Accounting for Capital Assets

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What We Will Cover

• Source of Information: GFOA Publication by Stephen Gauthier on *Accounting for Capital Assets*, copyright 2000 – overview of content

• FGFOA *Basic Government Resource Manual, Section 5, Capital Assets*

• **GASB Codification, section 1400, Reporting Capital Assets**

• GASB No. 87 on Leases

• Capital Assets Key Controls
1. Capital Assets: Definition, Accounting Function, Types, and Basic Information Requirements
2. Basic Accounting
3. Major Assets Classes
4. Capitalizable Costs
6. Impairments
7. Depreciation
8. Financial Statement Presentation and Disclosure
9. System Design and Policies
10. Inventorying
11. Sample Journal Entries
12. GFOA Recommended Practices
Section 5 - Capital Assets

Source of Information: FGFOA *Basic Government Resource Manual*

- Largest asset of a local government.
- Tangible and intangible assets acquired for use in operations that benefit the local government for more than a single fiscal period.
- Local governments should report only those capital assets that they own.
- Capital leases, although title to the financed asset does not pass to the lessee until the end of the lease term, the lessee does assume the risk of ownership. Therefore, it is reported as Property under Capital Lease.

Examples include:
- Land
- Land improvements
- Construction-in-progress
- Infrastructure/Improvements
- Buildings
- Furniture
- Motor vehicles
- Audio-visual
- Software
Chapter 274, F.S., governs the administration of tangible personal property owned by certain local governments.

Section 274.01, F.S., defines “governmental units” for purposes of the requirements as the governing board, commission, or authority of a county or taxing district of the State or the Sheriff of the county.

Section 274.02, F.S., defines “property” as fixtures and other tangible personal property of a nonconsumable nature and requires the State’s Chief Financial Officer to establish, by rule, the requirements for the recording of property.

Department of Financial Services (DFS) Rule 69I-73, F.A.C., prescribes requirements for recording and inventorying tangible personal property, marking of property items, and disposing of property items.
## Capital Asset Valuation

Capital assets should be reported at their historical cost, which can include:

1. all charges to place the asset in its intended location (for example, freight);
2. all charges to place the asset in its intended condition for use (for example, installation or site preparation); and,
3. subsequent additions or improvements that enhance a capital asset’s functionality or extend its expected useful life.

Expenditures for repairs are generally not included in historical cost.

If historical cost information is not available, estimated historical cost may be used.

Donated capital assets should be reported at their fair value on the date the donation is made.

Typical donated capital assets include land, buildings, furniture, fixtures, and equipment.
Capital Asset Capitalization and Accountability

Any asset that benefits more than one fiscal period potentially could be classified as a capital asset.

As a practical matter, not all items that meet the definition of a capital asset should be capitalized for reporting purposes.

Local government officials should establish a dollar value or capitalization threshold that capital assets must exceed if they are to be capitalized.
Capital Asset Capitalization and Accountability

Other considerations, as recommended by the Government Finance Officers Association (GFOA), include:

• Items capitalized should have an estimated useful life of at least two years from the date of acquisition;
• Capitalization thresholds are best applied to individual items rather than to groups of similar items unless the effect of doing so would be to eliminate a significant portion of total capital assets (e.g., books of a library district);
• Capitalization thresholds should not be set at less than $5,000 for any individual item; and,
• 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 (currently $5,000) for purposes of Federal reimbursement.
Capital Asset Capitalization and Accountability

When capital assets are not capitalized, governments should still ensure that adequate control and accountability is maintained, especially in certain circumstances, such as:

- For those local governments subject to Ch. 274, F.S., and DFS Rules, tangible personal property with a value or cost of $1,000 or more and a projected useful life of one year is required to be recorded for inventory purposes.
- Assets that pose a risk to public safety and could be the source of potential liability.
- Assets that must be accounted for pursuant to a legal or contractual provision.
- Assets that are easily transportable and readily marketable or easily diverted to personal use.
Capital Asset Capitalization and Accountability

Many governments use a perpetual inventory system to maintain effective control over capital assets. Such a system is constantly updated for additions and deletions of the capital assets inventory. Periodic verification is still required to ensure adequate control and accuracy of the government’s inventory.

GFOA recommends that governments inventory its tangible capital assets, at least on a test basis, no less than every five years. For those local governments subject to Ch. 274, F.S., and DFS Rules, an inventory is required for property with a cost or value of $1,000 annually or whenever there is a change in custody.
Capital Asset Maintenance and Replacement

Local governments should establish a system for assessing the condition of capital assets and develop a plan and budget for capital asset maintenance and replacement.

Assessing the condition of capital assets can be done in conjunction with the inventory process.

GFOA issued best practice recommendations for this process in its *Capital Asset Assessment, Maintenance and Replacement Policy*. 

