



Accounting for Capital Assets

Session #2 – Additions, Deletions



Training provided by:
Local Government Services Bureau
State Financial Services Division
Department of Administration
State of Montana
(406) 444-9101
<http://sfsd.mt.gov/LGSB>

Session #2: Accounting For Acquisition, Disposal and Impairment

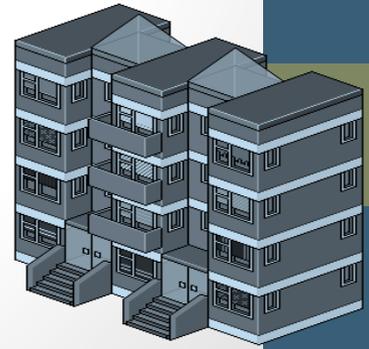
Session #3: Depreciation, Accounting Entries & Information to assist with the Annual Financial Report



- **Acquisition costs** - The cost of the capital asset should include not only the cost of the asset itself, but the “ancillary charges necessary to place the asset into its intended location and condition for use.”
- **Impairment** is a significant and unexpected decrease in the service utility of a capital asset that will continue to be used in operations
- **Disposal** of a capital asset can be through the sale, trade or complete retirement.
- **Fully Depreciated Capital Assets still in use** – Although capital assets should be depreciated over their useful life, sometimes capital assets are still in operation when fully depreciated. Consider this when assigning a useful life when the asset is replaced.

Capital Assets acquired as an investment

- **GASB 72** defines an investment as a security or other asset that:
 - A government holds primarily for the purpose of income or profit
 - Has a present service capacity based solely on its ability to generate cash or to be sold to generate cash
- **Capital Assets** are defined as assets the government uses in its operations and have an initial useful life in excess of one year
- **Investment or capital asset?**
 - An item that appears to be a “capital asset” in theory could actually be an investment and should not be reported as part of the capital assets
 - Going forward the designation of investment or capital asset should be made at the time of acquisition and retained for financial reporting
 - Local Governments that hold assets for profit or income that were previously classified as capital assets should reclassify them in this fiscal year when implementing GASB 72



Capital Assets acquired as an investment

- **Investment or capital asset – cont.?**

- Examples of a multi-use or mixed-use asset:

- Building houses government offices on the second floor – the first floor is rented for retail business

- Considerations:

- Will the building be considered one asset? Or will each floor of the building be considered a separate asset, with the upper floor accounted for as a capital asset and the lower floor accounted for as an investment?
- Once classified (as an investment or a capital asset) – the original classification shouldn't change
- Items currently classified as a capital asset that should be classified as an investment should be reclassified during GASB 72 implementation

- GASB 72 also changes the measurement at acquisition for **donated** capital assets, donated works of art, historical treasures and similar capital assets.

- These were previously required to be measured at fair value
- New measurement is acquisition or entry price



Valuation of Capital Assets:

