WGFOA WINTER CONFERENCE

Governmental Accounting 101

Accounting and Reporting for Capital Assets

DEFINITION OF A CAPITAL ASSET

- Used in operations and has an initial useful life in excess of one year
- Includes tangible and intangible assets
- However, the government must set the capitalization threshold (acquisition cost where an asset is considered “capital”)
- Costs to acquire, construct, improve, or otherwise place an asset into service should be capitalized
- How to treat large purchases of small dollar items

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DEFINITION OF INFRASTRUCTURE

- Long-lived capital assets that normally are stationary in nature and normally can be preserved for a significantly greater number of years than most other capital assets. Examples include roads, bridges, tunnels, drainage systems, water and sewer systems, dams, and lighting systems.

CAPITAL PROJECTS FUNDS

- Used to account for and report financial resources that are restricted, committed, or assigned to expenditure for capital outlays, except those financed by proprietary funds
- Required to be used when legally mandated (bond ordinance)
- Number of funds
- Arbitrage implications
- Measurement Focus and Basis of Accounting
- Revenues
    - Bond proceeds
    - Capital grants – recorded if eligibility requirements met
- Expenditures
    - Retainage payable
    - Construction in progress (not an asset)

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CAPITAL PROJECTS FUNDS

- Budgeting implications
    - Project-length budgets
    - Annual budgets (if CAFR issued, supplementary budgetary comparison should be included)
    - Capital budget

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CAPITAL PROJECTS FUNDS OTHER FINANCING SOURCES: ISSUANCE OF LONG-TERM DEBT

- If debt issued at par, record face amount of debt as OFS
- If debt issued at premium, record face amount plus premium as OFS (separately)
- If debt issued at discount, record as follows:

	DR	CR
Cash	4,540	
Expenditures – Issuance Costs	150	
Other Financing Use – Bond Discount (OID)	10	
Other Financing Source – Issuance of Bonds		4,700

- Record on the issue date
  - Proceeds not received, receivable at year-end

CAPITAL PROJECTS FUNDS OTHER FINANCING SOURCES: ISSUANCE OF LONG-TERM DEBT

- Exceptions to the rule:
    - Capital Accretion Bonds (CABs) – record amount of proceeds received
    - Accrue interest annually at GW level for governmental funds and at fund level for proprietary funds
- Special assessment bonds
    - Government obligated in some manner – same as other debt (OFS)
    - Government not obligated in some manner, record revenue – contribution from property owners (not an OFS)

OTHER FINANCING SOURCES: ANTICIPATION NOTES

- Recognize BANs as an other financing source IF the government can demonstrate that repayment of the BANs will not require the use of current financial resources within 12 months of the reporting date because:
    - Other debt was used to replace the BANs prior to the issuance of the financial statements or
    - A qualifying financing agreement is in place that ensures refinancing for a period that extends at least 12 months beyond the reporting date

	DR	CR
Cash	100	
Other Financing Source		100

LIABILITIES: RETAINAGE PAYABLE

- An amount that is due to a vendor for work completed under a contract which is withheld to compel the vendor's satisfactory completion of work

	DR	CR
Expenditures	50	
Cash		40
Retainage Payable		10

MAJOR ASSET CLASSES
TYPICAL CLASSES

- Land. Always separate. Not depreciated.
- Buildings. May have subclasses. Depreciate.
- Improvements other than buildings. Shorter useful lives. Depreciate.
- Furnishings and equipment. Moveable. Depreciate.
- Infrastructure. Normally reported as networks or subsystems. Depreciate.
- CIP. Not depreciated.
- Other. Separate depreciable/nondepreciable. Depreciate if appropriate.

