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| Volume No. 1—Policies and Procedures | TOPIC NO | 30325 |
| Function No. 30000—Capital Asset Accounting | TOPIC | Software and Other Intangible Assets |
| Section No. 30300—Asset Classification | DATE | May 2009 |

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Overview

Introduction

The purpose of this CAPP topic is to establish the policies by which agencies and institutions identify and report intangible assets as defined under GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, (GASB No. 51). Note: The use of the word “agency” or “agencies” throughout the remainder of this CAPP topic includes both agencies and institutions of higher education.

GASB No. 51 establishes a “specific-conditions” approach to recognizing intangible assets. Although GASB No. 51 is not applicable until July 1, 2009, agencies should review this CAPP topic and become familiar with the requirements. Internal policies and procedures should be revised, as necessary, to ensure that the appropriate information is captured in FAACS (or the agency’s internal capital asset accounting system, if applicable) and reported in the Comprehensive Annual Financial Report (CAFR) for fiscal year 2010.

This CAPP topic supersedes all prior capitalization limit exceptions and exemptions previously authorized by the Department of Accounts related to software or other intangible assets. The thresholds and other criteria described herein apply only to intangible assets and not to other types of capital assets.

Policy

General

Intangible assets are defined as assets having *all* of the following characteristics:

- a. **Lack of physical substance.** Intangible assets are assets that do not have a physical existence. However, an intangible asset may be contained within an asset having a physical presence, such as, computer software contained on compact discs, hard-drives or tape media. Intangible assets may also be associated with other assets having a physical existence, such as, land in the case of a right-of-way easement or mineral rights.

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Policy, Continued

General (continued)

- b. **Non-financial in nature.** Intangible assets are non-financial in nature, and are not in a monetary form similar to cash or investment securities. Further, they are neither claims or right to assets in monetary form similar to receivables nor prepayments for goods or services.
- c. **Useful lives or benefit periods exceeding one or more years.** Intangible assets as described in this CAPP topic are considered to have a useful life that is greater than one year. Intangible assets having a useful life of one year or less are not subject to the provisions of this CAPP topic.

Intangible assets consist of three, broadly-defined types as described below:

1. **Intangible assets generally defined as “software.”** Software intangible assets include computer “programming” or “coding language” that provide the necessary instructions for the computer hardware to perform a desired task or series of tasks. Software intangible assets include purchased “off the shelf” software, including all necessary modifications, software specifically developed by an outside contractor, and software developed internally by agency personnel, or acquired through any combination of the above. Software intangible assets are expected to be found at nearly every agency in the Commonwealth.
2. **Intangible assets associated with real property.** These include “land use rights” such as easements, right-of-ways, water rights, timber rights and mineral rights that provide specific benefits related to the real property upon which the right applies. “Land use rights” may be defined generally as rights that provide the right to control the use of the real property (right of way) or provide other benefits derived from the real property (mineral rights, etc.)

If an agency **actually owns the associated land** and the recorded land valuation already includes the “land use rights,” the intangible asset’s portion associated with the land **should not be reported separately** as it is already included in the land valuation. This type of intangible asset would likely be found at agencies that have significant land or roadway infrastructure assets.

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Policy, Continued

General (continued)

3. **Intangible assets that are not software or “land use rights.”** Other types of intangible assets are those intangible assets that are not specifically identified as being of the types shown in #1 or #2 previously. These other types of intangible assets are generally created through the development of intellectual property and include patents, copyrights, and trademarks. These types of intangible assets are most frequently found at agencies where there is ongoing research and development being performed, such as institutions of higher education.

Intangible assets can be purchased, including acquisition, through an installment purchase contract, acquired through a licensing agreement, acquired through non-exchange transactions such as a donation, or internally generated. Examples of intangible assets include computer software, right of ways, easements, water rights, timber rights, mineral rights, patents, copyrights and trademarks.

The “specific-conditions” approach provides agencies with the criteria for recognizing intangible assets and improves financial reporting by reducing accounting and financial reporting inconsistencies between reporting entities. The establishment of this new authoritative guidance addresses issues specific to the unique characteristics to intangible assets.