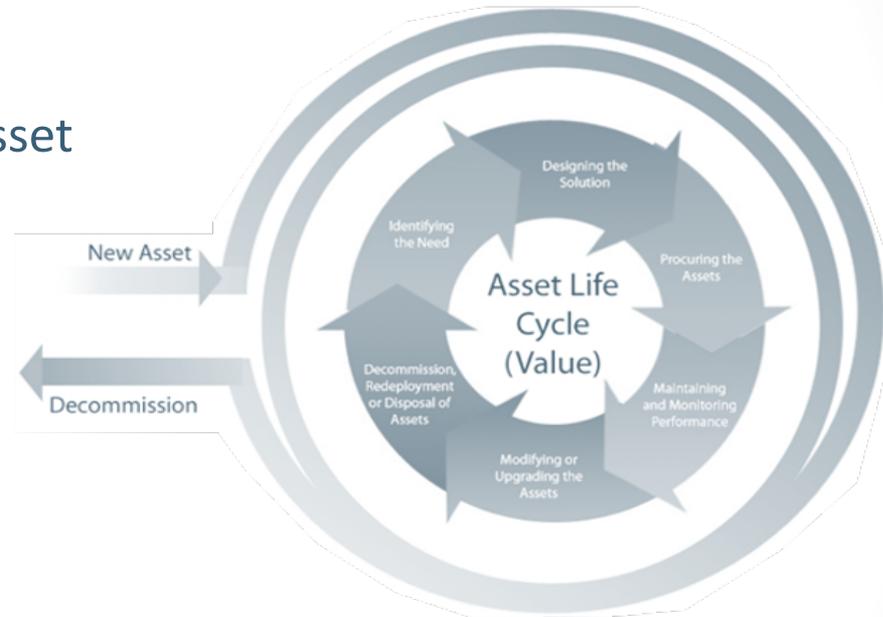
- Most acquired through purchase or construction
 - According to GFOA: *Reporting capital assets in financial statements is really a means to an end – rather than an end itself. Capitalization is not to show how much an asset is worth but rather to defer recognizing an expense of the current period at a cost incurred for the benefit of future periods. Consequently, the amount at which a capital asset is reported is the amount of the actual (historical) cost thus deferred.*
 - Historical cost
 - Direct costing – when local government tries to determine the historical cost of a capital asset acquired in an earlier period.
 - Estimated historical cost –
 - Standard costing – estimating the going price at the time it was acquired
 - Normal costing – determine the cost to reproduce the same asset new today and then restating that amount in acquisition year dollars
 - Assigning bundled costs to individual assets – when purchased or constructed in a bundle. An appropriate cost is assigned to each (i.e. building & land)
 - Valuing assets obtained through trade-ins – the book value of the asset surrendered in the trade plus any monetary considerations provided to the seller
 - Capital Assets acquired through donation – Should be reported at their estimated value to acquire at the time of acquisition plus ancillary charges if any.
 - Buy & sell prices are different (sell price only if the asset is acquired for resale; value determined by what it would cost to acquire the asset (buy price); not the amount the donated asset could be sold for.



Estimated Life Considerations:

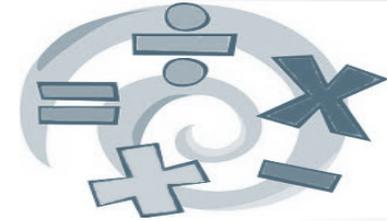
- **Considerations:**

- Materials and construction
- Specific use of the capital asset
- Physical environment
- Maintenance policy
- Technological advances



- Local Governments should regularly review the reasonableness of the estimated useful lives selected for capital assets
- If assets remain on your depreciation schedule that are fully depreciated consider extending the estimated useful life when replacing the capital asset

Estimating Useful Life:



- Estimating useful life of a capital asset depends on the use of the item:
 - Based on units of service provided over a period of time
 - Example: vehicle – transport mini-van for travel to training: \$20,000 – determine the amount of miles driven per year to determine the useful life: If 100,000 miles is the life and you expect to drive the vehicle 10,000 miles per year – useful life would be $100,000/10,000$ or 10 years
 - Useful life of similar items can vary depending upon the specific circumstances of its use
 - Example: vehicle – used on construction projects to haul materials: \$20,000; Useful life 60,000 miles and driven daily on construction jobs, 15,000 miles per year anticipated – useful life would be $60,000/15,000$ or 4 years



Acquisition by Purchase:

- **Purchase of a Capital Asset:** Cost would be the amount paid for the Capital Asset plus the costs to put the asset into service.

The purchase of a \$45,000 Dump Truck:

- **In a Governmental Fund:**

- ✓ 1000 – 430200 – 940 – Capital Outlay

- ✓ 1000 – 101000 Cash (per claim process)

Debit

\$45,000

Credit

\$45,000

- **In the Water Fund:**

- **Option 1 - GAAP compliant option:**

- ✓ 5210 – 186000 Machinery & Equipment

- ✓ 5210 – 101000 Cash

\$45,000

\$45,000

or

- **Option 2 - Not GAAP Compliant – will require the reversal at year-end**

- ✓ 5210 – 430500 – 940 – Capital Outlay

- ✓ 5210 – 101000 Cash (per claim process)