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CAPITAL ASSET NOTE DISCLOSURES

- Each asset class
  - Beginning balances
  - Capital acquisitions
  - Sales and dispositions
  - Ending balances
- Depreciable and nondepreciable assets reported separately
- Accumulated depreciation reported separately
- Governmental activities and business activities reported separately
- Depreciation expense for each function or program

MAJOR ASSET CLASSES GUIDING PRINCIPLES

- Group items that are similar in nature and usage
- Separate depreciable items from nondepreciable items
- Separate tangible assets from intangible assets

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VALUATION

- In general, use historical cost (as adjusted by accumulated depreciation)
- If historical cost is not available, estimate
  - Standard costing (comparable acquisitions)
  - Normal costing (backtrending from the present)
- Donations are recorded at fair value

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QUESTION #1

What capitalization threshold does your government use for equipment?

A. Less than $10,000
B. $10,000 to $50,000
C. Over $50,000
D. Not sure

QUESTION #2

What capitalization threshold does your government use for infrastructure?

A. Less than $50,000
B. $50,000 to $100,000
C. Over $100,000
D. Not sure

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QUESTION #3

Which of the following is an essential characteristic of a capital asset?

A. Tangible physical form

B. Use in operations

C. Use in multiple periods

D. Both B and C

CAPITAL ASSET REPORTING

- Reporting capital assets
  - Capitalization threshold
    - Purpose
  - Change in capitalization threshold
    - Change in an accounting estimate
    - Remove assets from schedule?
- Not required to capitalize when:
  - Older infrastructure
  - Collections of art and historical treasures
  - Immaterial items

CAPITAL ASSET REPORTING

- Reporting capital assets
  - Used in operations and have a useful life in excess of one year
  - Purchased or constructed
    - Historical cost
      - Costs to include
      - No capitalized interest
  - Estimate historical cost
    - Methodology for estimating
- Donated
  - Fair value when donated
  - How to value

CAPITAL ASSET REPORTING

- Depreciation
  - Fund level – never
  - Entity-wide – always – by function

- Depreciation not required when:
  - Capital asset has an indefinite useful life
  - Infrastructure accounted for using the modified approach
  - Construction in progress

CAPITAL ASSET REPORTING

- For conversion to entity-wide
  - Accumulated depreciation by class (BOY)
  - Purchases by function
  - Depreciation expense by function
  - Gain (losses) on sales/disposals (non-cash component)

CAPITAL ASSET SALE/DISPOSAL

Governmental Fund

	DR	CR
Cash	50	
Proceeds from sale (disposal) of capital asset		50

Or if traded in

	DR	CR
Expenditure – Capital Outlay	25	
Proceeds from sale (disposal) of capital asset		25

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CAPITAL ASSET SALE/DISPOSAL

Government Wide/Proprietary Fund entry

	DR	CR
Accumulated Depreciation	80	
Loss on Disposal	30	
Depreciation Expense (if partial year taken)		10
Capital Asset		100

CAPITAL ASSET IMPAIRMENTS

- An impairment is a significant, unexpected decline in the service utility of an asset
- To qualify, the decline in service must be:
  - Significant in relation to the asset's current service utility
  - Unexpected
  - Permanent
- An impairment reduces the carrying value of the asset
  - Can directly increase accumulated depreciation or
  - Proportionally reduce the reported value of the asset and accumulated depreciation

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IMPAIRMENTS

- A significant, unexpected, permanent decline in the service utility of an asset
- Indicators:
  - Physical damage where action would be needed to restore lost service utility
  - Changes in laws, regulations, or other environmental factors
  - Technological developments
  - A change in the manner or duration of use
  - Stoppage of construction
  - Stoppage of development

IMPAIRMENTS

- Accounting Treatment:
  - If insurance coverage exists, impairment is reported net of the insurance recovery
  - If a disaster assistance grant is awarded, record grant revenue
  - Impairments are reported as a program or operating expense, special item, or extraordinary item, depending upon the circumstances

CAPITAL ASSET IMPAIRMENTS

- Calculation of the impairment (i.e., reduction in carrying value) depends upon whether the asset will remain in use
- If asset will no longer remain in use, write down to fair value
- If asset will continue to be used, write down using one of the following methods:
- Restoration approach (for physical damage)
- Service units approach
    - Changes in laws, regulations, or other environmental factors
    - Technological developments
    - Change in manner or duration of use
- Deflated depreciation replacement cost (for change in manner or duration of use)

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QUESTION #4

To qualify as a capital asset impairment, a decline in service utility must be:

A. Significant
B. Unexpected
C. Permanent
D. All of the above

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QUESTION #5

A decline in demand for the services of a capital asset is an indication of impairment.

