

Getting with the Program: A Systematic Approach to Accounting for Capital Assets

Government Finance Officers Association

104th Annual Conference

Atlanta, Georgia

June 6, 2010



Getting with the Program: A Systematic Approach to Accounting for Capital Assets

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Today's Presentation Part I

- ◆ Introduction
- ◆ Designing capital asset information (worksheets)
- ◆ Monitoring capital asset information
- ◆ Maintaining capital asset information

Today's Presentation Part II

◆ Task at Hand

- Problems and Challenges
- Case Studies

◆ Miscellaneous issues and practical considerations

◆ Conclusion

Today's Presentation

- ◆ Comments and questions at conclusion
- ◆ Copies of outline is in GFOA Conference materials
- ◆ Copies of PowerPoint slides are available at GFOA website or via e-mail

Today's Presentation Introduction

- ◆ ...Overriding concept today is that many governments continue to have issues with capital asset accounting and reporting – and that these issues can be resolved

Task at Hand...

- ◆ Designing, monitoring, and maintaining an effective, economical, and efficient plan and process for the accounting and reporting of capital assets

Task at Hand...

◆ **Designing** capital asset information (point of reference)

- Land
- Buildings
- Improvements other than buildings
- Furnishings and equipment (includes vehicles)
- General infrastructure (roads, bridges, sidewalks, streetlights, traffic signals, rights-of-way, etc.)
- Construction-in-progress
- Minor but sensitive items

Task at Hand...

◆ **Designing** capital asset information

- Starts with a capital asset policy (road map)
- Continues with a plan for addressing capital asset issues of accounting and reporting
- Process includes deciding asset inclusions and exclusions
- Must include the separation of property accounting from property control
- Considers purpose, scope, staffing, timing, etc.

Task at Hand...

◆ **Designing** capital asset information

- Process includes 'defining' capital vs. expense; repairs vs. improvements; and additions and retirements
- Includes consideration of final format of capital asset information and seeks to be user-friendly

Task at Hand...

◆ **Designing** capital asset information

- information to include generic asset description, location, department, etc.
- For accounting purposes need to be auditable
- information frequency is part of design
- Prospective reporting is part of design
- Database may be in Excel or some other database system
- Reporting mechanism can be on-line input form

Task at Hand...

◆ **Monitoring** capital asset information

- Plan to periodically check integrity of entire database for both property accounting and property control
- An 'iterative process'
- Large assets (buildings, general infrastructure) may need to verify existence only

Task at Hand...

◆ **Monitoring** capital asset information

- Monitoring of land parcels, land improvements, buildings, and general infrastructure best done centrally
- Moveable assets (furnishings and equipment) plan to verify existence and remove unreported retirements and record additions not previously recorded

Task at Hand...

◆ **Monitoring** capital asset information

- Monitoring of minor but sensitive items best done at department level (these are the people who purchase, use, maintain, and retire these assets)
- Procedure is to take prior year's information and compare it to existing assets
- Procedure is to 'highlight' retirements (both current and unreported)
- Procedure is to record previously not recorded additions in similar detail

Task at Hand...

◆ **Monitoring** capital asset information

- ...a whole lot cheaper to monitor periodically than to start all over in three to five years

Task at Hand...

◆ **Maintaining** capital asset information

- Annual update of information to subsequent fiscal year ends taking into account additions and retirements and adjusting information accordingly
- Decision to be made is choosing the logical person to maintain the integrity at the database – both centrally (point person responsible for annual updates) and departmentally (person in charge of additions and retirements for both the property accounting information and the property control information)

Task at Hand...

◆ **Maintaining** capital asset information

- Land parcels – best done centrally
- Buildings – best done centrally
- Improvements other than buildings – best done centrally
- General infrastructure – best done departmentally (Engineer, Highway Director, Public Works Director, etc.)
- Furnishings and equipment – best done departmentally
- Vehicles – best done centrally with departmental input
- Minor but sensitive items – best done departmentally

Task at Hand...

◆ **Maintaining** capital asset information

- Centrally (comments)
- Departmentally (comments)
- Responsible person (comments)
- 'Clout' – reference large county that utilizes affidavit that must be signed by Elected Official or Department Head

Today's Presentation Part II

...a government needs a record of its capital assets for financial reporting purposes and this record must be maintained annually as of the fiscal year end to reflect changes (additions and retirements).

Task at Hand...

...governments must disclose their policy for capitalizing assets (additions) and for estimating the useful lives of those assets and the method and convention used in the calculation of depreciation expense

Task at Hand...

...therein lies the problem! Governments need to record capital additions and remove capital retirements **but** have not taken the time or made the decisions necessary to achieve this goal economically and efficiently.