Exceptions

The provisions of GASB No. 51 apply to all intangible assets meeting the above **except** for the following:

1. Intangible assets that are acquired or created primarily for the purpose of directly obtaining income or profit.
 2. Intangible assets resulting from capital lease transactions that are reported as leases.
 3. Goodwill created through the combination of government and another non-governmental entity.
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Procedures

Classification All intangible assets subject to the provisions of GASB No. 51 meeting the materiality thresholds shown in the *Materiality for Retroactive Reporting of Intangible Assets* in this CAPP topic should be classified as capital assets and recorded in FAACS or the agency’s internal capital asset accounting system (using the agency’s internally developed materiality threshold). This includes all intangible assets whether purchased, donated or internally developed. Additional reporting conditions for internally-generated, intangible assets, including software are outlined in the following sections of this topic.

Retroactive reporting of intangible assets considered to have **indefinite useful** lives as of **June 15, 2009**, is not required. **Therefore, intangible assets with indefinite useful lives will only be retroactively reported if the asset had been previously amortized (depreciated).**

Intangible assets with indefinite useful lives acquired on or after July 1, 2009, will not be amortized. If an agency has an intangible asset with an indefinite useful life, please contact DOA to discuss the reporting requirements to appropriately record the intangible asset in FAACS.

An intangible asset is considered to have an indefinite useful live if there are no legal, contractual, regulatory, technological, or other factors that limit the useful life of the asset. A permanent right-of-way easement is an example of an intangible asset that has an indefinite useful life.

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Procedures, Continued

Internally Generated Intangible Assets

Intangible assets are considered internally generated if they are created or produced by the agency or an entity contracted by the agency, or if they are acquired from a third party but require more than minimal incremental effort on the part of the agency to begin to achieve their expected level of service capacity.

Outlays incurred in the development of an internally generated intangible asset that are identifiable should be capitalized only upon the occurrence of all of the following:

- a. Determination of the specific objective of the project and the nature of the service capacity that is expected to be provided by the intangible asset upon the completion of the project.
- b. Demonstration of the technical or technological feasibility for completing the project so that the intangible asset will provide its expected service capacity.
- c. Demonstration of the current intention, ability, and presence of effort to complete or, in the case of a multiyear project, continue development of the intangible asset.

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

Internally Generated Computer Software

Computer software should be considered internally generated if it is developed in-house by agency personnel or by a third-party contractor on behalf of the agency.

During the development stage, evaluate the expenditures to determine whether capitalization appears appropriate. Record the applicable capitalizable expenditures as Construction in Progress. To ensure appropriate financial control of Construction in Progress, project numbers should be assigned to identify related expenditures.

Commercially available software purchased or licensed by an agency that requires modification using “more than incremental effort” before being put into operation should be considered internally generated for purposes of GASB No. 51. For example, licensed financial accounting software that the agency modifies to provide special reporting capabilities would be considered internally generated.

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Procedures, Continued

**Internally
Generated
Computer
Software**
(continued)

The activities involved in developing and installing internally generated computer software can be grouped into the following stages:

Preliminary Project Stage— Costs incurred during this stage are not capitalized. These costs include the following activities:

- a. Conceptual formulation of alternatives
- b. Evaluation of alternatives
- c. Determination of existence of needed technology
- d. Final selection of alternatives

Application Development Stage—Costs incurred during this stage involve both internal and external costs incurred to develop the software and are capitalized.

These costs include the following activities:

- a. Design of chosen path, including software configuration & software interfaces
- b. Coding
- c. Installation to hardware
- d. Testing, including the parallel processing phase
- e. Data conversion— only to the extent that the data is necessary to make the computer software operational.

Post-Implementation/Operation Stage—Costs incurred during this stage are not capitalized.

These costs include the following:

- a. Training
- b. Application maintenance
- c. Data conversion— data, such as historical, not necessary to make the software operational, but desirable from a management perspective.

For internally-generated computer software, the criteria for internally generated intangible assets should be considered to be met only when both the following occur:

- a. The activities noted in the Preliminary Project Stage are completed.
- b. Management implicitly authorizes and commits to funding, at least currently in the case of a multiyear project, the software development project.

