox"/> Oct 25, 2011	Oct 14 th
<input type="checkbox"/> Nov 8, 2011	Oct 28 th
<input type="checkbox"/> Nov 29, 2011	Nov 10 th
<input type="checkbox"/> Dec 13, 2011	Dec 2 nd

*Subject to Change

- Presentation Reports Consent Ordinance
 Resolution Quasi-Judicial Old Business New Business

FY2011 DESIGNATED HIGH PRIORITY ITEM - PRIORITY TOPIC

SUBJECT TITLE: Capitalization Threshold for Capital Purchases

EXPLANATION:

Items used in operations (e.g., equipment, machinery, vehicles) may provide benefits over a period of several years. In order to match the expense with the benefit received these items are capitalized (i.e., the expense is recognized over the item's useful life). An appropriate capitalization threshold should attempt to balance control and efficiency. By having the capitalization threshold set too low, the Finance staff spends an inordinate amount of time tracking and depreciating low cost items.

During the Town's FY 2010 audit, the Town's auditors, Grau and Associates, recommended that the capitalization threshold be increased from \$500 to a minimum of \$2,000. Their recommendation was implemented and the current Purchasing Manual, which was adopted by the Town Commission on June 28, 2011, set the capitalization threshold at \$2,000.

In response to a question that was raised at the October 6, 2011 Audit Committee meeting about the Town's accounting practices, staff indicated to the committee that the current capitalization threshold of \$2,000 may still too low and cited a Government Finance Officers Association (GFOA) best-practice that states "In no case should a government establish a capitalization threshold of less than \$5,000 for any individual item."

The Audit Committee agreed with staff's position and voted to recommend that the Town Commission increase the Town's capitalization threshold to \$5,000 consistent the GFOA best practices.

EXPECTED OUTCOME:

Town Commission will give direction to place an amendment to the Town's Purchasing Manual on a future agenda to increase the capitalization threshold from \$2,000 to \$5,000.

EXHIBITS:

GFOA Best Practice: Establishing Appropriate Capitalization Thresholds for Capital Assets
DRAFT Minutes of the Oct. 6, 2011 meeting of the Audit Committee of the Town of Lauderdale-by-the-Sea

Reviewed by Town Attorney
 Yes No

Town Manager Initials CB



BEST PRACTICE

Establishing Appropriate Capitalization Thresholds for Capital Assets (1997, 2001, and 2006) **(CAAFR)**

Background. The term *capital assets* is used to describe assets that are used in operations and that have initial lives extending beyond a single reporting period. Capital assets may be either intangible (e.g., easements, water (rights) or tangible (e.g., land, buildings, building improvements, vehicles, machinery, equipment and infrastructure). It is incumbent upon public-sector managers to maintain adequate control over all of a government's resources, including capital assets, to minimize the risk of loss or misuse.

As a practical application of the materiality principle, not all tangible capital-type items with useful lives extending beyond a single reporting period are required to be reported in a government's statement of position. Items with extremely short useful lives (e.g., less than 2 years) or of small monetary value are properly reported as an "expense" or "expenditure" in the period in which they are acquired.

When outlays for capital-type items are, in fact, reported on the statement of position, they are said to be *capitalized*. The monetary criterion used to determine whether a given capital asset should be reported on the balance sheet is known as the *capitalization threshold*. A government may establish a single capitalization threshold for all of its capital assets, or it may establish different capitalization thresholds for different classes of capital assets.

Capitalization is, of its nature, primarily a financial reporting issue. That is, a government's principal concern in establishing specific capitalization thresholds ought to be the anticipated information needs of the users of the government's external financial reports. While it is essential to maintain control over all potentially capitalizable items, there exist much more efficient means than capitalization for accomplishing this objective in the case of a government's smaller tangible capital-type items.¹ Furthermore, practice has demonstrated that capital asset management systems that attempt to incorporate data on numerous smaller items are often costly and difficult to maintain and operate.

Recommendation. The Government Finance Officers Association (GFOA) recommends that state and local governments consider the following guidelines in establishing capitalization thresholds:

- Potentially capitalizable items should only be capitalized only if they have an estimated useful life of at least two years following the date of acquisition;
- Capitalization thresholds are best applied to individual items rather than to groups of similar items (e.g., desks and tables), unless the effect of doing so would be to eliminate a significant portion of total capital assets (e.g., books of a library district);
- In no case should a government establish a capitalization threshold of less than \$5,000 for any individual item;

¹ See GFOA's best practice on "Ensuring Control over Noncapitalized Items" (2006).

