Capital Asset Policy for Financial Reporting Purposes in Government

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Sources and Acknowledgments


Second – Governmental Accounting Standards Series, No. 171-A, Statement No. 34 of the Governmental Accounting Standards Board, Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Government

Cities and Towns Manual – continued

**SBOA Accounting and Uniform Compliance Manual for Cities and Towns Disclosure Requirements**

- Capital Assets
  - Every unit must have a capital asset policy that details capitalization threshold
  - Every unit must have a complete listing of all capital assets owned reflecting acquisition value
Capital Assets for Financial Reporting

GASB Statement No. 34 General Disclosure Requirements

- Capital assets should be reported at historical cost. The cost of a capital asset should include all costs that are directly attributable to asset acquisition. Donated capital assets should be reported at their estimated fair value at the time of acquisition plus ancillary charges, if any.

continued

GASB Statement No. 34 General Disclosure Requirements

- ... the term capital assets includes land, improvements to land, easements, buildings, building improvements, vehicles, machinery and equipment, works of art and historical treasures, and all other tangible and intangible assets used in operations and have useful lives beyond a single reporting period.
continued

**GASB Statement No. 34 General Disclosure Requirements**
- ... the term capital assets also includes infrastructure assets such as roads, rights-of-way, bridges, tunnels, drainage systems, water and sewer systems, dams, and lighting systems, (and potentially traffic signals, sidewalks, alleys)

continued

**GASB Statement No. 34 General Disclosure Requirements**
- ... Infrastructure assets are long-lived capital assets that normally are stationary in nature and normally can be preserved for a significantly greater number of years than most capital assets
continued

◆ GASB Statement No. 34 General Disclosure Requirements
  ■ Capital Assets should be depreciated over their estimated useful lives
  ■ Depreciation expense is to be reported and measured by allocating the net cost of depreciable assets over their estimated useful lives in a systematic and rational manner

continued

◆ GASB Statement No. 34 General Disclosure Requirements
  ■ The policy for capitalizing assets and for estimating the useful lives of those assets (used to calculate depreciation expense) is a general disclosure requirement
  ■ Current-period depreciation expense reporting is a required note disclosure
GASB Statement No. 34 General Disclosure Requirements

- Capital assets that are being or have been depreciated should be reported net of accumulated depreciation in the statement of net assets.
- Capital assets should be depreciated over their estimated useful lives.
- Land should not be depreciated.

Information presented about major classes of capital assets:

- Beginning- and end-of-year balances with accumulated depreciation presented separately from historical cost.
- Capital acquisitions.
continued

GASB Statement No. 34 General Disclosure Requirements

- Information presented about major classes of capital assets, continued:
  - Sales or other dispositions
  - Current-period depreciation expense, with disclosure of the amounts charged to each of the functions in the statement of activities

Part II

**First** – Analysis

**Second** – Examples

**Third** – Initial Implementation of Capital Assets - Management Decisions

**Fourth** – Considerations in the Process

**Fifth** – Conclusion
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

Municipal Example

Where’s the Money

- Land/Rights of Way: $28,715,361
- General Infrastructure: $89,091,541
- Buildings: $33,411,514
- Improvements other: $14,146,333
- Vehicles: $11,829,835
- Equipment: $4,383,862

$181,578,446
### Municipal Example

**Money by percentage of total**

- Land/Rights of Way: 0.16
- General Infrastructure: 0.49
- Buildings: 0.18
- Improvements other: 0.08
- Vehicles: 0.07
- Equipment: 0.02 (rounded)

100%

### Municipal Example

**Equipment dollar amount and percentage impact of increasing capitalization threshold (for example) to $25,000**

- Equipment = $4,383,862 represents 2.4% of total capital assets of $181,578,446
- Take note to just where the dollars and %’s regarding capital assets is are located!
Municipal Example

Equipment by dollar amount and percentage impact of increasing capitalization threshold (for example) to $25,000

• Exception #1 to the $25,000 threshold is the capitalization of all land and rights-of-way regardless of size of parcel, location, date acquired, or acquisition value
• Exception #2 to the $25,000 threshold is the capitalization of all licensed vehicles regardless of acquisition value