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Internally Generated Computer Software (continued)

Once the criteria for internally generated software intangible assets have been met, outlays related to activities in the Application Development Stage should be capitalized. Capitalization of such outlays should cease no later than the point at which the computer software is substantially complete and operational. Outlays associated with activities in the Post-Implementation Stage should be expensed as incurred.

Internally Generated Modification of Computer Software

Outlays associated with an internally generated modification of software that is already in operation should be capitalized when all internally generated software intangible assets criteria have been met if the modification results in any of the following:

- a. An increase in the functionality of the computer software, that is, the computer software is able to perform tasks that it was previously incapable of performing.
- b. An increase in the efficiency of the computer software, that is, an increase in the level of service provided by the computer software without the ability to perform additional tasks.
- c. An extension of the estimated useful life of the software.

If the modification does not result in any of the above outcomes, the modification should be considered maintenance, and the associated outlays should be expensed as incurred.

Examples

Software or licenses purchased and placed it into operation without modification requiring “more than minimal incremental effort” should be considered an intangible asset. This type of computer software is not considered to be internally generated, and therefore, the entire purchase price of the software is capitalized as there should not be any outlays incurred by the agency for the Application Development Stage for this type of intangible asset. Generally, commercially available software that is not considered internally generated will meet the description of an intangible asset.

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Examples (continued)

An agency purchases commercially available computer software through a five-year license agreement. Under the agreement terms, the agency is required to make annual payments to the software vendor for the right to use the software over the life of the agreement. Under these circumstances, this qualifies as an intangible asset. However, since the asset life is one year and the payment term is one year, the intangible asset is self-amortizing and does not require recordation in FAACS (or the agency’s internal capital asset accounting system, if applicable) or inclusion in the CAFR or agency financial statements.

An agency purchases commercially available computer software through a five-year license agreement. Under the agreement terms, the agency is required to make a lump sum payment at the beginning of the agreement. Under these circumstances, this qualifies as an intangible asset, and the total amount to be paid must be capitalized and amortized over the five-year period.

Agencies may have **maintenance contracts with the software vendor** where the agency pays an annual fixed fee that covers all required maintenance and any minor unspecified upgrades issued during the year by the vendor such as those required to fix newly identified software “bugs.” Outlays for normal routine software maintenance should not be capitalized and should be expensed as incurred.

Significant upgrades to the software, such as an upgrade to a newer version of the software should be capitalized if the external modifications result in an increase in the functionality or efficiency of the software or the estimated useful life.

Agencies should determine if the website(s) meet the description of internally generated computer software. The outlays associated with website(s) development should be capitalized based on the Application Development Stage expenditures for the website(s).

Agencies may develop **software that has multiple modules**, including financial reporting, procurement and human resources. These modules may be developed on individual timelines and will likely become operational at different points. Generally, each module has its own development cycle as it relates to the Application Development Stage and Post-Implementation Stage, and therefore, the guidance for internally generated software should be applied to each module of the system rather than the system as a whole.

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Procedures, Continued

Examples (continued)

Agencies may enter into a **licensing agreement for computer software** that will be considered internally generated. The payments made to the vendor are for multiple components, including use of software, development of modifications for agency operation, training users of the software routine system maintenance, and rights to future upgrades and modifications. The outlays associated with each part of the agreement should be allocated among each of the individual elements and the guidance for internally generated software should be applied.

If an agency owns property that contains “land use rights,” water rights, timber rights and mineral rights, typically these are comprised as a **“bundle of rights”** that is included within the ownership rights to the tangible asset. The individual rights included in the “bundle of rights” are separable and intangible in nature; however, collectively they represent the ownership of the tangible asset. Therefore, the value of the individual rights in a “bundle of rights” included within the property ownership should remain aggregated and reported as a tangible capital asset such as land.

