

# Accounting for Capital Assets – What Doesn't Work and What Works

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# Accounting for Capital Assets – What Doesn't Work and What Works

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## Introduction and History

### ◆ Quote of a Fiscal Officer:

“ ... our fixed assets were a mess and we had a \$100 capitalization threshold. With a little guidance we created a new asset policy and put a plan of action in place – this made a seemingly monstrous task simple, manageable, and attainable.”

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## Summary of Today's Presentation

- ◆ Keep it Simple
- ◆ Take a Least Cost Approach
- ◆ What Doesn't Work
- ◆ What Works
- ◆ Additional Considerations
- ◆ Miscellaneous Items and Conclusion

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## Keep it Simple

- ◆ Staffing the work effort, taking advantage and utilizing existing staff, available information, and resources
- ◆ Decide first what information and assets are included and what assets are excluded
- ◆ Determining what 'is' and what 'is not' a capital asset

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## Keep it Simple

- ◆ Determine inclusions and exclusions with reference to **all** historical infrastructure assets or just from 1980 forward
- ◆ Option of just newly constructed infrastructure **prospectively** for smaller towns under a \$10M annual budget
- ◆ Decide minor and major infrastructure and possible exclusion of subsystems under **5%** of total infrastructure or networks under **10%** of total infrastructure

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## Take a Least Cost Approach

- ◆ Focus exclusively on capital asset accounting for financial reporting purposes
- ◆ Establish a capitalization threshold
- ◆ Write a clear and comprehensive capital asset policy and procedures document

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## What Does Not Work

- ◆ Note 1 – 10 points to follow
- ◆ Slides 9 – 19

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## 1. Dated Policy

- ◆ Existing policy is too long and complicated
- ◆ Policy is not clear and difficult to understand
- ◆ Policy may have been 'borrowed' from another government
- ◆ Document needs definitions and examples
- ◆ Capitalization threshold and Recommended Practice and wording ... 'no less than'

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## 2. Dated Property Record

- ◆ Recommended Practice says, "take a look at integrity at least every five years"
- ◆ Database contains unreported retirements
- ◆ Database is missing previously unrecorded assets
- ◆ In need of editing and possible need to re-classify assets

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### 3. Insufficient Departmental Involvement

- ◆ All departments have fixed assets
- ◆ Fixed assets are central and necessary to provide governmental services
- ◆ Policy is not communicated to and understood by the departments
- ◆ Departments are crucial to initial implementation and annual updating

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### 4. Too Much Attention Centrally to Smaller Assets

- ◆ Have not been honest about ability to control minor assets
- ◆ Responsible department does not get to set parameters and inclusions
- ◆ Current mix of 'control' and accounting issues
- ◆ Responsibility has not been delegated to departments
- ◆ Property record should be concise and manageable as a result of higher capitalization threshold

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## 5. No maximization of efforts or Top-Down Approach

- ◆ Have never attempted high level analysis of \$ and %
- ◆ Abbreviated analysis of account and classification totals
- ◆ Per GASB 34 and where is the money?

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## 6. Unreported Retirements

- ◆ ... get them out of the property record!
- ◆ Risk of overstated balances
- ◆ Reflection on management
- ◆ Can reflect on integrity of property record
- ◆ Can lead to confusion

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## 7. No Control of Minor but Sensitive Items at Department Level

- ◆ Items cannot be controlled centrally
- ◆ As stated, will only be possible at department level
- ◆ Refer to Recommended Practice on 'control of minor but sensitive items'
- ◆ May already be being done by some departments (IT, Fire, Police) and need only to be formalized

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## 8. No Definitions or Examples of Capital, Expense, Improvement, Repair, Maintenance

- ◆ Current policy is a 'vague' document
- ◆ Often 'boilerplate' with no real clarity
- ◆ Often no definitions – capital asset, improvement, repair/maintenance
- ◆ Often no examples – capital asset, expense, improvement, repair/maintenance
- ◆ Usually no examples (additions, retirements, partial retirements)

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## 9. Inadequate or Non-existing Information on Construction-in-Progress

- ◆ Often no reporting
- ◆ Many questions regarding capital v. expense
- ◆ Questions on elements of historical cost, asset lifing, date of acquisition
- ◆ Either too much or too little detail

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## 10. No Schedule or Timeline for Reporting Capital Assets at Year End

- ◆ Often wait until end of the year
- ◆ Often think about fixed assets after auditor suggestion
- ◆ No timeline translates to problems
- ◆ Result leads to hurried and uncomprehensive data gathering

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## Conclusion to What does Not Work

- ◆ 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

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## What Works

- ◆ Note 1 – 10 points to follow
- ◆ Slides 21 – 41

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... DON'T LET THE PERFECT GET IN THE  
WAY OF THE GOOD

-YOGI BERRA

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## 1. New Capital Asset Policy and Procedures

- ◆ Simple, short, and understandable
- ◆ Consider raising capitalization threshold
- ◆ Recommended Practices on capitalization threshold and on property control of minor but sensitive items

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## 2. High Level Analysis of Existing Property Record

