OHIO AUDITOR OF STATE
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CAPITAL ASSETS:
AN OVERVIEW

Local Government Services

So, What Are We Talking About?

- What is a capital asset?
- How do I value an asset?
- What do I have to capitalize?
- Depreciation and useful lives
- Impaired Assets
- Unorganized chaos
- Why do I even care?

Infrastructure

- Infrastructure assets are **long-lived capital assets that normally are stationary in nature and normally can be preserved for a significantly greater number of years than most capital assets.**
- Examples of infrastructure assets include roads, bridges, tunnels, drainage systems, water and sewer systems, dams, and lighting systems.
  - Buildings, except those that are an ancillary part of a network of infrastructure assets, should not be considered infrastructure assets.

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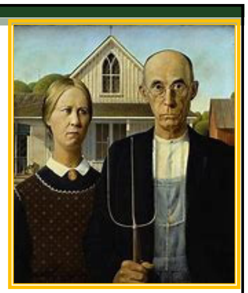
Unusual Capital Assets



Works of Art

Historical Treasures

These are most often considered non-depreciable assets.

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So, how much are my assets worth?

- **Capital assets should be reported at historical cost** – GASB 34, paragraph 18
  - The cost of a capital asset should include ancillary charges necessary to place the asset into its intended location and condition for use.
  - Ancillary charges include costs that are directly attributable to asset acquisition—such as freight and transportation charges, site preparation costs, and **professional fees such as architects and engineering**.

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Historical Cost

- How much you paid for your asset.
- What happens if you do not know the historical cost?
  - The Auditor of State's Office puts out a Bulletin every year regarding how to estimate historical cost using the Consumer Price Index, which is also included as part of the Bulletin. For 2021, it is AOS Bulletin 2021-03.

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So, how much is my donated asset worth?

- Donated capital assets should be reported at their acquisition value at the time of acquisition plus any ancillary charges, if any.

- **<u>Acquisition Value</u>** – GASB 72, paragraph 79 "The price that would be paid to acquire an asset with equivalent service potential in an orderly market transaction at the acquisition date, or the amount at which a liability could be liquidated with the counterparty at the acquisition date is referred to as acquisition value."

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Donated Assets *cont.*

- Basically, Acquisition Value is the price that you would have paid to acquire the same or very similar asset in a similar condition on the acquisition date.
- Acquisition value is a market based entry price and may be calculated from:
  - manufacturers' catalogs
  - price quotes in periodicals
  - recent sales of comparable assets
  - other reliable information.

**********Professional assistance may be helpful, <u>but is not required</u>.***

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What do I need to capitalize?

- Question 7.9.5. —**Does Statement 34 prescribe a minimum level for the capitalization of assets?**
  - Answer - No. Different types of assets, subsystems, or networks may have different capitalization thresholds, the dollar value above which asset acquisitions are added to the capital asset accounts.
  - Additionally, qualitative characteristics may also affect capitalization policies. Different thresholds may be established and used for purposes other than financial reporting—for example, for management control purposes or for compliance with laws and regulations.

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What do I need to capitalize?

- Question 7.85.4 - **Paragraph 115e of Statement 34 requires disclosure of a government's capitalization policy. What information should be included?**
  - *Answer —There are no specific requirements for capitalization policies. However, capitalization policies may include:*
    - (a) capitalization thresholds
    - (b) the methods used for determining historical cost or acquisition value, and
    - (c) the extent of infrastructure capitalization including (for phase 1 and phase 2 governments) whether infrastructure acquired prior to fiscal years ended after June 30, 1980, are reported and (for phase 3 governments) whether infrastructure acquired prior to implementation of GASB Statement 34 are reported.

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What do I need to capitalize?

- Question 7.9.6 - **Is title to an asset always equivalent to ownership?**
  - Answer - For the purposes of Statement 34, as amended, **ownership is considered a collection of rights to "use and enjoy" property, including the right to transmit it to others.**
    - For assets held for public benefit, such as roads, the right to use and enjoy property includes the right to determine how the property is used. All rights may not be vested in a single entity.
    - The term title is used to refer to the right to or ownership of an asset and is also used to refer to the evidence of such ownership. Title may be evidence of legal ownership; however, that ownership may be held for the entity's own benefit or for the benefit of another entity.
    - Generally, holding title to an asset equates to ownership, and the entity that holds title to an asset should report the asset in its financial statements.
    - **However, the facts and circumstances of the situation should be considered. There may be instances in which title is held by one entity, yet some rights of ownership are held by another entity. For example, the lessee reports assets under a capital lease although the lessor holds title.**

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What do I need to capitalize?

- Question 7.9.8 (Updated in the 2021 Implementation Guide) - **Should a government's capitalization policy be applied only to individual assets or can it be applied to a group of assets acquired together?**
- *EXAMPLE - Consider a government that has established a capitalization threshold of $5,000 for equipment. If the government purchases 100 computers costing $1,500 each, should the computers be capitalized?*

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And the answer is…….