\$45,000

\$45,000

**see session 3 for further information*



Acquisition by Purchase:

- **Year-end Adjustment for the Purchase of a Capital Asset:**

The original entry for the purchase of a \$45,000 Dump Truck:

In a Governmental Fund:	<u>Debit</u>	<u>Credit</u>
✓ 1000 – 430200 – 940 – Capital Outlay	\$45,000	
✓ 1000 – 101000 Cash (per claim process)		\$45,000

The year-end adjustment:

- The Governmental Fund Financial Statements do not report Capital Assets – Measurement focus: modified accrual
- Capital outlay would remain in the General Fund
- Add the Dump Truck to Fund 9000 – Governmental Capital Assets Account Group (GCAAG) if fund is updated:

✓ 9000 – 186000 Machinery & Equipment	\$45,000	
✓ 9000 - 280000 Investment in Capital Assets		\$45,000

Acquisition by Purchase:

- **Year-end Adjustment for the Purchase of a Capital Asset:**

The original purchase of a \$45,000 Dump Truck:

- **In the Water Fund:**

		<u>Debit</u>	<u>Credit</u>
✓ 5210 – 430500 – 940	Capital Outlay	\$45,000	
✓ 5210 – 101000	Cash (per claim process)		\$45,000

Or

✓ 5210 – 186000	Machinery & Equipment	\$45,000	
✓ 5210 – 101000	Cash		\$45,000

- **The year-end adjustment for entry #1:**

✓ 5210 – 186000	Machinery & Equipment	\$45,000	
✓ 5210 – 430500 – 940	Capital outlay		\$45,000

- **There is no adjustment necessary for entry #2**



Acquisition by Transfer:

- Transferring an asset from one fund to another:
 - Basic rule: The value of a capital asset cannot change so long as it remains within the same financial reporting entity
 - This includes discretely presented component units
 - If an asset is moved from governmental activities to business-type activities:

On Government-Wide Statements

- *From Governmental activities*

- Transfer out
- Capital Asset

- *To Business Type Activities*

- Capital Asset
- Transfer In

- Fund level statements:

- *General Fund or Other Governmental Funds:*

- No activity shown

- *Business-Type Fund*

- Capital Asset
- Capital Contribution

Debit

Credit

\$10,000

\$10,000

\$10,000

\$10,000

\$10,000

\$10,000



Acquisition by Donation:



- Capital Assets acquired through Donation should be reported at the value it would cost to acquire at the time of acquisition
- The assigned value should be the amount the local government would have to pay to acquire or “buy” the capital asset
 - The assigned value is not what the asset would “sell” for
 - Add the amount of ancillary charges to put the capital asset into operation
- The City of Somewhere received a donated building – the value to purchase or acquire was determined to be \$25,000
 - Governmental Funds would not show the donation – an adjustment would be made to produce the Government-wide Statements on the GASB 34 Balance Sheet and Operating Conversion Worksheets
 - Business-type Funds would show the addition of the capital asset and a revenue or capital contribution

Making adjustments for governmental fund capital assets while preparing the Annual Financial Report:

The City of Somewhere received a donated building to be used by the Parks & Recreation Department. The cost to purchase would have been \$25,000.

The land was valued at \$5,000 and the building was valued at \$20,000

Step 1:

Below is the addition of the land and building on the GCAAG:

ACCOUNT DESCRIPTION	BALANCE July 1, 2015	DEBITS	CREDIT	Adjustments for inventory/prior year depreciation	BALANCE June 30, 2016
LAND	1,000.00	5,000.00			6,000.00
CONSTRUCTION IN PROGRESS					0.00
BUILDINGS	76,000.00	20,000.00			96,000.00
ALLOWANCE FOR DEPRECIATION	(31,000.00)		1,500.00		(32,500.00)
INTANGIBLES/WORKS OF ART	0.00				0.00
AMORTIZATION/ALLOW. FOR DEPRECIATION					0.00
IMPROVEMENTS OTHER THAN BUILDINGS	45,000.00				45,000.00
ALLOWANCE FOR DEPRECIATION	(2,250.00)		2,250.00		(4,500.00)
MACHINERY & EQUIPMENT	99,000.00	(28,000.00)			71,000.00
ALLOWANCE FOR DEPRECIATION	(41,400.00)	26,000.00	5,600.00		(21,000.00)
INFRASTRUCTURE					0.00
ALLOWANCE FOR DEPRECIATION					0.00
TOTAL ASSETS	146,350.00	23,000.00	9,350.00	0.00	160,000.00