Depreciation

- The systematic and rational allocation of the cost of a capital asset over its estimated useful life.
- Land and construction-in-progress are typically not depreciated.
- Local government officials need to establish the useful life and depreciation method for each class of capital asset.
  - Straight-line depreciation is the most common method.
  - The composite depreciation method is applied to a certain type of capital asset rather than to an individual capital asset.
Depreciation

• Past experience should be used to determine the estimated useful life of an asset. When the government has no past experience to rely upon, the experiences of other governments can be useful. However, when depending on others’ experiences, the government should take into consideration:
  – differences in quality of materials that comprise the asset
  – differences in the extent of use or the intended uses of the asset
  – environmental differences between assets held by others and those acquired by the government

• Once established, estimated useful lives should be periodically compared to actual experiences to make adjustments as necessary.
Capital Asset Reporting

- Governmental Accounting Standards Board, Statement 34, requires capital assets to be reported on the government-wide Statement of Net Position and in the Notes to Financial Statements. Each local government must make four distinctions:

  - Capital assets related to governmental activities that must be reported separately from those related to business-type activities.
  - Different major classes of capital assets.
  - Capital assets that are not being depreciated.
  - Accumulated depreciation.
Capital Asset Reporting

• In addition, the following must also be reported:
  – The historical cost of capital assets (or their fair value at the time of donation)
  – Accumulated depreciation
  – Additions during the period
  – Deletions during the period

• The format of the disclosure must demonstrate the change between the beginning and ending book values.
References


- Chapter 274 Tangible Personal Property Owned by Local Governments, Florida Statutes – Statutes regarding tangible personal property for certain local governments – [http://www.leg.state.fl.us/Statutes/index.cfm?Mode=View%20Statutes&Submenu=1&Tab=statutes](http://www.leg.state.fl.us/Statutes/index.cfm?Mode=View%20Statutes&Submenu=1&Tab=statutes)


References

• GFOA Best Practices and Advisories:
  
  
  – *Ensuring Control over Noncapitalized Items* – [http://www.gfoa.org/search/node/%E2%80%A2%09Ensuring%20Control%20over%20Noncapitalized%20Items](http://www.gfoa.org/search/node/%E2%80%A2%09Ensuring%20Control%20over%20Noncapitalized%20Items)
  
  
References

• *Role of the Finance Director in Capital Asset Management* - [http://www.gfoa.org/role-finance-director-capital-asset-management](http://www.gfoa.org/role-finance-director-capital-asset-management)


GASB Codification

• Section 1400, Reporting Capital Assets
A clear distinction should be made between general capital assets and capital assets of proprietary and fiduciary funds. Capital assets of proprietary should be reported in both the government-wide and fund financial statements.
Capital assets of fiduciary funds (and similar component units) should be reported only in the statement of fiduciary net position. All other capital assets of the governmental unit are general capital assets. They should not be reported as assets in governmental funds but should be reported in the governmental activities column in the government-wide statement of net position.
Valuation of Capital Assets

Capital assets should be reported at historical cost. The cost of a capital asset should include ancillary charges necessary to place the asset into its intended location and condition for use. Donated capital assets should be reported at their acquisition value at the time of acquisition plus ancillary charges.
Depreciation of Capital Assets

Capital assets should be depreciated over their estimated useful lives unless they are inexhaustible, are intangible assets with indefinite useful lives, or are infrastructure assets using the modified approach as set forth in this section. Inexhaustible assets should as land and land improvements should not be depreciated.
Selected Questions from GASB
Codification, section 1400
What are land improvements?
.702-3

What is an inexhaustible capital asset?
.702-5

Does this section prescribe a minimum level for the capitalization of assets?
Should a government’s capitalization policy be applied only to individual assets or can it be applied to a group of assets acquired together?

Consider a government that has established a capitalization threshold of $5,000 for equipment.

If the government purchases 100 computers costing $1,500 each, should the computers be capitalized?
.702-15

If a road is being depreciated, how should the cost of a project to remove and replace or to resurface the road be reported?
How detailed should records of infrastructure assets be?
.702-20

Are land improvements depreciable?
How is estimated useful life calculated?
.703-2

What is the modified approach for reporting infrastructure assets?
May one agency or department of a government select the modified approach and another select depreciation accounting?
A road reported using the modified approach undergoes a major reconstruction. As with most reconstruction efforts, the project consists of preserving the existing road as well as making additions and improvements. Should the cost of the project be expensed or capitalized?
What constitutes a change in capacity or efficiency?
An asset management system should include an up-to-date inventory. Would that require each road sign, light pole, and traffic signal to be tagged and inventoried annually?
What is a *complete* condition assessment? Does that refer to an assessment of all components of the network of subsystem?
A sanitary district adopted the modified approach and completed an initial inspection cycle over a seven-year period for its sewers. Based on the results, cost considerations, and expected lives, the next cycle was split into two schedules. Sewers in “very good” condition will be inspected on a 10-year cycle and all others on a 3-year cycle (15-20 % of all sewers). Could a 7-year initial assessment satisfy the requirements of an initial assessment under this section?
.703-26