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Tests for Intangible Assets

1. Does the agency have assets that meet the above intangible asset criteria?
 2. If the agency does NOT have any assets that meet the intangible asset criteria, the agency must communicate in writing to DOA that there are no intangible assets that are required to be reported.
 3. Does the agency have intangible assets that have an indefinite useful life?
 4. Determine if any intangible asset with an indefinite useful life has been (amortized) depreciated.
 5. If the intangible asset that has an indefinite useful life has been depreciated, it must be restated. Contact DOA if the agency has any intangible assets with indefinite useful lives that need to be restated. DOA will provide additional guidance on how to record an intangible asset having an indefinite useful life that has previously been depreciated in FAACS.
 6. If the agency has other intangible assets, the agency should apply remaining tests to determine proper reporting of these intangible assets.
 7. Does the agency have any intangible assets that have not been documented in FAACS or on the agency's financial statement template submitted to DOA?
 8. Do these assets equal or exceed the materiality thresholds for the asset based on the fiscal year of acquisition (see *Materiality for Retroactive Reporting of Intangible Assets* in this CAPP topic for the statewide thresholds or the agency's internal threshold)?
 9. If YES, the agency should ensure that the assets are properly recorded in FAACS or on the agency's financial statement template submitted to DOA.
 10. Does the agency have assets that meet the internally generated computer software criteria?
 11. Do these assets equal or exceed the materiality thresholds for the asset based on the fiscal year of acquisition (see *Materiality for Retroactive Reporting of Intangible Assets* in this CAPP topic for the statewide thresholds or the agency's internal threshold)?
 12. If YES, the agency should ensure that the assets are properly recorded in FAACS or other financial statement directive attachment.
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Retroactive Reporting of Intangible Assets

GASB No. 51 requires retroactive reporting for intangible assets acquired in fiscal years beginning on July 1, 1980, and later whenever the following conditions have been met.

1. The intangible asset is in use as of July 1, 2009, and will continue to be used for some future period(s) of time. **Intangible assets that are not in use as of July 1, 2009, will not be retroactively reported.**
2. The agency has never reported the intangible asset identified in #1 as a capital asset in any prior period.
3. Internally generated intangible assets (software) should be reported based upon the actual costs incurred during the Application Developmental Stage of the software development project. See *Internally Generated Software* in this CAPP topic for additional guidance.
4. An intangible asset identified as having an **indefinite useful life**, but that has been previously amortized (depreciated as having a finite useful life), must be retroactively reported as of **July 1, 2009**. Accumulated amortization (depreciation) related to these assets reported prior to the **July 1, 2009**, should **be restated** to reflect the fact that these assets should not have been amortized (depreciated). Contact DOA if the agency has any intangible assets having an indefinite useful life where depreciation has been previously reported.

Computer software should not be considered to have an indefinite useful life. Specifically, the actual useful life of the software may be unknown, however, it is known that that the software will become obsolete and need to be replaced at some future point (**therefore, the useful life is limited or finite**).

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Materiality for Retroactive Reporting of Intangible Assets

For reporting in the CAFR, DOA will use information from FAACS as one source to identify the required restatements that can be appropriately measured beginning in FY 2010. As such, the following materiality thresholds will be used for FAACS and CAFR statewide reporting. For CAFR reporting, the retroactive threshold will be consistent with the threshold currently used to identify asset impairment requiring disclosure.

Please note that individual agencies that prepare financial statements are responsible for identifying an appropriate scope for those individual statements, and it is likely the statewide scopes are inappropriate for individual agency reporting.

| <u>Fiscal Years (date placed in service)</u> | <u>Acquisition Cost</u> |
|--|-------------------------|
| 1981— 2008 (for retroactive reporting) | \$ 1,000,000 |
| 2009 — Forward | \$ 100,000 |

If the actual historical cost of the intangible assets cannot be determined due to the lack of sufficient records, agencies should report the estimated historical cost for these intangible assets that were acquired in fiscal years beginning on July 1, 1980, or later.

Estimating Historical Cost

DOA provides the following **informational** guidance to assist agencies in “estimating” the historical cost of intangible assets that require retroactive reporting. The guidance presented here should not be considered the only available methodologies for estimating historical costs. Documentation should be maintained to support any estimated historical cost and the methodology used to determine the estimated historical cost.