Making adjustments for governmental fund capital assets while preparing the Annual Financial Report:

The City of Somewhere received a donated building to be used by the Parks & Recreation Department. The cost to purchase would have been \$25,000
 The land was valued at \$5,000
 and the building was valued at \$20,000

Step 2:

Below is the addition of the land and building on the Operating Conversion Worksheet:

Account Number	Description	FROM GOVERNMENTAL FUNDS	Remove proceeds from sale of assets from other financing sources	Add net adjustments made to capital assets in the GFAAG (i.e. donated capital assets & other adjustments to inventory)	Add change in net position of internal service funds applicable to governmental activities	ADJUSTED AMOUNT FOR ENTITY-WIDE STATEMENT
REVENUES						
310000/						
363000	Taxes/assessments	0.00				0.00
320000	Licenses and permits	0.00				0.00
330000	Intergovernmental revenues	0.00				0.00
340000	Charges for services	0.00				0.00
350000	Fines and forfeitures	0.00				0.00
360000	Miscellaneous	0.00				0.00
370000	Investment and royalty earnings	0.00				0.00
	Capital assets adj. gain/loss on sale/donated			25,000.00		25,000.00
	Total Revenues	0.00	0.00	25,000.00	0.00	25,000.00

Making adjustments for governmental fund capital assets while preparing the Annual Financial Report:

The City of Somewhere received a donated building to be used by the Parks & Recreation Department. The cost to purchase would have been \$25,000
 The land was valued at \$5,000
 and the building was valued at \$20,000

Step 3:

Below is the Revenue Analysis Worksheet of the Annual Financial Report:

Functional Activity	Intergovernmental			Investment Earnings	Gain (Loss) on Sale of Capital Assets	Special/ Extra-ordinary Items	TOTAL
	Operating Grants and Contributions	Capital Grants and Contributions	State and Federal Shared Revenues				
From OP Conversion Spreadsheet		0.00		0.00	0.00	0.00	0.00
<u>PROGRAM REVENUES</u>							
General Government							0.00
Public Safety							0.00
Public Works							0.00
Public Health							0.00
Social/Economic Services							0.00
Culture/Recreation		25,000.00					25,000.00
Housing/Community Development							0.00
Conservation of Natural Resources							0.00
Interest on long-term debt							0.00
Miscellaneous							0.00
TOTAL PROGRAM REVENUES	0.00	25,000.00	0.00	0.00	0.00	0.00	25,000.00

Capital Asset Improvements:

- Improvements or betterments to a capital asset
 - Improvements – Provides additional value by:
 - Lengthening a capital asset's estimated useful life
 - Increasing a capital asset's ability to provide service (greater effectiveness or efficiency)
 - Repairs and maintenance – only retain value rather than add value and should be shown as an expenditure or expense



Disposal of an Asset:

- **Disposing of an asset may involve:**

- Sale for scrap (not assigned as a salvage value)
- Or sale for reuse
- Retirement from service – the asset should be removed from capital asset schedule

- **To Determine the carrying value:**

- Take the original cost and subtract the total of accumulated depreciation
- Example:
- \$45,000 Truck with an estimated useful life of 9 years:
 - After 8 years the accumulated allowance for depreciation would be \$40,000
 - $\$45,000 / 9 = \$5,000$ annual depreciation; $\$5,000 \times 8 \text{ years} = \$40,000$
 - **\$45,000** (original cost) minus **\$40,000** (accumulated depreciation) = **\$5,000** carrying value





