

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

Indiana Association of County Auditors
Fall Conference
Belterra Casino Resort
Florence, Indiana
October 24, 2018

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

Michael M. Nielsen

Government Fixed Asset Services, Inc.

Long Beach, Indiana 46360-1712

(219) 221 6147

(773) 298 0289

nielsen@fixedassetservices.com

Introduction and History

- ◆ Accounting and Reporting of Capital Assets for Financial Reporting
- ◆ Largest number in financials
- ◆ GAAP Compliance
- ◆ GASB Statement No. 34
- ◆ Governments have struggled but the challenges are avoidable

Introduction and History

◆ Quote of a County Auditor:

“ ... 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.”

What Does Not Work

- ◆ Cause of age-old challenge
- ◆ Past implementations have not been systematic or well-planned
- ◆ Annual updating not efficient, timely, or comprehensive

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'

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

3. Insufficient Departmental Involvement

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

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

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 and where is the money?

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

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 being done by some departments (IT, Fire, Police) and need only to be formalized

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)

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

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
- ◆ Too late
- ◆ No timeline translates to problems
- ◆ Result leads to hurried and uncomprehensive data gathering

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

What Works

- ◆ High level analysis and planning
- ◆ Start with a new policy and new procedures that spell out the who, what, where, when, how and why of the process
- ◆ Strive for simplicity
- ◆ Be honest about capabilities to implement and to annually update



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

-YOGI BERRA

1. New Capital Asset Policy and Procedures

- ◆ Simple
- ◆ Short
- ◆ Understandable
- ◆ Recommended Practices on capitalization threshold and on property control of minor but sensitive items

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

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

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

Actual Mid-size County

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

Actual Mid-size County

Money by percentage of total

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

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

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

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
- C - new asset meeting criteria for capitalization
- D - improvement

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 in procedures documentation
- ◆ Minor assets below unit capitalization threshold

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

Deciding What 'Is Not' a Capital Asset

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

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

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

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

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

9. Formal Schedule for Annual Update

- ◆ With a 12-31-18 fiscal year end
 - 10-1-18 – gather information on additions
 - 10-15-18 – separate capital and expense
 - 11-1-18 – update report by department
 - 11-15-18 – send update to departments for retirements
 - 12-1-18 – update list
 - 12-31-18 – prepare financial report

10. Commitment to Annual Updating

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

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

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

If You Remember Anything from Today's Presentation ...

- ◆ Streamline your fixed asset accounting
- ◆ Establish simple and clear policy and procedure documents
- ◆ Monitor your property record
- ◆ Commit to the annual update
- ◆ ... remember, you can do this!

Two Important Miscellaneous Items

- ◆ Recommended Practices
- ◆ Purdue University/Government Fixed Asset Services, Inc. General Infrastructure Assistance Manual of 2004, updated 2006, and revised 2012

Recommended Practices for the Financial Reporting of Capital Assets

1. Establishing appropriate capitalization thresholds
2. The need for periodic inventories
3. Control of noncapitalized items

Inventory Example

Inventory columns A, B, C, D, E, G

	A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P	Q	R	S
9	Urban Local Roads Calculations													ROW for Urban Local Roads Calculations					
	Road Name	From	To	Length (miles)	Width (ft)	Year Constructed (before 1980 go to middle of decade)	Length x Width (yards ²)	Replacement Cost Total (\$)	*Deflation for Year Constructed	** Historical Total Cost (\$)	Asset Life (years)	*** Annual Depreciation (\$)	Accumulated Depreciation (\$)	Net Book Value (\$)	**** Weighted Average Width of ROW (ft.) (Use 43.4' if value is not known)	ROW Area (Acres)	Total Fair Value per Acre for ROW (\$)	***** Deflation for Year Acquired for ROW (Used CPI-Deflator)	Historical Cost/Fair Value of ROW (\$)
10	Madson	500E	600E	2.2	20	2003	25,555	\$1,431,091	1.00	\$1,431,091	50	\$28,622	\$57,244	\$1,373,848	43.4	11.6	\$266,687	1.000	\$266,687
12	Jersey	Union Ch.	Hursh	1.9	22	1999	24,277	\$1,359,537	0.91	\$1,237,178	50	\$24,744	\$148,461	\$1,088,717	43.4	10.0	\$230,321	0.905	\$208,440
13	Akron	SR 1	Ohio Rd.	3.6	25	2000	52,272	\$2,927,232	0.97	\$2,839,415	50	\$56,788	\$283,942	\$2,555,474	43.4	19.0	\$436,397	0.936	\$408,468
14	Puff	CR 261	Frosh	0.9	25	1940	13,068	\$731,808	0.09	\$65,863	50		\$65,863		43.4	4.7	\$109,099	0.102	\$11,128
15	Popp	Sutton	500 E	2.7	22	1965	34,500	\$1,931,973	0.17	\$328,435	50	\$6,569	\$262,748	\$65,687	43.4	14.2	\$327,298	0.175	\$57,113
16	Deer Track	Manick Rd.	600E	7.9	20	1989	91,766	\$5,138,918	0.72	\$3,700,021	50	\$74,000	\$1,184,007	\$2,516,014	43.4	41.6	\$957,649	0.674	\$645,456
17	David	Hursh	Frosh	1.5	22	1909	19,166	\$1,073,318	0.03	\$32,200	50		\$32,200		43.4	7.9	\$181,832	0.035	\$6,310
18	Sunflower	Treelane	600E	6.1	25	2002	88,572	\$4,960,032	0.99	\$4,910,432	50	\$98,209	\$294,626	\$4,615,806	43.4	32.2	\$739,451	0.978	\$723,183
19	Farmland	100'w	SR 34	0.7	22	1954	8,944	\$500,882	0.15	\$75,132	50		\$75,132		43.4	3.7	\$84,855	0.147	\$12,465
20	Waldron	Treelane	250S	2.7	25	1968	39,204	\$2,195,424	0.17	\$373,222	50	\$7,464	\$276,184	\$97,038	43.4	14.2	\$327,298	0.175	\$57,113
21	51	SR 40	250S	7.9	22	1975	100,943	\$5,652,810	0.36	\$2,035,012	50	\$40,700	\$1,221,007	\$814,005	43.4	41.6	\$957,649	0.285	\$272,547
22	Newton	SR1	100'w	1.5	20	1974	17,424	\$975,744	0.36	\$351,268	50	\$7,025	\$217,786	\$133,482	43.4	7.9	\$181,832	0.285	\$51,749
23	Taylor	Frosh	Treelane	6.1	20	1964	70,858	\$3,968,026	0.17	\$674,564	50	\$13,491	\$553,143	\$121,422	43.4	32.2	\$739,451	0.175	\$129,034
24	Ross	Maniek Rd.	Ohio Rd.	0.7	25	1932	10,164	\$569,184	0.06	\$34,151	50		\$34,151		43.4	3.7	\$84,855	0.077	\$6,559
45	If more rows are added please change the total sum equation.																		
46												Total Sum:	\$357,613	\$4,706,493	\$13,381,491			Total Sum:	\$2,856,253



Questions and Comments

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

Michael M. Nielsen

Government Fixed Asset Services, Inc.

Long Beach, Indiana 46360-1712

(219) 221 6147

(773) 298 0289

nielsen@fixedassetservices.com