Accounting for Capital Assets

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Accounting for Capital Assets

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Introductory Remarks

- Have watched the progression of statements and opinions about capital assets go from "not a big deal to this is the largest $ number in the AFR and deserves our attention"
- Clerk-Treasurers are busier than ever
- Cities and Towns are big businesses with large budgets, many employees, and a tremendous investment in capital assets

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Introductory Remarks

- Now GAAP Reporting and Depreciation of Capital Assets is expected as is a current Capital Asset Policy
- Today's message is about streamlining your reporting by focusing on the process, exercising Management Decisions that are yours to make, and concentrating on a top-down approach

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Introductory Remarks

- The Management Decisions that significantly impact your potential success include:
  - Setting capitalization threshold level and don't forget on a unit basis and no capitalization of groups of small items
  - Establishing estimated useful lives
  - Choosing a depreciation method and convention
  - … more on all of this later in presentation

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What's the problem?

- … the struggle with capital asset reporting is needless and can be mitigated!
- Need to assess the situation, do some planning, and apply a timely and appropriate response
- The project of accounting for capital assets is achievable or it can be lengthy, confusing, cumbersome and time consuming – and all with a risk of failure

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If you have a dated Capital Asset Policy

- Existing policy is too long and complicated
- Current policy is not clear and difficult to understand
- Document needs definitions and examples
- Capitalization threshold and Recommended Practice and wording … 'no less than' and 'no groups of minor items'

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Try a Top-Down Approach

- Try high level analysis of $ and %
- Abbreviated analysis of account and classification totals
- Per GASB 34 and 'where is the money'?
- … more on this later

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If Minor Items are an Issue Please Note

- This is not an accounting or financial reporting issue – items below your capitalization threshold are expensed in the year acquired
- Items cannot be controlled centrally
- As stated, will only be possible at department level
- May already be done by some departments (IT, Fire, Police) and need only to be formalized

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Need Definitions or Examples of Capital, Expense, Improvement, Repair and Maintenance

- Current policy is a 'vague' document
- Often 'boilerplate' with no real clarity
- Often no definitions – capital or expense, improvement, repair/maintenance
- Often no examples – capital asset or expense, expense, improvement, repair/maintenance

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Conclusion to Introductory Remarks

- Fixed assets are an issue with most governments
- Ref Conferences in 2014 at 400, and 2016 at 450, and 2017 at 500
- Challenge is needless
- Planning is extremely important
- Commitment of Administration and Finance is necessary
- Here's what to do …

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First – Establish a New Capital Asset Policy and Procedures

- Simple, short, and understandable
- Consider raising capitalization threshold (don't forget … on a unit basis and no groups capitalized in aggregate)
- GFOA Recommended Practices on capitalization threshold and on property control of minor but sensitive items are available online
- Establish estimated useful lives
- Choose depreciation method and convention

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Second – High Level Analysis of Existing Property Record

- Organize the data
- Consistency of classifications
- Conduct an analysis of $ and %
- Edit, roll-up, break-out, and check classification and possible re-classification of assets
- Inclusion/exclusion

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Time to be Honest with Ourselves

- Does our current property record have integrity?
- Have we comprehensively captured additions and retirements over the past years?
- Is the process working well and is it economically employed?
- What can wee do to improve our accounting for capital assets?

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Prepare Definitions and Examples of Capital, Expense, Improvement, Repair, Maintenance

- Samples of definitions and examples
  - A - increased capacity and efficiency
  - B - extended useful life (beyond original expectation)
  - C - new asset meeting criteria for capitalization
  - D - improvement

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Conclusion

- New/Improved policy and procedures
- Get departments involved in process
- Where's the money?
- Get ready to make some management decisions
- Set schedule and adhere to it

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Additional Considerations

- May need a facilitator in the process of establishing the capital asset report – to ask the right questions, make decisions, get the necessary information, and put together the accounting elements of estimated date of acquisition, historical cost, useful life, and depreciation calculations
- If your capital asset implementation is not efficient and economic it may fail

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Analysis and Allocation of Asset Account Balances

- This will assist the focus of efforts
- It's all about time and money – your time and its best use and materiality of the amount per classification or account balance amount
- Truly, time well spent

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Municipal Example

Percentage of capital assets by account

• Land/Rights of Way	16%
• General Infrastructure	49%
• Buildings	18%
• Improvements other	8%
• Vehicles	7%
• Equipment	2%
	100%