A. True

B. False

RECORDING THE ACQUISITION OF A CAPITAL ASSET

- In governmental funds: as an expenditure
- In proprietary and fiduciary funds and at the government-wide level: as an asset and generally depreciate/amortize

CAPITAL ASSETS ASSOCIATED WITH MORE THAN ONE GOVERNMENT

- Same capital asset cannot be reported by more than one government
- Ownership is the decisive criterion
- If ownership cannot be determined, responsibility for managing the asset can be used as a surrogate

QUESTION #6

Which of the following statements is true?

A. Sometimes items that meet the definition of a capital asset do not have to be capitalized
B. Sometimes capital assets do not have to be depreciated
C. Both A and B
D. Neither A nor B

QUESTION #7

Government A owns a capital asset, but Government B is required to maintain it. Which government should report the asset in its financial statements?

A. Government A

B. Government B

C. Both A and B

QUESTION #8

There is no “title” for a given capital asset. Government B must maintain the asset, but Government A is required to replace it at the end of its useful life. Which government should report the asset in its financial statements?

A. Government A

B. Government B

C. Neither A nor B

CAPITALIZABLE COSTS

- Acquisition costs
- Ancillary charges
- Interest
- Application of internal resources

CAPITALIZABLE COSTS: INTERNALLY GENERATED INTANGIBLE ASSETS

- All of the following criteria must be met first:
- Specific objective of the project has been determined;
- Nature of the service capacity to be provided has been determined;
- Feasibility of successfully completing the project has been demonstrated; and
- The government has demonstrated that it 1) intends, 2) is able to, and 3) is making an effort to develop and complete the project

CAPITALIZABLE COSTS:
INTERNALLY GENERATED COMPUTER SOFTWARE

Stage	Related Activities	Capitalize?
Preliminary project stage	1) Conceptual formulation and evaluation of alternatives 2) Determination of the existence of needed technology 3) Final selection of alternatives for development	No
Application development stage	1) Design of the chosen path 2) Coding 3) Installation to hardware 4) Data conversion 5) Testing	Yes, but only if incurred after completion of the preliminary project stage
Post-implementation/operation stage	1) Application training 2) Data conversion beyond what is necessary to make the software operational 3) Software maintenance	No

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QUESTION #9

How should the cost of land under a highway be treated?

A. Include as land

B. Include as infrastructure

C. Either A nor B

QUESTION #10

A government that uses the modified approach for infrastructure reporting is required to:

A. Capitalize the asset

B. Depreciate the asset

C. Both A and B

D. Neither A nor B

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QUESTION #11

Which of the following costs associated with the acquisition of a capital asset is capitalizable?

A. Training costs
B. Cost of a feasibility study
C. Legal costs
D. All of the above

QUESTION #12

Which of the following statements is true concerning the capitalization of the cost of internally developed software?

A. All costs may be capitalized

B. No costs may be capitalized

C. Some costs may be capitalized

INTEREST AS A CAPITALIZABLE COST

- Another ancillary cost
- Only capitalize for assets of the enterprise funds
- Can capitalize even when debt not issued if there are other interest-bearing enterprise fund liabilities
- Amount of interest to be capitalized depends upon whether tax-exempt debt is issued and whether qualifying assets are specified
- Period of interest capitalization depends upon whether tax-exempt debt is issued and whether qualifying assets are specified

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INTEREST AS A CAPITALIZABLE COST: Taxable Debt or Tax-Exempt Debt for General Capital Purposes

Average Cumulative Expenditures Since Inception	x	Borrowing Rate (Weighted Average or Specific to Borrowing)	=	Capitalized Interest (Not to Exceed Total Interest Cost of the Period)

