

### **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

- 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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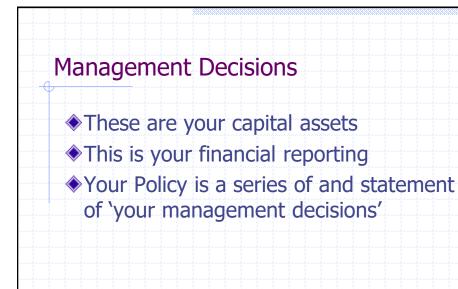
### Analysis and Allocation of Asset Account Balances

- 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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Iunicipal Example  Percentage of capital assets by account		
General Infrastructure	49%	
• Buildings	18%	
Improvements other	8%	
• Vehicles	7%	
• Equipment	2%	
	100%	

Money by account totals using \$100		
General Infrastructure	\$49	
<ul> <li>Buildings</li> </ul>	\$18	
<ul> <li>Improvements other</li> </ul>	\$8	
• Vehicles	\$7	
• Equipment	<u>\$2</u> (rounded)	
	\$100	



# 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, fullyear/convention)

Management Decisions		
<ul> <li>Examples of progressive capitalization thresholds that reflect asset accounts or classifications</li> </ul>		
• 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	

Management Decisions  ◆Examples of Asset Estimated Useful		
◆ 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	

### **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 <u>not</u> 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

# 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

# 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)

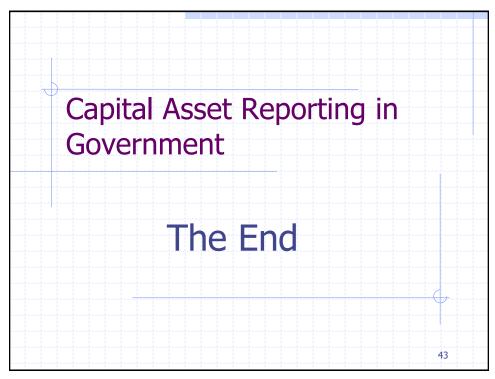
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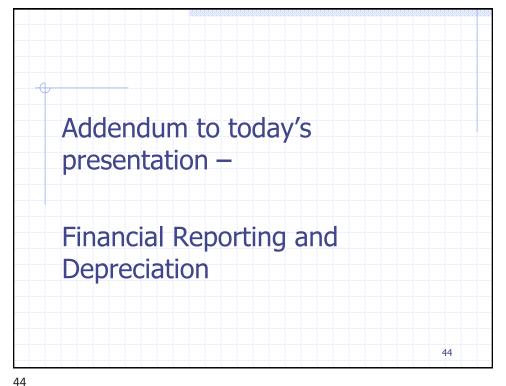
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# Capital Asset Reporting – Conclusion

- 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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# 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

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# 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

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### 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

### 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

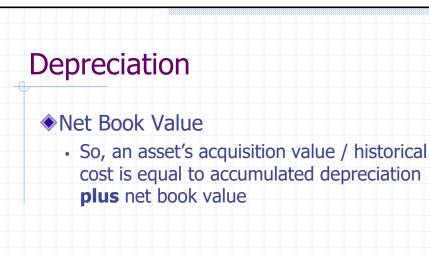
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### Depreciation

- ♦ 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

- 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

# 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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