Is the three-year requirement for completing condition assessments absolute, or will other considerations allow for an extension based on the extensive life of some classes of assets?
.703-30

Should an impairment loss be reported for capital assets accounted for using the modified approach that have incurred physical damage?
What are some examples of organizations that hold collections of works of art and historical treasures?
What is meant by “inexhaustible” collections or individual works of art or historical treasures?
What is the difference between a network and a subsystem?
.705-10

Should capital assets be written off when they become fully depreciated?
.705-14

What are composite depreciation methods? Is composite depreciation similar to group depreciation?
.711-2

Should capitalized interest be removed from the cost of capital assets of enterprise funds that are reported as *governmental* activities in the government-wide statements?
A government uses an enterprise fund to account for a specific activity, but is not required to do so, pursuant to the criteria in paragraph .103 of Section Sp20. Does the requirement to capitalize construction period interest apply to capital asset construction in that fund?
Paragraph .102 of this section clarifies that construction-period interest on assets used in governmental activities should not be capitalized. If capital assets that will be used in enterprise funds are financed with general long-term debt, should a portion of the interest on that debt be capitalized as construction-period interest?
.742-1

Do the provisions of paragraphs .181-.197 of this section apply to capital assets accounted for using the modified approach?
How should the impairment of an intangible asset be determined?
Paragraph .193 of this section provides guidance on how the loss from the impairment of a capital asset should be reported. Which capital asset accounts should be adjusted when the loss is reported?
GASB No. 87 Leases

• Issued June 2017
• Effective periods beginning after 12/15/19 which is FYE 9/30/21
• Similar to the FASB lease standard
  1) Right to use asset – substance over form
Defines Lease

• A contract that conveys control of the right to use another entity’s nonfinancial asset (the underlying asset) as specified in the contract for a period of time in an exchange or exchange-like transaction.

• Examples of nonfinancial assets include buildings, land, vehicles and equipment
Different from FASB Leases

• Lease period includes expected extensions or terminations
• A fiscal funding or cancellation clause should affect the lease term only when it is reasonably the clause will be exercised
Types of Leases

- Short Term lease (12 months or less)
- Lease (term more than 12 months)
- Leases transferring ownership of leased asset
Short Term leases and Leases Transferring Ownership

- Payments are inflows/outflows of resources

Lease term more than 12 months

- Lessee = lease liability and leased asset
- Lessor = lease receivable and deferred inflow
- May need to consider leased assets separately when lease covers multiple assets
Capital Asset Key Controls

Ensure that capital asset additions, disposal, and depreciation are fairly stated:

- A control to ensure that the capital asset is not authorized for purchase unless it has gone through an appropriate budget and/or capital improvement process
- A control to ensure that the capital addition was really an addition, as opposed to a repair/maintenance item
Capital Key Controls

• A control to ensure that the assets are retained on hand, and not misappropriated.

• A control to ensure that capital assets replaced, no longer needed, or impaired are disposed of/sold/written down in a responsible manner?
Capital Key Controls

• A control to ensure that depreciable lives and methods are reasonable and periodically reviewed
• A control to ensure that depreciation expense is calculated accurately
Capital Key Controls Questions

1. How do you ensure that capital assets are not authorized for purchase unless the need for the asset has been clearly proven, and the funding is available? (E/O)

**Client responses:**
- Capital expenditures are approved during the budget process by the Commission.
- Purchase orders cannot be encumbered unless the funding is available.
Capital Key Control Questions

2. How do you ensure that capital additions exclude maintenance, relocations, or similar non-capital items, especially for infrastructure (e.g., utility and road improvements)? (A/CL)

Client responses:

• Each invoice is reviewed before the acquisition is capitalized by Dolly. The City has written capital assets policies.

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Capital Key Control Questions

3. How do you physically control for theft, misuse, or misappropriation of capital assets? (E/O, R/O)

Client responses:
- All equipment is issued an adhesive decal with an identifying number. An annual inventory is taken each May, and the results are reviewed, entered in the FA module of FMS and kept by the Accounting and Payroll Supervisor.
Capital Key Control Questions

4. How do you ensure that capital assets replaced or no longer needed, are disposed of/sold in a responsible manner? How do you make sure that infrastructure is removed from the books when replaced or upgraded? How do you ensure that impaired assets are written down? (C)
Client Response to Question 4

Equipment that is replaced or no longer needed must be transferred to the City’s surplus department (dept 027) in the City-wide FA Workflow system. The Asset Manager is responsible for disposal of all equipment.
Capital Key Control Questions

5. How do you assure yourself that all and only capital outlay expenditures are charged to the capital outlay accounts in the appropriate fund? How do you make sure that all capital outlay is capitalized to asset accounts in the proprietary fund types and governmental activities? (E/O, C, A/CL)
Client Response to Question 5

Each purchase order is reviewed by the Accounting Systems Administrator for account accuracy. Capital expenditures are balanced by fund to ensure that everything is capitalized.

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Final Questions