Capital Asset Impairments:

- Retirement from service:
 - An asset no longer in service should be “written down” to its fair value or removed
- An impairment is a significant and unexpected decrease in the service utility of the capital asset that will continue to be used in operations
 - Result from:
 - Physical damage
 - Changes in law, regulations or environmental factors
 - Technological developments
 - Change in the manner or duration of use
 - Stoppage of construction or development
 - A temporary decline does not constitute an impairment
 - Must be both significant & unexpected
 - Amount of impairment should equal a portion of book value proportionate to the asset’s lost service utility
 - If an impairment is insured, the loss is netted against the insurance recovery
- Impairment – the cost of restoring lost service capacity resulting from an impairment should be capitalized as part of the cost of the asset

Disposal of a Capital Asset:

- **Year-end Adjustment for the Disposal of a Capital Asset:**

The original purchase of a \$45,000 Dump Truck that was fully depreciated and retired:

- **In the GCAAG – if applicable**

		<u>Debit</u>	<u>Credit</u>
✓ 9000 – 186100	Allowance for Depreciation	\$45,000	
✓ 9000 – 186000	Machinery & Equipment		\$45,000

- **In the Water Fund:**

		<u>Debit</u>	<u>Credit</u>
✓ 5210 – 186100	Allowance for Depreciation	\$45,000	
✓ 5210 – 186000	Machinery & Equipment		\$45,000

Disposal of a Capital Asset:

- **Year-end Adjustment for the Disposal of a Capital Asset:**

The original purchase of a \$45,000 Dump Truck that wasn't fully depreciated when retired, no cash was received as part of retirement:

- **In the Governmental Funds:**

		<u>Debit</u>	<u>Credit</u>
✓ 9000 - 280000	Investment in Cap Assets	\$ 5,000	
✓ 9000 – 186100	Allowance for Depreciation	\$40,000	
✓ 9000 – 186000	Machinery & Equipment		\$45,000

- **The \$5,000 book value for which no cash is received represents a loss on the disposal of an asset, and will be shown on the Government-wide Statements – adjust during the GASB34 conversion**

- **In the Water Fund:**

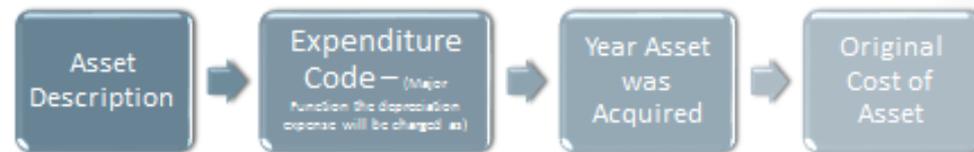
		<u>Debit</u>	<u>Credit</u>
✓ 5210 – 186100	Allowance for Depreciation	\$40,000	
✓ 5210 – 510360-810	Loss on Sale/Disposal of Capital Asset	\$5,000	
✓ 5210 – 186000	Machinery & Equipment		\$45,000

Capital Assets – the next step

- Once the required adjustments are made for newly acquired capital assets and/or the disposal of capital assets the next step will be the annual allowance for depreciation adjustments

The Third Session in the Capital Assets Training Video Series will cover the annual depreciation adjustments

Depreciation Schedule #1 - Section 1: Capital Asset information



MACHINERY & EQUIPMENT				10000					Clear All Negative	
Description	Acct	Expendure Code	FY/Bookyear	FY 12 Objct/Cost	FY14 Adjustments/ Transfer	FY14 Adjctbx	FY14 Disposed	FY14	FY14	
Chevrolet Dump Truck		43	2000	\$ 28,000.00					\$ 28,000.00	
Ford F250 Pickup		43	2010	\$ 12,000.00					\$ 12,000.00	
Blower		43	2012	\$ 11,000.00					\$ 11,000.00	
TOTAL MACHINERY & EQUIPMENT				\$ 51,000.00	\$ -	\$ -	\$ -	\$ -	\$ 51,000.00	