1. Determine when the intangible asset was originally purchased or internally developed and placed into production. Discussion with agency personnel or the existing vendor will usually be the best source for this type of information. If it is not possible to determine the exact month that the intangible asset was placed in service, use January 1st of the year that the intangible asset was placed in service as the “estimated” acquisition date. The original acquisition date or date that the intangible assets was first placed into production is important for determining the amount of amortization (depreciation) that is necessary to retroactively report the intangible asset.
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Procedures, Continued

Estimating Historical Cost (continued)

2. Review source documentation such as original purchase contracts, licensing agreements, etc., to determine if a purchase amount can be identified. Possible sources for this type of information include agency records, court records, patent office records, etc., or other documentation that may be available from the vendor or might be found in the public domain using an internet search for the vendor and the agency name and/or the Commonwealth of Virginia. If an estimate of the original cost can be determined using this methodology, record the asset in FAACS or the agency's capital asset system using the acquisition date identified in #1 above. Retain any source documentation to support the valuation amount recorded for the intangible asset.
3. If the vendor or agency personnel cannot provide information related to the original purchase price that might be determined in #2 above, inquire as to the cost of new software that closely performs the same or similar functions as the older software being used. Apply a "reverse consumer price index" using the yearly average consumer price index posted on the DOA website at: http://www.doa.virginia.gov/Financial_Reporting/FAACS/FAACS-CPI2.xls to determine the estimated acquisition cost based upon the year of acquisition identified in #1 above. An example of using the "reverse consumer price index" methodology is as follows:

Suppose that in 2008 it is determined that the cost of new software would be \$3,000,000, and that the software was actually placed in service in 1991. Using the consumer price index (CPI) table shown at the link above, the average CPI for 2008 was 645.0 and the average CPI for 1991 was 408.0. The estimated historical cost of this software would be calculated as follows:

$$\mathbf{\$3,000,000 \times 408.0/645.0 \text{ (rounded to 4 decimal places)} = \mathbf{\$1,897,800}}$$

4. If the software has been internally developed, ask the agency's Information Systems and Programming Management to provide an estimate of the number of programming hours associated with the Application Developmental Stage that would be required for a similar development or enhancement project using current agency personnel. Multiply the estimated number of development hours by an average hourly wage for agency programming personnel. Apply the "reverse consumer price index" methodology shown in #3 to determine the "estimated historical cost."

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Estimating Historical Cost (continued)

If the estimated historical cost or development cost as determined in #'s 2, 3, or 4 above is below the reporting thresholds shown in *Materiality for Retroactive Reporting of Intangible Assets* in this CAPP topic, the agency is not required to retroactively report the intangible asset in FAACS or the CAFR.

However, agencies preparing individual agency financial statements must consider the internal materiality threshold to determine whether restatement is needed for the individual financial statements.

Intangible assets that are required to be retroactively reported should be assigned useful lives that are sufficient to allow for depreciation to be calculated from the original date of acquisition through the anticipated period of future use for the asset.

Internal Control

General

Each agency and institution should implement cost beneficial internal control procedures to ensure that:

- Capital assets purchased with federal grant funds are recorded appropriately in FAACS.
 - Assets are properly classified for financial reporting purposes.
 - Controls are in place to exclude the depreciation of capitalized assets purchased with Federal grant funds from the indirect cost recovery plan.
 - Assets are properly classified for financial reporting purposes.
 - Recordkeeping procedures exist that account for assets.
 - Assets are safeguarded against damage or theft.
 - A periodic inventory is performed of assets.
 - Assets are recorded in a timely manner.
 - Assets are adequately safeguarded and controlled.
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Records Retention

General

Fiscal records related to managing capital assets should be retained for a period of two years plus current fiscal year, or until audited, whichever is greater. However, for pending, ongoing, or unresolved litigation, audits or claims, retain documentation until completion, resolution, or negotiation of settlements.

Destruction of records must be in accordance with policies and procedures of the Records Management Section, The Library of Virginia.

DOA Contact

Contact

Assistant Director, Financial Reporting

☎ (804) 225-2257

FAX (804) 225-2430

✉ finrept@doa.virginia.gov

Subject Cross References

References

CAPP Topic No. 30105—*Introduction*

CAPP Topic No. 30305—*Capitalized or Controlled Assets*

CAPP Topic No. 30505—*Physical Inventory*

CAPP Topic No. 31105—*Federal Requirements*

CAPP Topic No. 70325—*Data Entry*