Task at Hand...

...the problem(s):

- ◆ We struggle with the annual task of prospective reporting of capital assets
- ◆ We have no roadmap to assist and guide the process
- ◆ We have never defined capital v. expense

Task at Hand...

...the problem(s):

- ◆ We have never defined capital additions
- ◆ We have never defined 'improvement' as to a new asset and/or increased capacity or efficiency

Task at Hand...

...the problem(s):

- ◆ We have never thought through the inherent difference between a capital addition and repair/maintenance
- ◆ We have never defined retirements and don't know when to retire an asset or a portion of an asset as to historical cost and often times just ignore this issue

Task at Hand...

...the problem(s):

- ◆ There is no consistent way of reporting construction-in-progress
- ◆ Historically no one has taken the time to be specific regarding prospective reporting procedures as to the who, what, where, when, how, and why of the entire process

...in the interest of time

...let's get right to actual examples and abbreviated case studies

1. Struggle
2. Creation of a roadmap
3. Defining capital v. expense
4. Defining additions
5. Defining 'improvement'
6. Defining repair and maintenance
7. Defining retirements
8. Reporting construction-in-progress
9. Delineating procedures
10. Misc. (elements of historical cost, capitalization threshold, extend life v improve, contributed assets)

Example – **struggle** with annual task of prospective reporting of capital assets

- ◆ There is often no specific commitment to maintaining the property record
- ◆ There is no effective coordination in getting the right information from the right people
- ◆ No 'point person' at departments i.e., Highway Department or Buildings and Grounds Department to gather and report information as to additions and retirements
- ◆ Process equates to 'reinventing wheel' annually

Example – Struggle

- ◆ ...staff turnover causes problems
- ◆ Capital Assets at last minute equates to some additions and usually no retirements
- ◆ Reference large county government and maintaining all additions centrally and all retirements departmentally

Example – creation of a prospective reporting **roadmap** for capital assets

◆ Policies and procedures

- Responsible person
 - ◆ Centrally
 - ◆ Departmentally
- Information required
- Information sources
- Timeframe for completion

Example – Roadmap

- ◆ ...a simple, understandable, and brief written document that all are familiar with...
- ◆ Reference to documentation of the who, what, where, when, how, and why (more later on this)
- ◆ Possibly a joint meeting every three to five years with annual contact (phone, e-mail)
- ◆ Highway Department usually says, “tell us what you want and we’ll provide it”

Example – defining **capital v. expense**

- ◆ Capital defined
- ◆ Expense defined
- ◆ Specific written examples of each can help (in procedures documentation)
- ◆ Capital to be considered in light of increased capacity or efficiency
- ◆ Repairs and maintenance usually restore an asset to original service potential and does not necessarily comprise an improvement
- ◆ Potential checklist

Example – Capital v. Expense

- ◆ Reference capitalization threshold(s) of, say, \$5,000 (or a higher amount) for furnishings and equipment, \$100,000 for building improvements, and \$250,000 for general infrastructure improvements
- ◆ Concept of improvements vs. maintenance of current service potential (maintain = maintenance)

Example – Capital v. Expense

◆ Common expense items for buildings:

- Painting
- Roof re-surfacing
- Replace HVAC
- Re-carpet
- Plumbing repair and replacement
- Upgrade electrical service
- Landscaping

Example – Capital v. Expense

◆ Common expense items for Roads

- Re-stripe
- Replace culvert
- Replace signage
- Replace guardrail
- Re-surface existing road
- Bridge joint repair
- Replace streetlight

Example – defining asset **additions**

- ◆ Only assets at or above capitalization threshold (a separate and increased amount for building and general infrastructure improvements)
- ◆ Assets must meet written definition and criteria of an improvement
- ◆ Newly constructed assets
- ◆ Level of detail with a view to future maintaining information for reporting future additions and retirements

Example – defining asset **additions**

◆ Sources of cost information

- Invoices, expenditure vouchers, purchase orders
- Construction contracts, real estate closing documents
- Recorded of deeds
- Journal entries, work orders
- Appropriations
- Budget documents
- Bond documents

Example – Additions

- ◆ New asset where one did not exist – this is easy
- ◆ Example of installing air conditioning in old courthouse that had no air conditioning – improvement
- ◆ Example of new furnace/boiler in City Hall replacing original unit – repair

Example – defining capital asset **'improvement'**

- ◆ 'New' asset defined
- ◆ Increased capacity defined
- ◆ Increased efficiency defined
- ◆ Example from GFOA Capital Asset Seminar
- ◆ An improvement generally extends an asset's estimated useful life beyond the original expectation
- ◆ An extended estimated useful life usually involves a significant alteration or structural change

