HARDIN COUNTY GENERAL HOSPITAL
HOSPITAL-WIDE POLICY

Title: Capitalization Policy Regarding Fixed Assets	**Effective Date: 8/1/2003**
Policy Number: HW104	**Med Staff:**
Regulation:	**Admin:**

I. POLICY

The resources used by Hardin County General Hospital to provide patient services can be classified as (a) staff, (b) supplies and (c) fixed assets. Utilization of these resources incurs expenses and generates revenue to conduct fiscal operations of the hospital. Since our accounting system requires reporting of the hospital's operations in terms of operating expenses and revenue, rather than just recording of cash outlays and receipts, costs associated with the utilization of these resources are identified and appropriately reported. Costs related to using hospital staff and supplies are identifiable and reportable in terms of wage and salary expenses and supply costs (accounts payable). The operating costs associated with the use of fixed assets are the depreciation expenses. Appropriate procedures are designed to account for them so that accurate financial statements can be prepared.

A. FIXED ASSETS

Fixed assets of this hospital have the following characteristics:

They are acquired and used by the hospital in providing function related to the primary goal of providing patient services.

They are tangible and reported with appropriate dollar value.

They are relatively permanent in nature, in the sense that their use is not expected to be limited only to the accounting period when they are acquired.

They are not intended to be sold in the market to derive cash until and unless their usefulness to the hospital is not judged to be satisfactory.

Unlike other hospital assets such as cash and accounts receivable, which are constantly changing in value, fixed assets values remain relatively constant during an accounting period.

Land, buildings and equipment, major and minor, fixed or moveable, which are owned by the hospital, whose service is judged to be derived for more than an accounting period, are considered as fixed assets. We may acquire the use of these assets in many different ways: by purchasing, leasing of a specific period of time, renting, as a donation, etc. Sometimes fixed assets may be loaned to the hospital for a short duration of time to cover specific services.

B. DEPRECIATION EXPENSES

Expenses associated with all activities conducted that are related to providing services during an accounting period shall be identified and reported as operating expenses. These are not necessarily the same as the outgoing cash during the same accounting period since cash outlays do not always coincide with the performance of the activities associated with such cash outlays.

Since fixed assets are relatively permanent in nature and their use is derived for more than one accounting period, depreciation expenses related to their use must be identified during each accounting period.

Reimbursement of the depreciation expenses may be accumulated over the useful life of the asset and used toward its eventual replacement.

II. DEFINITIONS

NA

III. RESPONSIBILITY

All Staff

IV. EQUIPMENT

NA

V. PROCEDURES

INFECTION CONTROL: N/A

DEPRECIATION ACCOUNTING PROCEDURE

In order to properly account for all depreciation expenses, the following steps shall be followed:

1. Identify the fixed asset items that should be depreciated.
2. Determine all costs associated with the process of acquiring the asset and placing it in use.
3. Estimate the useful life and the salvage value at the end of the useful life.
4. The uniform straight-line depreciation method is used in this hospital.
5. Proper records to account for acquisition and depreciation of the fixed assets shall be maintained.
6. Re-evaluate the procedure of the depreciation accounting whenever a need arises to represent the appropriate accounts more accurately.
7. Make appropriate adjustments if needed in the recorded depreciation expenses when the asset is disposed of or replaced.

Each of these steps is described in more detail as follows:

1. Identifying Depreciable Items

All capital expenditures except the purchase of land are considered depreciable. These expenses are related to fixed assets which will provide useful services over more than one accounting period. Fixed assets acquired by leasing or renting or on loan, whose title of ownership does not belong to the hospital and for whose services the hospital makes periodic payments, are not considered depreciable. Periodic payments for their services are considered as direct expenses attributable to the accounting period during which they occur.

Any fixed asset acquired at a cost less than $5,000.00 will not be considered as a capital expense, even though the fixed asset acquired, itself, may be useful for more than one accounting period.

Fixed assets for depreciation purposes are buildings and equipment. Land is not considered as a depreciable asset because its estimated useful life is not limited, it does not deteriorate and hence there is no need to allocate costs of land to the different accounting periods over which it is used. The following disbursements may be considered as depreciable:

- Buying of any new fixed asset.
- Addition or subtraction from the present fixed asset to the extent that it affects either the value of the asset, or its useful life or both.
- Renovation of the asset that will increase the useful life of the asset.

