Capital Asset Management

From CIP to Fixed Asset to Disposition:
Booking a Capital Asset Through it's Life Cycle

Government Financial Professional Training
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Lincoln Chapter Association of Government Accountants

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TOPICS

1. Basics –
2. PBC's (audit schedules)
3. Life Cycle/General Ledger/JE's
4. Ownership/Impairments
5. Audit Standards & Procedures

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CAPITAL ASSET DEFINITION

Capital assets are assets that:
- Are used in operations, and
- Have an initial useful life in excess of one year.

The cost to acquire, construct, or improve a capital asset is deferred *(capitalized)* and allocated over its estimated useful life in the form of *depreciation expense* (tangible capital assets) or *amortization expense* (intangible capital assets.

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Major Capital Asset Classes

Capital assets not being depreciated:
- Land
- Construction in Progress

Capital Assets (net of accumulated depreciation):
- Buildings
- Improvements Other Than Buildings
- Machinery and Equipment
- Infrastructure
- Other Capital Assets

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Capital Assets on Statement of Net Assets

- Exceed by far the amounts reported for all other types of assets combined.
- Found only on financial statements prepared using the economic resources measurement focus and the full accrual basis of accounting (Statement of Net Assets)
- Are not financial assets, and are therefore not found in financial statements of governmental funds.

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Capital Assets Presentations and Disclosures in Financial Statements

- MD&A
- Statement of Net Assets
- Notes
  - SSAP
    - Capital threshold
    - Useful lives
  - Tables
    - Roll forward

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Audit Schedules

- Reconciliation of Capital Outlay to total Expenditures within a Fund
  - Identifies items to be capitalized (capital outlay)
  - Total capital outlay agrees to capital asset additions on capital assets roll forward schedules
- Capital Assets Roll Forward
  - Beginning balances
  - Additions
  - Disposals
  - Ending Balances

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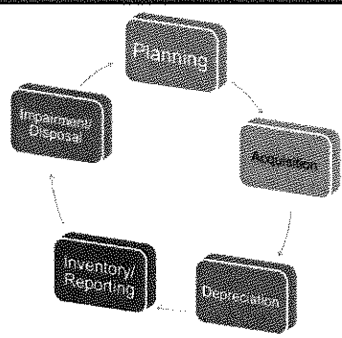
Life Cycle



Capital Project Life Cycle
Capital Improvements Plan (CIP)

Capital Project Life Cycle Starts in the CIP

The CIP is a planning document, a multi year rolling projection of the City's capital needs as well as the future financing requirements.

CIP is often linked to City financial and strategic plans.

CIP does not impart any spending authority.

Capital Project Life Cycle
Capital Budget

Capital Budget - imparts spending authority for capital projects.

Includes only capital projects with budgets appropriated by specific City Council action.

Capital budget may be appropriated on a project by project, multi-year basis, <u>or</u>

Capital budget may run concurrently with the operating budget fiscal year.

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Capital Projects General Ledger

Result - display information on capital assets by major asset class either on face of the financials or in the Notes.

Separate display for:

- Capital assets that are not being depreciated (land)
- Capital assets that are being depreciated (buildings, equipment, etc)

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Costs to Capitalize

Purchase and/ or construction costs.

Ancillary charges necessary to place the asset into its intended location and condition for use.

Include only costs incurred after it has become probable that an asset will be acquired.

Cost of a feasibility study is <u>not</u> capitalizable, because cost was incurred prior to determination of feasibility.

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Capitalization JE

Expenditure	Capital Outlay – Construction - Public Works	1,500,000	
Current Asset	Cash		1,500,000
	Capital Projects Fund - Construction Costs		
Capital Asset	Construction in Progress	1,500,000	
Expenditures	Capital Outlay – Construction - Public Works		1,500,000
	Convert capital outlay from functional activities to capital assets		

Capitalized Interest

An ancillary charge.

Limited to capital assets reported in enterprise funds.

Interest rate = weighted average rate for all outstanding interest bearing liabilities of that particular enterprise fund.

Capitalization period = begins at the start of preconstruction activities and ends when asset is substantially complete and ready for use.

Capitalized Interest

Non-externally restricted tax-exempt debt (does not warrant offsetting interest expense against interest earnings)

$4M Bonds @ 5%

Average accumulated expenditures = $600K

Capitalized interest = $600K x 5% = $30,000

Accrued interest = $4M x 5% = $200,000

Capitalized Interest JE

Capital Asset	Construction in Progress	30,000	
Expense	Interest Expense	170,000	
Liability	Accrued Interest Payable		200,000

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Project Placed in Service JE

Account Type	Description	Dr	Cr
Capital Asset	Infrastructure - Water Distribution System	1,530,000	
Capital Asset	Construction in Progress		1,530,000
	Record completion of elevated water storage tank placed in service Oct-2013		

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Depreciation JE

Account Type	Description	Dr	Cr
Expense	Depreciation	51,000	
Contra-Asset	Accumulated Depreciation		51,000
	Record FY 13 Depreciation expense (1,530,000 / 30 years = 51,000)		

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Disposition

- FY 2033 water tank is sold for scrap metal
- Proceeds at auction $20,000
- Net Asset Value
  - – Original Cost $1,530,000
  - – Accumulated Depreciation 20 years @ $51,000 = $1,020,000
  - – Net Book Value = $510,000
  - – Loss on Disposal $490,000