Example – Improvement

- ◆ Increase capacity – adding square footage to an existing building
- ◆ Increase capacity – adding new lanes to an existing road
- ◆ Increase efficiency – same size etc., but service provided at less cost (example)

Example – defining **repair and maintenance** (to be expensed)

◆ Buildings

- Repair and maintenance

◆ General infrastructure

- Repair and maintenance

Example – Repair and Maintenance

- ◆ Buildings and \$100,000 capitalization threshold on improvements – does not mean capitalization of \$112,000 in painting cost
- ◆ Roads with a \$250,000 capitalization threshold on improvements – does not mean capitalization of re-surfacing because road is still same length and width etc.

Example – defining **retirements** relating to buildings and general infrastructure

- ◆ Buildings
- ◆ General infrastructure
- ◆ Full retirement
- ◆ Partial retirement (example)
- ◆ Estimates and use of indexes to determine amount of historical cost to retire

Example – Retirements

- ◆ Full retirements are easy
- ◆ Partial retirement means to isolate retired portion and retired percentage of the total asset and retired percentage of the asset's historical cost
- ◆ Partial retirement may take current cost of the replacement asset and index to its estimated historical cost and retire that amount

Example – Retirements

- ◆ Example – road replacement of $\frac{1}{2}$ of an existing road
 - Take length at 50%
 - Take historical cost at 50%
 - Retire these amounts
- ◆ Example – road replacement at \$1,000,000 current cost replacing a 1947 road
 - take the \$1,000,000 deflated by the 1947 FHWA index/deflator of .09 = 's \$90,000
 - \$90,000 becomes the retired historical cost
 - Assuming no salvage value and a fully depreciated asset – \$90,000 becomes the retired historical cost and accumulated depreciation

Example – Retirements

- ◆ Example – 1937 building and installation of \$1,000,000 replacement windows (to be considered an improvement) –
 - take the \$1,000,000 and deflate to 1937 with a building index/deflator of .047
 - the retirement = 's \$47,000 in historical cost
 - Assuming no salvage value and a fully depreciated asset – \$47,000 becomes the historical cost and retired accumulated depreciation

Example – reporting **construction-in-progress**

- ◆ '...first payment to last payment'
- ◆ All costs to be captured
- ◆ Separation of potential expense items
 - Furniture
 - Moveable office partitioning
 - Other

Example – **construction-in-progress**

- ◆ Building – starts at planning and continues on to include design, architectural fees, site preparation, construction costs, etc.
- ◆ Bridge – starts at planning and continues on to include design, engineering, environmental, and construction costs, etc.

Example – delineating capital asset prospective **procedures** (wwwwhw)

◆ Specifics:

- Who – assignment of responsible person
- What – information to be gathered and maintained
- Where – information source
- When – timing of information reporting
- How – procedures as to reporting of additions and retirements
- Why – financial reporting and property control and separation of both issues

Example – Procedures

- ◆ Who – central and departmental
- ◆ What
 - Additions centrally (Purchasing or Finance)
 - Retirements departmentally
- ◆ Where – sources of information
- ◆ When – with reference to timely reporting for financial reporting (so) 12/31 fiscal year end means begin on 9/30 and report by 12/31 so information is ready for audit in February

Example – Procedures

- ◆ How – reference large county and centrally doing additions and revising information and sending out to departments for indication of retirements (only)
- ◆ Why – communicating impact and importance of financial reporting

Issues to remember...

- ◆ Capitalization thresholds relating to buildings and building improvements and general infrastructure and infrastructure improvements
- ◆ Elements of historical cost to capture
- ◆ Improving an asset's capacity and efficiency
- ◆ Extending an asset life v. meeting the estimated useful life expectation
- ◆ Contributed assets and the determination of Fair Value

Issues to remember...

- ◆ Report 'all' retirements
- ◆ Construction-in-progress can be significant
- ◆ Be honest in assessment of what you can and cannot do now and in the future
- ◆ Don't let the perfect get in the way of the good

Issues to remember...

- ◆ Define capital vs. expense – should not have to reinvent the wheel every year
- ◆ Focus on the money (greatest percentage of capital asset balance is in general infrastructure, buildings, and the fleet of vehicles – perhaps 90% or more)

Issues to remember...

- ◆ Process does not have to be difficult or overly time consuming – planning is key
- ◆ Policy is where you can make life easier (don't forget auditor concurrence)
- ◆ Get others involved
 - Capitalize on people, information, and resources within your government
 - Get in touch with the departments (they purchase, use, and retire the assets)



Questions and Comments





Summary and Conclusion