- "**Capitalization policies adopted by governments include many considerations such as finding an appropriate balance between ensuring that all significant capital assets, collectively, are capitalized and minimizing the cost of recordkeeping for capital assets**."
- "A government should capitalize assets whose individual acquisition costs are less than the threshold for an individual asset if those assets in the aggregate are significant."
- "Computers, classroom furniture, and library books are examples of asset types that may not meet the capitalization policy on an individual basis, yet could be significant collectively."

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Let's Make a Deal!

- I purchased an asset for $1. Am I good or what?
- Question 7.12.17 - **A city purchased land from another government for the sum of $1. How should the city report this acquisition?**
- **Answer:** The purchase price of $1 does not meet the definition of an exchange transaction as defined in Statement No. 33, Accounting and Financial Reporting for Non-exchange Transactions, paragraph 1. An exchange transaction is one in which each party receives and gives up essentially equal values.
- **The substance of the transaction is that the city received a donation of land (a non-exchange transaction), and the city should report the acquisition at the estimated fair value of the land at the date of donation as required by paragraph 18 of Statement 34.**

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Software Licenses

- Question Z.51.21 - **A government acquires commercially available computer software through a five year licensing agreement. Under the terms of the agreement, the government is required to make annual installment payments to the software vendor for the right to use the software over the life of the agreement. How should this transaction be reported?**

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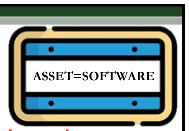
Answer



- As discussed in Question Z.51.1, **in such circumstances, the government should report the licensed software as an intangible asset.**
- A long-term liability representing the government's obligation to make the annual payments over the life of the contract also should be reported.
- The provisions of Statement 62, paragraphs 211–271, should not be applied to determine the financial reporting for such a licensing agreement, even if the agreement is referred to as a lease, because the provisions of Statement 62 do not apply to licensing agreements.

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So many assets, so little time

- **Each entity's capitalization threshold should be specific to them**.
- If you start to see over time that you are picking up more and more "immaterial" assets, what can you do?
- From Question 7.22.17 - Use of a capitalization threshold is an application of accounting policy, not a change in accounting principle. **Changes in capitalization threshold involve many considerations such as ensuring that all significant capital assets, collectively, are capitalized while considering the cost of recordkeeping for capital assets**.

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Depreciation and Useful Lives

- Per GASB 34 paragraphs 21 & 22:
  - Capital assets should be depreciated over their estimated useful lives unless they are inexhaustible or are infrastructure assets reported using the modified approach.
  - Inexhaustible capital assets such as land and **<u>land improvements</u>** should not be depreciated.

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Wait a second…….

- Question 7.13.4 – **Are land improvements depreciable?**
- It depends:
  - Improvements that produce permanent benefits—for example, fill and grading costs that ready land for the erection of structures and certain landscaping—are not depreciable.
  - Alternatively, improvements that are considered part of a structure or that deteriorate with use or the passage of time, such as parking lots and fencing, should be considered depreciable.

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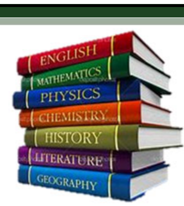
What about books?



- Question 7.9.2 – **Are library / textbooks depreciable assets?**
  - Answer - If library books are considered to have a useful life of greater than one year, they are capital assets and are depreciable.
  - Because most library holdings consist of a large number of books with modest values, group or composite depreciation methods (as discussed in paragraphs 163 –166 of Statement 34) may be appropriate.

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Depreciation Methods

- Per Question 7.13.2 - **Any rational and systematic method may be used**. Some of the common categories of depreciation methods include:
  - Straight-line method – **MOST WIDELY USED**
  - Decreasing-charge methods which include declining balance, double-declining balance, and sum-of-years digits
  - Increasing-charge method
  - Unit-of-production/service methods, which allocates depreciable cost of an asset over its expected output.

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Salvage Values

- From Question 7.13.3 - Salvage value is the **estimated fair value of a capital asset, infrastructure or otherwise, remaining at the conclusion of its estimated useful life**. In most cases, it is probable that many infrastructure assets will have no salvage value, given the cost of demolition or removal.
  - These are not required.
  - An asset with an estimated salvage value will, in theory, never be fully depreciated.

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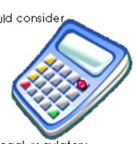
How long will these things last?

- Question 7.14.1 – **How is estimated useful life calculated?**
  - Answer - In determining estimated useful life, a government should consider
    - an asset's present condition,
    - use of the asset,
    - construction type,
    - maintenance policy, and
    - how long it is expected to meet service and technology demands.
  - For an intangible asset, a government also should consider any legal, regulatory, or contractual provisions that may limit the length of the asset's useful life.
- **Useful lives should be based upon the government's own experience and plans for the assets. Although comparison with other governments or other organizations may provide some guidance, property management practices, asset usage, frequency of routine maintenance, and other variables (such as weather) may vary significantly between governments.**



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Any recommendations?