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Municipal Example

Money by account totals using $100

• Land/Rights of Way	$16
• General Infrastructure	$49
• Buildings	$18
• Improvements other	$8
• Vehicles	$7
• Equipment	$2 (rounded)
	$100

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Management Decisions

- These are your capital assets
- This is your financial reporting
- Your Policy is a series of and statement of 'your management decisions'

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Management Decisions

- Per the Governmental Accounting Standards Board in Statement No. 34 you must disclose in your policy
  - Capitalization threshold
  - Determination of estimated useful lives
  - How depreciation is to be calculated (straight/line method, no salvage, full-year/convention)

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Management Decisions

- Examples of progressive capitalization thresholds that reflect asset accounts or classifications

Land	capitalize all
Improvements to Land	$25,000
Buildings	$100,000
Furnishings/Equipment	$10,000 – $25,000 to $25,000
Vehicles	capitalize all
General Infrastructure	$100,000

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Management Decisions

- Examples of Asset Estimated Useful Lives

Land	non-depreciable
Improvements to Land	20 years
Buildings	50 years
Furnishings/Equipment	5 years
Vehicles	5-15 years
General Infrastructure	50 years
Software	7 years

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Management Decisions

- Capital Asset Depreciation
  - Lifing best based on your experience
  - You can choose no salvage
  - You can choose depreciation method and convention (straight-line is all but universal in governments)
  - Depreciation is simply an allocation of acquisition value / historical cost over time

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Management Decisions

- … here is when and where to make the entire process easy – so go easy on yourself
- Important to think through from a management perspective
- Project and decide what we can do and how to be successful

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Management Decisions

- Establishing a Capital Asset Policy
  - Don't forget that you do need the approval (Ordinance) of your elected officials and administration
  - Easier if you give auditors a 'heads up' as to your plans
  - This is where the whole process of accounting for capital assets can made easier and do-able

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Management Decisions

- Decide what is and what is not a capital asset
  - Create examples of both for future guidance
  - Create a capital / expense checklist for staff (ref. AZ DOT)
  - Avoid making and re-making the same decisions (you don't have the time)

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Deciding What is a Capital Asset –

- New asset that meets all criteria for capitalization
- Increased capacity – adding square footage to an existing building
- Increased capacity – adding new lanes to an existing road
- Increased efficiency – same size etc., but service provided at less cost
- An extended estimated useful life usually involves a significant alteration or structural change and an extension beyond original useful life expectation

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Deciding What is a Capital Asset –

- Specific written examples of each can help (in policy document and procedures documentation)
- Repairs and maintenance usually restore an asset to original service potential and does not necessarily comprise an improvement
- Potential checklist
- An improvement generally extends an asset's estimated useful life beyond the original expectation and involves a significant alteration or structural change

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Deciding What is not a capital asset – general

- What is not a Capital Asset?
  - Expenditures that do not result in increased capacity, efficiency or extension of estimated useful life by improving an asset with a major structural change or alteration
  - Repairs and maintenance
  - Replacing a truck transmission while quite expensive merely restores the truck to good working order and is expensed

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Deciding What is not a capital asset – general

- What is not a Capital Asset?
  - Minor assets that are below the established capitalization threshold on a unit basis are expensed in the current year
  - Common building maintenance including painting, plumbing repairs, HVAC upgrades and the like are expensed in the current year
  - Re-surfacing a road, while costly, does not increase capacity or efficiency and is expensed in the current year
  - A roof replacement does not increase a building's size or capacity and is expensed

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Deciding What is not a Capital Asset – examples:

- Common expense items for buildings:
  - Painting
  - Roof re-surfacing
  - Replace HVAC
  - Re-carpet
  - Plumbing repair and replacement
  - Upgrade electrical service
  - Landscaping

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Deciding What is not a Capital Asset examples:

- Common expense items for streets
  - Re-stripe
  - Replace culvert
  - Replace signage
  - Replace guardrail
  - Re-surface existing road
  - Bridge joint repair
  - Replace streetlight

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Deciding What is not a Capital Asset examples:

- Water system and sewer and storm collection infrastructure expense items
  - Water main break repair
  - Sewer collection collapse
  - Storm collection collapse
  - Reline old pipes

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Deciding What is not a Capital Asset examples:

- Equipment and vehicles
  - Replacing a truck or auto transmission (expensive but still a repair)
  - Rebuilding heavy machinery and equipment
  - Vehicle repair following a collision

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Establishing Historical Cost and Date of Acquisition

- Estimates are absolutely acceptable
  - Per GASB Statement No. 34
  - In general per accounting and financial reporting
  - Acceptable to use normal and standard costing to estimate historical cost
  - Acceptable to use vintages and other comparisons to age assets via estimates

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Establishing Historical Cost and Date of Acquisition

- Per GASB Statement No. 34 estimates are absolutely acceptable
  - … if determining the actual historical cost of … assets is not practical because of inadequate records, governments should report the estimated historical cost for … assets that were acquired or significantly reconstructed, or that received significant improvements, in fiscal years ending after June 30, 1980

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Establishing Historical Cost and Date of Acquisition

- Per GASB Statement No. 34 estimates are absolutely acceptable
  - … a government may estimate the historical cost of assets by calculating a current replacement cost of a similar asset and deflating this cost through use of price-level indexes to the acquisition year (or estimated acquisition year if the actual year is unknown)

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Capital Asset Reporting

- A word about accuracy
  - Good faith effort
  - Unless egregious errors, your property record should be ok and acceptable
  - These are your government's capital assets to submit to your auditors (in light of your responsibility)

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Capital Asset Reporting

- A word about accuracy continued
  - Again your capital assets and your reporting BUT smart to run your decisions in this regard by your auditors – a bit of deference and avoidance of a surprise
  - (we can't forget that your capital asset total is the largest dollar amount in all of your Annual Financial Reporting)

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Capital Asset Reporting – Conclusion

- Nothing Authoritative in the Accounting Literature
  - You have the latitude to make many decisions and, thus, to make the process easier
  - These are the 'management decisions' that are your opportunities and responsibilities to make

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Capital Asset Reporting in Government

The End

Addendum to today's presentation –

Financial Reporting and Depreciation

Financial Reporting and Depreciation

… Generally Accepted Accounting Principles (GAAP)

- Accounting and Financial Reporting which includes depreciation
- Focus on annual depreciation, accumulated depreciation, and net book value amounts

Financial Reporting and Depreciation

… assuming that your Capital Asset Policy streamlines the process of reporting and depreciating capital assets …

- Choose straight-line depreciation
- Take full year's depreciation in year one
- Recognize no salvage value

Depreciation

- Annual Straight-line Depreciation
  - A vehicle with an acquisition value / historical cost of $40,000 and a five year estimated useful life = 20% depreciation rate per year (so) 20% depreciation rate x $40,000 = $8,000 annual depreciation (again, full-year depreciation in year of acquisition and no salvage value)

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Depreciation

- Accumulated Depreciation
  - Total of all annual depreciation from date of asset acquisition to current year end for a specific asset

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Depreciation

- Accumulated Depreciation
  - Assume a three year old $40,000 vehicle with a five year estimated useful life = 20% annual depreciation amount (so) annual depreciation of $8,000 x three years = $24,000 in total accumulated deprecation

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Depreciation

- Net Book Value
  - With a calculation of all annual depreciation to date being $24,000 in annual depreciation reported in the past and in current year, a $40,000 asset has a Net Book Value of $16,000

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Depreciation

- Net Book Value
  - So, an asset's acquisition value / historical cost is equal to accumulated depreciation **plus** net book value

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Depreciation

- Straight-line depreciation means an equal amount of annual depreciation per year of estimated useful life – the 'life' of an asset becomes the divisor in this calculation
- No negative numbers in any calculation
- No salvage value

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Depreciation

- Net Book Value can be $0 as it is ok to have fully depreciated assets
- Basic, uncomplicated, and simple formulas to do the calculations
- Formulas need to 'turn off' annual calculation when accumulated = acquisition value / historical cost and net book value = $0

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Depreciation … one more thing

- The calculation of accumulated depreciation includes all annual depreciation charged and reported in the past plus the current year's annual depreciation amount

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Capital Asset Reporting – Conclusion

- In all of this and if you remember anything from today's presentation …
  - Take a least-cost approach
  - Keep it simple
  - Do implementation in-house and capitalize on professional staff, available information, and extensive resources
  - Consider appointing an internal staff member or hiring external facilitator to drive the process

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Capital Asset Policy for Financial Reporting Purposes in Government

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