I. REFERENCES

II. GENERAL POLICY

The use of Equipment in a Sales and Service activity can raise questions regarding Equipment Depreciation and Equipment replacement reserves. Whereas a rate structure that includes Depreciation expense based on the original cost of the Equipment may be appropriate for Federal users (depending on whether or not the piece of Equipment was already accounted for in the Facilities & Administrative (F&A) rate), a rate structure that is intended to accumulate funds to replace Equipment based on the expected funding needed at a point in time in the future (i.e., build an Equipment replacement reserve) would not be appropriate. Nevertheless, a Sales and Service activity can establish a dual-rate structure, if needed, to charge Federal users only those costs that are allowed under OMB Circular A-21 and charge non-Federal users for any and all appropriate costs regardless of Federal allowableness. Such a dual-rate structure results in two rates for a product or service; that is, a rate for Federal users and a rate for non-Federal users, where non-Federal users can be both internal or external users.

III. DEFINITIONS

For purposes of this Policy, the following definitions shall apply:

**Acquisition Cost** means the cash price of obtaining Equipment (less any discounts taken), accessories needed to make Equipment usable, installation (excluding costs for reassembling Equipment dismantled for shipment), freight (provided the amount was included in the invoice or where charges represent a significant cost factor in the acquisition of the Equipment, even if the charges are billed separately), taxes (sales, excise, use, duty), and insurance costs to cover Equipment while in transit. For Equipment that is donated to the University, the fair market value of the Equipment at the time of the donation becomes the “Acquisition Cost” for purposes of calculating Depreciation.

**Capitalization (or Capitalized)** means the treatment of an Equipment expenditure as an asset.
**Depreciation** means the allocation of the Acquisition Cost of inventorial Equipment over the Useful Life of the Equipment.

**Equipment** means an article of nonexpendable, tangible personal property having a Useful Life of more than one year and an Acquisition Cost which equals or exceeds the current Capitalization Threshold.

**Replacement Cost** means the expected cost of obtaining Equipment at some point in the future.

**Special Purpose Equipment** means Equipment used only for research, medical, scientific, or other technical activities. Examples include microscopes, x-ray machines, surgical instruments, and spectrometers.

**Threshold for Capitalization (or Capitalization Threshold)** means the lowest dollar value of Equipment which should be Capitalized. The current Threshold for Capitalization is $5,000.

**Useful Life** means the number of years that Equipment is expected to be in service, as established by the UC Office of the President (UCOP), and for use in the Depreciation calculation.

**Working Capital Loan** means internal financing provided from campus resources for capital needs. The loan is repaid by factoring depreciation into the activity’s rate structure.

### IV. GUIDELINES & EXAMPLES

**A. Funding Equipment Purchases**

1. In a dual-rate environment, the allocated costs stemming from either Depreciation (in the case where Federal users are to be charged) or the allocation of Equipment Replacement Costs (in the case where non-Federal users are to be charged) can be built into the Sales and Service Activity’s annual budget and rates. OMB Circular A-21 allows for Special Purpose Equipment to be charged directly (that is, expensed) but this requires the approval of the Federal activity to be charged.

2. Equipment purchases may be funded by a Working Capital Loan from the Chancellor to be repaid via inclusion of Equipment Depreciation in the activity’s rates. [Note: Working Capital Loans are available only to those activities that can demonstrate a stable financial and business future.] Working Capital Loans are to be requested via an e-mail to the Policy Committee on Sales and Service Activities and Service Enterprises (POSSSE) Chair, accompanied by a fund application/revision that includes Depreciation in its rate structure.

3. Equipment that was purchased originally from Federal funds and then assigned to the activity cannot be depreciated and included in the activity’s rates charged to Federal users as that would constitute charging Federal users twice for the same piece of Equipment.

4. To ensure that Equipment is Capitalized if it meets the Threshold for Capitalization, use object codes 9110 – 9116. Depreciation expense should then be included in the budget and rates although it will not actually be recorded in the financial system. The net result is that the annual Depreciation will accumulate in the fund balance and, by the end of the Equipment’s Useful Life, will have accumulated funds equivalent to the original Acquisition Cost which can then be used towards the purchase of a replacement piece of Equipment. Due to inflation, the accumulated funds may not be sufficient to purchase replacement Equipment and additional funding will be needed.

Following are examples of how Equipment is purchased and accounted for under different scenarios:

1. *Fund surplus IS sufficient to cover the Acquisition Cost as well as the replacement of any existing Equipment for which Equipment Depreciation is contributing to the fund balance AND the fund surplus IS NOT attributable to Federal Contract & Grants*
Obtain approval from POSSSE to purchase Equipment on the sales fund; use object codes 9110 - 9116 to record the purchase so the Equipment is Capitalized and then include Depreciation in the rate structure on an ongoing basis.

2. **Fund surplus IS sufficient to cover the Acquisition Cost AND the fund surplus is at least partially attributable to Federal Contracts & Grants**
   
   Only the non-Federal excess can be used. Contact POSSSE Staff for guidance.

3. **Fund surplus IS NOT sufficient to cover Acquisition Cost as well as the replacement of any Equipment Depreciation contributing to the fund balance AND the fund surplus IS NOT attributable to Federal Contract & Grants**
   
   **Option A:** Equipment was initially purchased using a Federal fund source but then is transferred to the sales fund.
   Depreciation cannot be included in the rate structure.

   **Option B:** Purchase Equipment using a non-Federal fund source and transfer the Equipment and associated costs to the sales fund.
   Depreciation can be included in the rate structure upon approval by POSSSE.

   **Option C:** Purchase Equipment on the sales fund by requesting a Working Capital Loan from the POSSSE Chair.
   Depreciation must be included in the rate structure, upon approval of the POSSSE Chair, to repay the Working Capital Loan.