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Disposition JE

Account Type	Description	Dr	Cr
Current Asset	Cash	20,000	
Capital Asset	Infrastructure – Water Distribution System		1,530,000
Contra Asset	Accumulated Depreciation	1,020,000	
Non-Operating Income	Loss on Disposal	490,000	
	Record dismantling and sale of elevated storage tank		

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Ownership

- Can be reported on one and only one set of financial statements (FS).
- Reported on the FS of the government that owns them.
  - Title generally establishes ownership
  - Capital lease exception "use and enjoyment"
- When ownership cannot be established
  - Belongs to the government responsible for managing the capital asset
  - Key responsibility is maintenance

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Impairment

- GASB 42: A capital asset is considered impaired when its service utility has declined significantly and unexpectedly.
- Required to evaluate "prominent events" or changes in circumstances affecting capital assets

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Impairment

Considered impaired if both:

a) Decline in service utility of capital asset is large in magnitude, and

b) The event or change is outside the normal life cycle of the capital asset

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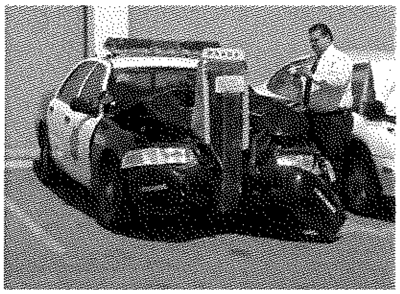
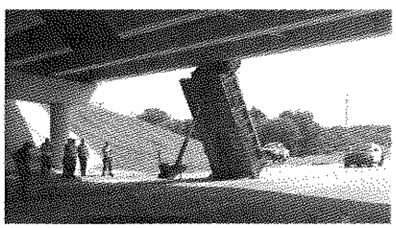
Impairment



Impairment



Impairment

Building

- Original cost $35M
- Accumulated depreciation $17.5M
- Book value $17.5M
- Loss in service capacity 20% ($17.5M / 5 = $3.5M)
- Restoration costs $6M
- Insurance recovery $4.5M

Impairment JE
Proprietary Fund

Account Type	Description	Dr	Cr
Current Asset	Cash	4,500,000	
Contra asset	Accumulated depreciation		3,500,000
Non Op Income	Gain on impairment		1,000,000
	Record net effect of insurance recovery for storm damage		
Capital Asset	Building	6,000,000	
Current Asset	Cash		6,000,000
	Capitalize restoration costs		

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Impairment JE
Governmental Fund

Account Type	Description	Dr	Cr
Current Asset	Cash	4,500,000	
Other financing source	Insurance recovery		4,500,000
	Record insurance recovery for storm damage		
Expenditures	Capital outlay	6,000,000	
Current Asset	Cash		6,000,00
	Record restoration costs		

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Impairment JE
Government-wide Conversion

Account Type	Description	Dr	Cr
Capital Asset	Building	6,000,000	
Other financing source	Insurance recovery	4,500,000	
Contra asset	Accumulated depreciation		3,500,000
General revenue	Gain on impairment		1,000,000
Expenditures	Capital outlay		6,000,000

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Auditing standards

- SAS 106– Audit Evidence
- SAS 107 – Audit Risk & Materiality in Conducting an Audit

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Risk analysis definitions

1. *Inherent risk (IR)* the susceptibility of a relevant assertion to a misstatement that could be material, either individually or when aggregated with other misstatements, **assuming that there are no related controls.**
2. *Control risk* (CR) is the risk that a misstatement that could occur in a relevant assertion and that could be material, either individually or when aggregated with other misstatements, **will not be prevented or detected on a timely basis by the entity's internal control.**
3. *Detection risk (DR)* is the risk that the **auditor will not detect a misstatement that exists in a relevant assertion** that could be material, either individually or when aggregated with other misstatements.

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Audit Procedures

Analytical Procedures

- Ratios:
  - depreciation expense to total depreciable fixed assets
  - repairs and maintenance exp to total depreciable fixed assets
- Comparisons:
  - of actual capital expenditures with capital budget
  - maintenance accounts with operating budget

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Audit Procedures (cont'd)

Substantive Testing

- Observing asset inventory and vouching of current-year additions and disposals;
- Searching for unrecorded disposals and tracing assets to and from asset listings;
- Reviewing:
  - lease agreement for capital leases;
  - other agreements for intangible assets;
  - maps and other engineering documents for completeness of infrastructure assets;
  - repairs and maintenance account transactions;
  - documentation for potential asset impairments;
  - estimated useful lives and depreciation methods;
- Recalculating:
  - depreciation expense; and
  - capitalized interest.

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Applicable problem areas

1. Charged to the wrong account or **not recorded at all**.
2. Used for purposes other than those for which they were intended.
3. Fail to include certain intangible assets and infrastructure.
4. Adequately safeguard capital assets from weather, loss, or misuse.
5. No procedures in place to identify and record intangible assets or infrastructure.
6. Segregation of duties:
   1. the individual responsible for asset accountability and the person who accounts for the assets is not adequate.
7. Periodic inventories of the capital assets are not performed.
8. Periodic counts of the capital assets are performed, but the custodian makes adjustments to the asset listing without obtaining the proper approvals.

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Applicable problem areas (cont'd)

8. Capital assets have been charged to repairs and maintenance or not recorded at all.
9. Entity is using improper lives or methods for calculating depreciation charges.
10. Material amounts of assets no longer in service are included in the capital asset amounts and have not been separately identified or removed from the books.
11. Asset impairments are not periodically evaluated.

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Final Thoughts

Capital Asset Policies

- Additions
- Accurate Records
- Depreciation
- Existence
- Disposal
- Funding

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Questions?

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