Disbursements made for the restoration of an asset to its proper productive capacity after damage, accident or prolonged use, without increase in the previously estimated service life, is not considered depreciable expenses. Examples of such disbursement might be x-ray tubes, motor mechanisms for large pieces of equipment, interior painting of a hospital wing, etc. These are considered part of the operating expenses during the accounting period.

2. Determining Cost of Fixed Assets

In order to determine the depreciation expenses, all costs of acquiring fixed assets shall be identified. This total cost then represents the cost incurred to receive all services from the asset over its useful life with the hospital. The following cost elements shall be included in the depreciable cost of the asset:

a. Initial Cost

   For an asset purchased on the market, this cost is the price paid by the hospital to the seller.

   When an asset is donated to the hospital, this initial cost is the value of the asset at the time it is donated.

   If the donor had not acquired title of the asset through an arm's length transaction, of if the asset were owned by the donor for a long period before donating to the hospital, this initial cost of the asset would have to be estimated as the fair market value on the open market or based on the independent appraisals of one or several qualified personnel.

b. Cost of transportation and delivery

   Cost of transportation and delivery, if not included in the initial cost, is a one-time cost involved at the time of the asset's acquisition and will be included in determining the total depreciable cost.

This cost component may be applicable to newly purchased items or when the hospital must incur such costs on a donated asset.

c. Taxes

Sales and other governmental taxes that may be accrued on the asset and must be paid by the hospital at the time of purchase of the asset are considered in the cost of acquisition.

d. Installation and preparation costs

Any installation and preparation costs will also be included in determining the total value of the asset. Such costs are necessary to make the asset ready to be of continuous service for its useful life. These costs are one-time costs required at the time of acquiring the asset and making ready for functioning.

e. Other costs

Any other one-time costs incurred at the time of asset acquisition shall be included in its total value. These may include fees paid to surveyors, architects, engineers, construction contractors, legal fees, temporary storage and delay costs, and cost of interest paid on any borrowed money relating to the acquisition of the asset.

In case of newly acquired used assets, all costs incurred in getting the asset ready for use again, such repairs, new parts, reconditioning, shall also be included.

When all such one-time costs are added for an asset, the total depreciable cost of the asset is obtained. It represents the cost of acquiring the asset and making it ready to provide service over its useful life.

3. Estimating Useful Life and Salvage Value

The useful life of an asset for depreciation accounting purposes is an estimate of the time period, made at the time of acquisitions of the asset, over which the asset is expected to provide service to the hospital.

Salvage value is the fair market value of the asset that can be obtained when it is disposed of. Estimate of the salvage value should be consistent with estimate of the useful life.

It is necessary to make such estimates of the useful life and salvage value so that the total value of the asset, as determined in the previous step, can be adjusted by the salvage value and appropriately allocated over all accounting periods during the estimated useful life. This determines the costs related to the services derived from the asset during each accounting period. Estimate of useful life can be obtained in several ways:

- From past historical data about the useful lives of similar assets, average useful life expectancy of the asset can be derived.
- Based on studies considering the various costs associated with acquisition, functioning and replacing of the asset, an economic life of the asset may be estimated. This represents the time period after which it will be more economical to replace the asset than

to continue with its operations. Such economic lives may be considered as useful lives in certain instances where assets are of the repetitive replacement type.

- Since depreciation is a reimbursable expense, the government has published guidelines for many assets regarding their useful life expectancies.
- When an asset is being used for the first time, such as a new machine introduced in the market, the hospital may rely on the estimate of the manufacturer about its useful life.
- Many times comparative data from other similar institutions will also provide guidelines in estimating the useful lives.

Final decisions regarding the actual useful life to be used for particular depreciation accounting shall be made by the Administrator and/or Director of Fiscal Services based on the expected use of the asset in the hospital.

<u>Uniform depreciation method</u>

The uniform depreciation cost is calculated by dividing the depreciable cost (total asset cost-salvage value) by the estimated useful life of the asset. The same cost is used every accounting period for the purpose of reporting the depreciation cost of this asset.

4. Maintaining Proper Records

Depreciation expense, as a reimbursable expense, will be:

- Identifiable and recorded in the hospital's accounting records
- Based on the total cost of the asset for which the process of acquisition and justification of cost should be identified
- Prorated over the estimated useful life of the asset, which is properly substantiated in the hospital's records

The mechanisms by which the records are collected and kept by the hospital are identified as follows:

<u>Fixed asset records for Hardin County General Hospital</u>

Pertinent information regarding each fixed asset when acquired by the hospital shall be recorded on the hospital's "Asset Record" on computer. During the time when the asset is in use, additional information shall be entered on this record. The record becomes closed when the asset is disposed of when no longer in use.