- ◆ Organization of data
- ◆ Consistency of classifications
- ◆ As stated, analysis of \$ and %
- ◆ Need for editing, roll-up, break-out, and check of classification and possible re-classification of assets
- ◆ Inclusion/exclusion

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## 3. Communication with Departments

- ◆ Finance Department can't do it all
- ◆ Need for additions and retirements annually (and adjustments)
- ◆ Departments that use and maintain an asset have a responsibility to assist any related 'reporting'
- ◆ Need to be clear as to expectations and timing

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## 4. Analysis and Allocation of Asset Account Balances

- ◆ By dollar amount
- ◆ By percentage of total
- ◆ This high level analysis takes minutes
- ◆ This process can assist setting priorities

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## Actual Mid-size Government

### Where's the Money

• Land	\$ 857,652
• Infrastructure/ROW	85,598,074
• Buildings	14,930,643
• Improvements other	107,356
• Equipment/vehicles	6,561,663
• Software	<u>1, 187,095</u>
	\$109,242,483

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## Actual Mid-size Government

### Money by percentage of total

• Land	.008
• Infrastructure/ROW	.784
• Buildings	.137
• Improvements other	.001
• Equipment/vehicles	.060
• Software	<u>.011</u>
	100.00%

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## 5. Establish Control of Minor but Sensitive Items

- ◆ Recommended Practice
- ◆ Departments to decide asset types and class codes to be included for control
- ◆ Not by dollar amount
- ◆ Really a 'control' and stewardship document and not subject to accounting data elements

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## 6. Deal with Unreported Retirements Once and For all

### ◆ Abbreviated case study

- Adds centrally using claims process documentation to update listing to reflect current year
- Updated inventory then sent to each department for indication of retirements
- Process has worked for over 10 years

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## 7. 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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## Deciding What 'Is Not' a Capital Asset

- ◆ No Increased capacity or efficiency
- ◆ No extension of asset's estimated useful life beyond the original expectation
- ◆ Repairs and maintenance
- ◆ Specific written example of each can help
- ◆ Minor assets below unit capitalization threshold

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## Deciding What 'Is Not' a Capital Asset

- ◆ 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

- ◆ 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' 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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## Annual Additions

- ◆ Only assets at or above capitalization threshold (a separate and increased amount for building and general infrastructure improvements)
- ◆ Assets must meet criteria of an improvement
- ◆ Department must understand capital additions v. repairs and maintenance
- ◆ No capitalization of groups of minor assets

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## 8. Policy and Procedures to Address Construction-in-Progress

- ◆ Apply the who, what, where, when, how, and why concept to the process
- ◆ Significance of CIP
- ◆ Good discipline for future capitalization of new asset and retirement of replaced asset
- ◆ Generally applies to buildings and general infrastructure

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## 9. Formal Schedule for Annual Update

- ◆ With a 12-31-19 fiscal year end
  - 10-1-19 – gather information on additions
  - 10-15-19 – separate capital and expense
  - 11-1-19 – update report by department
  - 11-15-19 – send update to departments for retirements
  - 12-1-1 – update list
  - 12-31-19 – prepare financial report

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## 10. Commitment to Annual Updating

- ◆ Administration, Finance, and Departments
- ◆ Additions centrally
- ◆ Retirements with departmental input
- ◆ Control of minor but sensitive done by departments

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## Conclusion to What Works

- ◆ New/Improved policy and procedures
- ◆ Analysis of existing property record
- ◆ Get departments involved in process
- ◆ Where's the money?
- ◆ Control of minor items to departments

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## Conclusion to What Works

- ◆ Get rid of unreported retirements
- ◆ Create definitions and examples for accuracy, clarity, efficiency
- ◆ Report construction-in-progress
- ◆ Adhere to schedule for annual update
- ◆ Administration, Finance, and Departmental commitment to annual update

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## Additional Considerations for Least Cost Approach – Inclusions and Exclusions

- ◆ Per GASB Statement Number 34
  - Option to exclude general infrastructure constructed or acquired before 1980
  - Small city or town option to only report general new infrastructure prospectively
  - Option to exclude certain minor general infrastructure networks and subsystems (5% and 10%)

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## Additional Considerations for Least Cost Approach – Use of Estimates and Logical Assumptions

### ◆ Per GASB Statement Number 34

- OK to use estimates as to historical cost
  - ◆ Current replacement cost deflated
- OK to estimate dates of acquisition or vintage
  - ◆ Weighted or Unweighted averages
- OK to employ logical assumptions
  - ◆ Standard costing and standard aging of assets

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## Additional Considerations for Least Cost Approach

### ◆ Capital asset policy per GASB Statement Number 34

- Establishing a capitalization threshold
- Deciding on estimated useful asset lives
- Choosing depreciation and convention

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## Additional Considerations

- ◆ Need for a facilitator in the process of establishing the capital asset report – ask the right questions, make decisions, get the necessary information, and put together the accounting elements of estimated date of acquisition, estimated historical cost, asset useful life, and depreciation as to annual, accumulated, and net book value amounts
- ◆ If your capital asset implementation is not efficient and economic it may fail

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