- Per Question 7.14.2 – **Is there a recommended schedule of useful lives?**
  - Answer - No. A specific schedule is not recommended. Schedules of useful lives recommended by professional organizations may be a helpful starting point. However, schedules of depreciable lives established by federal or state tax regulations are generally **NOT** intended to represent useful lives.

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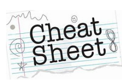
Are you sure there is not a ?



- Per Question 7.14.3, some sources of potential useful lives are:
  - (a) general guidelines obtained from professional or industry organizations,
  - (b) information for comparable assets of other governments, or
  - (c) internal information. Examples of internal information include property replacement policies for equipment or vehicles, property disposal records, and budget documents.

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Finally, I'm done!

Not so fast…

- Question 7.14.4 – **Once a depreciable asset's useful life is estimated, is it ever necessary to review the estimate in later years?**
  - Answer - Yes. Because depreciation is a method of allocating an asset's cost over its useful life, a periodic review of this useful life is necessary for depreciation to reflect that allocation.
  - Any change in useful life is applied prospectively in accordance with paragraph 69 of Statement 62.
  - As many factors may affect the useful life of an asset, periodic reassessment of estimated useful lives may be appropriate. For example, equipment may not be replaced according to property management policies if appropriations for the replacement costs are not made. Planned preventative maintenance may not be performed, resulting in a reduction in the useful life of an asset. The use of the asset may have changed, or the asset may have been damaged or impaired by weather or other circumstances.

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When should I remove assets from my system?

- Question 7.13.5 - **Should capital assets be written off when they become fully depreciated?**
  - Answer - **No. Capital assets should be written off when they are disposed of.** As a result of differences between estimated useful lives used for depreciation computations and actual useful lives, governments may, in limited cases, have capital assets that are fully depreciated but have not been disposed of. (See also question 7.14.4.) Such capital assets should continue to be reported by the government.
  - Fully depreciated capital assets do not affect the net balance of capital assets reported in the statement of net assets. However, the balances of historical cost and accumulated depreciation that are disclosed in the financial statements or notes to the financial statements are affected by and should include fully depreciated capital assets that have not been disposed of.

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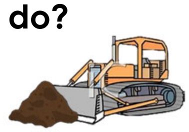
We only have part of an asset we use. What do we do?



- You could have an impaired asset. According to GASB 42, an asset is impaired if it has both:
  - (a) the decline in service utility of the capital asset is large in magnitude and
  - (b) the event or change in circumstance is outside the normal life cycle of the capital asset.

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Impairment Examples

- Evidence of physical damage – fire or tornado or earthquake strikes.
- Enactment of approval of laws or regulations or other changes in environmental factors – if the State of Ohio outlawed the use of computers.
- Technological changes or evidence of obsolescence – Texas Instruments TI 80 or Commodore 64 computers….how many of you still have one of these?
- Changes in the manner or duration of use of a capital asset – School District closes a newly-constructed building after only 2 years of operation due to substantial traces of radiation being discovered. It is determined the building cannot reopen.
- Construction stoppage – School District starts digging and pouring a foundation for a new building only to discover a hidden diamond mine.

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What are my auditors REALLY looking for?

- Are your assets complete? Have you accounted for everything you should?
- Are your assets in the correct assets classification / function for depreciation?
- Do you have buses sitting in Buildings and Improvements or are you depreciating your water equipment and showing the cost against the sewer fund?
- Are you following your asset policy? Do you need to adjust your policy?
- Does your asset policy and useful lives make sense and appear reasonable?
- Is depreciation in your asset system (whatever system you use) calculating depreciation correctly/reasonably?
- **Every audit firm, every audit team and every year can be different. Each one looks for certain things based on their audit programs and experiences. They also may have a requirement to look at certain things one year that they were not required to test in prior years.**

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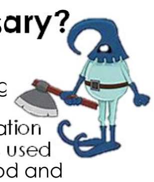
Is all of this really necessary?



- **GAAP answer** - The purpose of reporting capital assets, including CIP and infrastructure, is to contribute to information about the consumption of all resources used in providing services in the current period and about the net economic resources remaining that can be used to provide services in the future.
- **Non-GAAP answer** - It is used as a planning tool – a way to keep track of how long the things you purchase are lasting and, based on those life spans, it allows you to prepare financially for their replacement.

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Sources

- Governmental Accounting Standards Board (GASB)
  - GASB Statement No. 34
  - GASB Statement No. 72
  - GASB Implementation Guide, Chapters 7 and Z
  - GASB Implementation Guide No. 2021-1
- Auditor of State Bulletins
  - https://ohioauditor.gov/publications/bulletins/2019/default.html
- https://www.gfoa.org/best-practices
- 20+ years of providing assistance to local governments.

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