The following items are recorded on all fixed assets in the hospital:

1. Identification information regarding the asset, such as name, source of acquisition, specifications and description.
2. Date when the asset was acquired and put into use. The date from which the asset was put into use may be different from the date of acquisition.
3. Total cost of the asset. A breakdown of this cost into the initial cost, transportation cost, etc.
4. Location(s) of the asset in the hospital.
5. Estimated useful life of the asset and an explanation of how this was derived.

6. Estimated salvage value at the end of the useful life and an explanation of how this was derived.
7. Annual depreciation rate and method of depreciation.
8. Cost of depreciation during each accounting period of operation.
9. Accumulated depreciation over all the accounting periods over which the asset has been in use since its original acquisition.
10. The "book value" of the asset at the end of each accounting period. This is calculated by subtracting the accumulated depreciation from the total cost of the asset.
11. Any improvements to the asset that either increased the value of the asset or its useful life or both.
12. Any changes made in the depreciation rate as a result either of improvements or a selection of a different depreciation method.
13. When the asset is disposed of or replaced, date of such act, explanation and any related costs.
14. References to other related general ledger accounts and files where substantial or detailed information can be located.

Contents of such records shall be checked against other records as well as with the physical existence and location of the asset periodically to make sure that the records show the true picture at any given time. An annual report is prepared from such records giving a detailed listing of all fixed assets owned by the hospital, their location and values.

Supporting documents

Documents supporting the recorded data such as invoices, canceled checks, receipts, packing slips, appraiser's report, work order on improvements, etc., shall be kept.

General Ledger Accounts

In addition to the above records, general ledger accounts shall be kept to record the operational transactions that occur with respect to the various assets during their useful lives. General ledger fixed-asset accounts shall include the following:

Land and land improvements
Building (Structures)
Fixed equipment
Movable equipment

The depreciation expense itself shall be recorded with a debit to the "depreciation expense" account.

5. Re-evaluating Depreciation Expenses

Depreciation expenses recorded based on the estimated salvage value and useful life and the depreciation method selected may need to be adjusted during the useful life of the asset.

In such cases, proper adjustments in the depreciation expenses recorded so far and the book value of the asset will be made. Such adjustments are related to the undepreciated balance and the remainder of the useful life from the date of such changes. Undepreciated balance is adjusted by the revised salvage value, and it is depreciated using one of the depreciation methods over the remainder of the useful life. If the estimate of the useful life is also revised, then this remainder of the useful life is also recalculated.

6. Disposing of Fixed Assets

In many situations a fixed asset may be removed from active use, but it is still held for probably future use or for use in cases of emergency need. Even though there are no services available from this asset and hence no equivalent costs, depreciation expenses shall still be recorded.

When an asset is kept in possession, whether with or without active use for emergency need purposes, after its estimated useful life is over, the book value of the asset will be equivalent to the salvage value. This could then be depreciated over the estimated period of years for which this asset may be kept.

When an asset is removed due to a casualty loss, or if it is sold, scrapped or traded in, the gain or loss on the disposition must be computed and recorded. The following general procedure may be applied.

a. Determine the actual salvage value.
b. Subtract it from the total cost of the asset incurred at the time of its acquisition.
c. This difference should be considered as the total cost of depreciation that should have been recorded during all the accounting periods over which the asset was kept.
d. Determine the actual accumulated depreciation recorded for this asset over these years.
e. Subtract the accumulated depreciation (found in [d]) from the actual depreciation that should have been taken (calculated in [c]).

If this is positive, this much additional depreciation is allowed to the hospital. If it is negative, more depreciation cost was allowed to the hospital than entitled.

The following example illustrates this procedure:

Asset: X-ray machine
Purchasing date: January 1992
Cost: $100,000
Estimated useful life = 10 years
Estimated salvage value= $7500
Machine sold on December 31, 1996
Actual salvage value = $45,000
Method of recorded depreciation = straight line
Number of years for which the machine was used = From January 1992 through December 1996 = 5 years
Depreciation that should have bee taken = $100,000 - $45,000 = $55,000
Yearly depreciation recorded = ($100,000 - $7,500) / 10 = $9,250
Accumulated depreciation in 5 years = $9250 x 5 = $46,250
Additional depreciation that should be allowed = $55,000 - $46,250 = $8,750

Such adjustments in the recorded depreciation at the time the asset is disposed of should be properly recorded and should be considered in the reimbursement mechanism.

VI. DOCUMENTATION

Request for Capital Equipment Form