- In establishing capitalization thresholds, governments that are recipients of federal awards should be aware of federal requirements that prevent the use of capitalization thresholds in excess of certain specified maximum amounts (i.e., currently \$5,000) for purposes of federal reimbursement; and
- Governments should exercise control over potentially capitalizable items that fall under the operative capitalization threshold.²

Approved by the GFOA's Executive Board, February 24, 2006.

² See GFOA's best practice on "Ensuring Control over Noncapitalized Items" (2006).

TOWN OF LAUDERDALE-BY-THE-SEA

AUDIT COMMITTEE MEETING RESOLUTION OF PRIOR YEAR FINDINGS

JARVIS HALL

4505 Ocean Drive

Thursday, October 6, 2011

11:00 A.M.

1. CALL TO ORDER

Ben Freeny called the meeting to order at 11:15 a.m. Also present were Committee member - John Oughton, Finance Director - Tony Ryan, and Accountant - Edner Saint-Jean.

2. RESOLUTION OF PRIOR YEAR FINDINGS

a) ACCOUNTING

b) NOT MAINTAINING FIXED ASSET SCHEDULES

c) INCORRECT PAYOUT TO TERMINATED EMPLOYEE

d) PAYROLL CONTROLS

Finance Director, Tony Ryan gave a brief overview of 2010 audit findings and discussed the steps that have been taken by staff to address each finding, including:

- Reconciling cash accounts monthly
- Not backdating checks
- Recording liabilities and expenditures in the proper reporting periods,
- Researching discrepancies between fixed asset account balances recorded in the general ledger and the CAFR, and booking the appropriate correcting entries.
- Maintaining fixed asset schedules monthly, and
- Reviewing employee timesheets prior to processing payroll.

The Finance Director provided summaries showing how the adjusted general ledger balances as of September 30, 2009 and September 30, 2010 compared to the 2010 CAFR to show that the discrepancies had been resolved.

In addition to the work that was done by staff to address the issue that was identified in the CAFR related to fixed-assets, staff also prepared a high-level comparison of the total fund balances in the general ledger to the CAFR. That reconciliation showed the following:

Audit Committee Meeting
October 6, 2011

- The General Fund Balance as per the general ledger was approximately \$37,000 less than what is reported in the CAFR. Given that the issues pertaining to fixed-assets had been addressed, staff surmised that the discrepancy was related to another financial statement line item.
- A difference of \$120,000 between the general ledger and the CAFR which appears to be related to the Town's liability associated for compensated absences (e.g., vacation and sick-leave).

Both of these differences were identified the evening prior and as of the time of the meeting staff was unable to research and / or address either of these discrepancies.

Mr. Oughton requested that staff consider the possibility of fraud when researching the discrepancies. The Finance Director said that he will look into it and provide an answer.

Mr. Oughton inquired regarding whether there is a pre-payment penalty associated with the outstanding loan to SunTrust. Mr. Bryan indicated that there is a pre-payment penalty and that staff recently negotiated an agreement with SunTrust that allows the Town to pre-pay up to 25% of the outstanding balance of the loan each calendar year without penalty. Mr. Freeny made a motion that the Audit Committee make a recommendation to the Town Commission to have staff issue an RFP for the Town's bookkeeping services. The motion passed 2-0.

Mr. Oughton inquired about exactly what the \$389,500 of net revenues on page 32 of the CAFR. Mr. Bryan indicated that he would research it and return with a response.

Mr. Freeny inquired about Mr. Bryan's thoughts regarding the Town's Accounting Software? Mr. Bryan indicated that he recently identified a "bug" in the system whereby the system generates false "over budget" alerts. Mr. Bryan indicated that the "bug" is being addressed by the software manufacturer and otherwise the system was sufficient.

Mr. Freeny inquired as to whether there were any other concerns related to the accounting process and Mr. Bryan indicated that that the Town's capitalization threshold for capital outlay (i.e., furniture, machinery, and equipment) is currently \$2,000 whereas the Government Finance Officers Association (GFOA) recommends \$5,000. Mr. Freeny made a motion to request that the Town Commission increase the Town's capitalization threshold for capital outlay to \$5,000 consistent the GFOA best practices. The motion passed 2-0.

Audit Committee Meeting
October 6, 2011

3. ADJOURNMENT

With no further business before the Audit Committee, the meeting was adjourned at 12:30 p.m.

DRAFT