... let’s think for a moment – slides 19 – 22 ... if considered and implemented can make accounting for capital asset easier and streamline the process of annual updating and reporting of capital assets
Capital Asset Policy

- Capital Asset Accounting MANAGEMENT DECISIONS
  - These are your capital assets
  - This is your financial reporting
  - Your Policy is a series of and statement of ‘your management decisions’

Capital Asset Policy – Initial Implementation

- Management Decisions
- Issues and Considerations
Capital Asset Policy

Capital Asset Accounting MANAGEMENT DECISIONS

- Again, 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)

Examples of progressive capitalization thresholds that reflect asset accounts or classifications

- Land: capitalize all
- Improvements to Land: $25,000
- Buildings: $100,000
- Furnishings/Equipment: $25,000
- Vehicles: capitalize all
- General Infrastructure: $100,000
Capital Asset Policy

Capital Asset Accounting 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

- Lifting best based on your experience
- You can choose no salvage
- You can choose depreciation method and convention
- Reference allocation of acquisition value / historical cost over time
Capital Asset Policy

Capital Asset Accounting 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

Capital Asset Policy – Issues and Considerations

Establishing a Capital Asset Policy

- 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
**Capital Asset Policy – Issues and Considerations**

**What is a Capital Asset**

- A new capital asset that is on a unit basis at or above the established capitalization threshold in cost or acquisition value.
- An improvement that increases capacity, efficiency, or extends the estimated useful life of an asset beyond the original expectation.

**Capital Asset Policy – Issues and Considerations**

**What is a Capital Asset**

- An addition to a building provides additional square footage and increased capacity and the capital outlay is capitalized.
- Newly constructed or totally reconstructed roads are capitalized.
- Widening a road increases capacity and efficiency and is capitalized.
Capital Asset Policy – Issues and Considerations

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

- Minor assets below 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
Capital Asset Policy – Issues and Considerations

Policy document
- Determinations to be made
  - System for initial information and for annually updating data as to additions and retirements and a re-calculation of depreciation as to annual, accumulated, and net book value amounts
  - Excel works just fine and can become the tool for annual updating and reporting

Information exists
- Buildings
- General Infrastructure
- Vehicles
- Information for annually updating the property record
  - Additions centrally
  - Retirements from departments
Establishing historical cost and date of acquisition

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

... 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
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).

In all of this don’t let the perfect get in the way of the good

Don’t forget ... done is better than perfect
Capital Asset Policy – Issues and Considerations

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)

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)
Capital Asset Policy – Conclusion

Reference in all of this to ...

- Take a least-cost approach
- Keep it simple
- Do implementation in-house and capitalize on professional staff, available information, and extensive resources
- Consider an internal staff member or external facilitator to drive the process

Capital Asset Policy – 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
Capital Asset Policy for Financial Reporting Purposes in Government

The End

Addendum to today’s presentation – Financial Reporting in the Future
Financial Reporting in the Future

... 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 in the Future

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

- Choose straight-line depreciation
- Take full year’s depreciation year one
- Recognize no salvage value
**Depreciation**

**Annual Straight-line Depreciation**

- A vehicle with an acquisition value / historical cost of $50,000 and a five year estimated useful life = 20% depreciation rate per year (so) 20% depreciation rate x $50,000 = $10,000 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 $50,000 vehicle with a five year estimated useful life = 20% annual depreciation amount (so) annual depreciation of $10,000 x three years = $30,000 in total accumulated depreciation

Net Book Value

- With a calculation of all annual depreciation to date being $30,000 in annual depreciation reported in the past and in current year, a $50,000 asset has a Net Book Value of $20,000
Depreciation

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

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
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

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
Conclusion to Depreciation Addendum

- Keep it simple
- Excel works quite economically
- Excel works very well for the initial implementation of a capital asset report

Conclusion to Depreciation Addendum

- Worksheets can easily become your tool for annual updating and reporting
- Depreciation formulas are made simple and easy to work with when you choose straight-line depreciation and no salvage value
# Depreciation example

![Depreciation example table](image)

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