	DR	CR
Construction in Progress	1,000	
Accrued Interest Payable		1,000

INTEREST AS A CAPITALIZABLE COST:

Tax-Exempt Debt for Specified Qualifying Asset

Interest Expense on Tax-Exempt Debt Inception - Interest Revenue on Reinvested Proceeds = Capitalized Interest

	DR	CR
Construction in Progress	400	
Accrued Interest Receivable	600	
Accrued Interest Payable		1,000

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ARBITRAGE REBATE

- Option #1: Record excess interest earnings as a reduction of interest revenue on the reinvested proceeds
- Option #2: Record excess interest earnings as an arbitrage expense

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QUESTION #13

Interest capitalization is essentially limited to capital assets reported in the enterprise funds.

A. True

B. False

QUESTION #14

In which of the following situations would interest *not* be capitalized?

A. Acquisition financed through a grant restricted for that purpose
B. Acquisition financed with existing available resources
C. Both A and B
D. Neither A nor B

QUESTION #15

When should interest capitalization begin?

A. Date of borrowing
B. Start of preconstruction activities
C. Either A or B

QUESTION #16

When capitalizing interest, the netting of interest cost and related interest revenue on reinvested bond proceeds is:

A. Sometimes appropriate
B. Always appropriate
C. Never appropriate

IMPROVEMENTS VS. REPAIRS

- Improvements/betterments. Should be capitalized.
- Maintenance/repairs. Should not be capitalized.
- Modified approach. Costs to maintain condition level should not be capitalized.

QUESTION #17

A government purchases a capital asset with an estimated fair value of $100 for $1. What amount should be capitalized?

A. $100

B. $1

C. Either A or B

DEPRECIATION

- Applies to all capital assets with limited useful lives that are not accounted for using the modified approach
- Methods of depreciation:
  - Straight-line method
  - Activity method
  - Allocate increasingly smaller amounts of expense over time to compensate for increased maintenance expense on older assets

DEPRECIATION

- Establish the useful life of the asset considering:
  - The asset's quality
  - The asset's application
  - The environment in which the asset will be used
  - The government's maintenance and replacement policy
  - The government's experience with similar assets
- Estimate the salvage value
- May depreciate assets individually or similar assets as a group

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DEPRECIATION

- Componentization
  - Options:
    - Depreciate separately
    - Depreciate component as part of larger/longer-lived asset
  - Subsequent options:
    - Account for the replacement as a retirement of the old unit
    - Account for the new unit as a repair expense

FINANCIAL STATEMENTS: GOVERNMENT-WIDE STATEMENT OF NET POSITION

- Depreciable and nondepreciable capital assets should not be reported on the same line
- Net position should be displayed in three separate categories – one of them being “Net Investment in Capital Assets”
    - Include tangible and intangible assets
    - Resources accumulated for capital assets are excluded
    - Equity interest in capital assets of joint ventures is excluded

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FINANCIAL STATEMENTS: GOVERNMENT-WIDE STATEMENT OF ACTIVITIES

Depreciation is treated as a direct cost of the function or program that uses the asset

NOTES TO THE FINANCIAL STATEMENTS: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- Describe the government's policy for capitalizing assets
- Describe the government's policy for estimating the useful lives of assets
- Describe the method used to calculate depreciation expense

NOTES TO THE FINANCIAL STATEMENTS: DETAILED NOTE DISCLOSURES

- For each major asset class:
    - Beginning balance (with accumulated depreciation reported separately)
    - Capital acquisitions
    - Sales and dispositions
    - Ending balance (with accumulated depreciation reported separately)
    - Separate capital assets associated with governmental and business-type activities
    - Separate capital assets that are depreciated from capital assets that are not being depreciated

NOTES TO THE FINANCIAL STATEMENTS: DETAILED NOTE DISCLOSURES

- For depreciation expense:
  - Amount reported for each function or program
  - If interest is capitalized, total interest cost of the period charged to expense
  - Amount of capital assets pledged as security for loans