Following are the same purchase/Depreciation scenarios shown in tabular form:

<table>
<thead>
<tr>
<th>Example#</th>
<th>Sales &amp; Svc Surplus Sufficient?</th>
<th>Is any part of Surplus due to Federal C&amp;G?</th>
<th>Source of Purchase?*</th>
<th>Depreciate?</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Yes</td>
<td>No</td>
<td>Sales &amp; Svc Fund</td>
<td>Yes</td>
</tr>
<tr>
<td>2</td>
<td>Yes</td>
<td>Yes</td>
<td>Contact Staff</td>
<td>TBD</td>
</tr>
<tr>
<td>3A</td>
<td>No</td>
<td>No</td>
<td>Federal (initially)</td>
<td>No</td>
</tr>
<tr>
<td>3B</td>
<td>No</td>
<td>No</td>
<td>Non-Federal</td>
<td>Yes</td>
</tr>
<tr>
<td>3C</td>
<td>No</td>
<td>No</td>
<td>Sales &amp; Svc Working Capital Loan</td>
<td>Yes</td>
</tr>
</tbody>
</table>

* Purchasing Equipment using the Sales and Service fund surplus requires the approval of the POSSSE Chair.

**B. Equipment Depreciation**

Equipment Depreciation must begin to be charged in the fiscal year that the Equipment is acquired. The appropriate Depreciation schedule(s) corresponding to the UCOP Useful Life/Lives indices must be submitted along with the fund application (see APB website [www.apb.ucla.edu/ss.html](http://www.apb.ucla.edu/ss.html)). Once a unit has decided to depreciate Equipment, it cannot then decide to exclude Depreciation expense, at a later point in time, in an effort to reduce its rates. Also, for existing Equipment, if the Equipment was not depreciated previously and was included in the F&A rate calculation, it cannot be depreciated subsequently.

The fund surplus attributed to accumulated Depreciation is not to be used to cover operating deficits since it must be available when the time comes to replace the Equipment that has been depreciated.
Following are Equipment Depreciation vs. Expensing scenarios:

1. *Equipment is neither owned by the University nor used in the activity*
   The Equipment is neither expensed nor Capitalized and cannot be depreciated.

2. *Equipment is owned by the University, used in the activity, and classified as Special Purpose Equipment*
   The Equipment may be expensed, provided that items with an Acquisition Cost of $5,000 or more have the prior approval of the Federal agency to be charged. Alternatively, the Equipment may be depreciated.

3. *Equipment is owned by the University, used in the activity, not classified as Special Purpose Equipment, and the Acquisition Cost is less than the Capitalization Threshold*
   The Equipment is expensed in the month it is acquired.

4. *Equipment is owned by the University, used in the activity, not classified as Special Purpose Equipment, and the Acquisition Cost is greater than or equal to the Capitalization Threshold*
   The Equipment is Capitalized, depreciated, and not expensed.

5. *Equipment is on loan to the University but used in the activity*
   The Equipment is not to be expensed and cannot be depreciated.

### C. Equipment Replacement Reserves

A charge that creates an Equipment replacement reserve, beyond prescribed Depreciation, is not an allowable cost to Federal contracts and grants. Consequently, while Equipment replacement reserves may be created to provide for the future Replacement Cost of Equipment (which usually exceeds the original Replacement Cost), a dual-rate structure will be required to accommodate Federal requirements and ensure that such costs are not charged to Federal users.

Following are examples of the need and solution for Equipment replacement reserves:

1. **Accumulating funds for future purchase of Equipment**
   *The unit has an ongoing Sales and Service activity but does not currently have a means to pay for a $2,000 refrigerated centrifuge, having a 5-year Useful Life, that it would like to purchase for the benefit of its Sales and Service activity. The activity currently charges $10 per analysis. The annual Federal user volume is 7,500 analyses and the annual non-Federal user volume is 2,500 analyses.*

   **Solution:** The unit obtains approval from the POSSSE Chair to include the cost of building an Equipment replacement reserve in its rate structure over the next five years. The unit adds annual expense of $400 [($2,000 / 5 years)] to the activity’s budget to build the reserve but the resulting rate cannot be charged to Federal users. At the end of the 5-year period, the unit will have accumulated the funds to purchase the Equipment. The unit can then buy the Equipment and depreciate it to accumulate funds for the future replacement.

   Federal rate = $10; Non-Federal Rate = $10.16 (where $400 / 2,500 analyses = $0.16 add’l)

2. **Accumulating additional funds, beyond accumulated Depreciation, for future purchase of Equipment**
   *The unit owns a $4,000 refrigerated centrifuge already and is depreciating it over a 5-year period. With two more years left in the Useful Life, the unit knows that it will cost $5,000 to replace the centrifuge with a state-of-the-art centrifuge (that is, the unit will not just be replacing the Equipment but, instead, will be upgrading it). The activity currently charges $20 per analysis. The annual Federal user volume is 750 analyses and the annual non-Federal user volume is 250 analyses.*
Solution: The unit obtains approval from the POSSSE Chair to include the difference between the original Acquisition Cost and the expected Replacement Cost ($1,000) in its rate structure for the number of years remaining in the Useful Life. Consequently, the unit will add annual expense of $500 [($1,000 / 2 years)] to the activity’s budget to build the reserve but the resulting rate cannot be charged to Federal users. At the end of the 5-year period, the unit will have accumulated the funds to purchase the Equipment. The unit can then buy the Equipment and depreciate it to accumulate funds for the future replacement.

Federal rate = $20; Non-Federal Rate = $22 (where $500 / 250 analyses = $2.00 add’l)

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Questions concerning this policy or procedure should be referred to the Responsible Department listed at the top of this document.