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July 1, 1994	July 1, 1994	I	GAAP Accounting and Financial Reporting Principles
Revision No.	**Date Revised**	**Chapter**	**Title:**
2	November 2008	16	Capital Assets

NATURE AND PURPOSE

Prior to the Governmental Accounting Standards Board's (GASB) issuance of GASB Statement No. 34, Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments (GASBS 34), Local Units of Administrations' (LUAs') capital assets not used in proprietary fund operations or accounted for in trust funds, were classified as general fixed assets. In most instances, these were the capital assets purchased from governmental fund type resources. LUAs accounted for capital assets in the General Fixed Assets Account Group (GFAAG) rather than the governmental fund which financed the acquisition.

GASBS 34 eliminated the GFAAG. Rather, GASBS 34 requires LUA's to report capital assets at the government-wide reporting level and in both the governmental activities and business type activities column and at the fund reporting level.

ACCOUNTING ISSUES

The GASB provides specific guidance regarding various issues in accounting for general capital assets.

The capital asset system that the LUA uses will serve as the database for reporting their capital assets in the governmental fund activities column on the government-wide statement of net assets. The LUA will need to add the capital assets it purchases from governmental fund types to its capital asset system.

Valuation of Capital Assets

The 2014 Codification Sections 1400.102 and 1400.103 indicate that all purchased capital assets should be recorded at historical cost (i.e., original cost). The cost of a capital asset includes not only its purchase price or construction costs, but also any other reasonable and necessary costs incurred to place the asset in its intended location and use. Such costs could include the following:

- Legal and title fees
- Closing costs
- Appraisal and negotiation fees
- Surveying fees
- Site preparation costs
- Demolition cost
- Architect and accounting fees
- Insurance premiums during the construction phase
- Transportation charges

The capitalization of interest on capital assets the LUA finances with debt issuances may not be capitalized in the governmental activities column on the government-wide statement of activities.

If an LUA is establishing capital asset records for the first time, the LUA may value the purchased capital assets at estimated historical cost if the original cost is not available. Original cost is defined as the cost of capital assets in accordance with costs prevailing at the date the LUA first constructed or originally installed the capital asset.

LUAs should record donated or contributed capital assets at their fair market value on the date they record the donation. Fair market value may be defined as the estimated amount at which the capital asset might be exchanged between a willing buyer and a willing seller, neither being under compulsion, each having reasonable knowledge of all relevant facts, with equity to both. Chapter 37 provides specifics regarding valuing and costing capital assets.

Acquisitions of Capital Assets

LUA's may acquire capital assets by outright purchase, construction, lease-purchase agreement, installment purchase contract, or through donation. Generally, capital assets acquired by purchase or construction are valued in the capital asset records in the amount of the related governmental fund expenditure.

Subsequently, the LUA should add this capital asset to its capital asset system. The journal entry to record a capital asset acquisition (e.g., machinery and equipment) in the general fund at a cost of $19,000 is:

Description	Account No.	DR	CR
Expenditures - machinery and equipment (function)	730.xx	$19,000	
Accounts payable	421		$19,000

Note - the LUA must add this asset to its capital asset system; however, a journal entry is not required since the LUA does not report capital assets in the General Ledger.

If an LUA receives a donated capital asset, the LUA would simply add the donated asset to its capital asset system.

Trade-Ins

When an LUA trades in a capital asset, the reporting of the purchase of a new asset on the operating statement is more complex than those without a trade-in. Generally, there are two acceptable methods, the gross method and the net method. When using the gross method, the fair value or final invoice amount before trade-in allowance is reported as an expenditure and the trade in value is reported as an other financing source captioned compensation for the traded-in asset.

For example at the fund reporting level, an LUA's general fund purchases a capital asset (e.g., a truck) for $19,000 (i.e., cost $21,000 less trade-in of $2,000 for a capital asset originally purchased at a cost of $15,000 from general fund revenues). This example reports the purchase using the gross method.

General Fund:

Description	Account No.	DR	CR
Machinery and equipment	730.xx	$21,000	
Cash in bank	0101		$19,000
Sale or compensation for Loss of assets	5300		2,000

Under the net method, the net fair value of the new asset or net amount of the final invoice is reported as an expenditure.

General Fund:

Description	Account No.	DR	CR
Machinery and equipment	730.xx	$19,000	
Cash in bank	0101		$19,000

Under either method, the value of the capital asset in the LUA's capital asset system is the same.

At the government-wide financial reporting level, the LUA would follow APB Opinion 29, Accounting for Nonexchange Transactions to report trade-ins. The section "Disposition of Capital Assets" presented later in this chapter explains how to report these transactions at the government-wide reporting level.

Construction in Progress

When an LUA is constructing a capital asset in a capital projects fund and it is not complete at June 30, the LUA reports the current year costs in its capital asset system as "construction in progress." The value of construction-in-progress is the amount of expenditures incurred during the fiscal year.

If an LUA has a building project completed in the current year, the LUA reclassifies the capital asset from the "construction in progress" account into the "buildings" account.

Capital Leases

LUAs routinely use capital assets in governmental fund activities under lease agreements with third parties covering one or more years. Many of these lease agreements, which in form appear to be extended rental agreements, are in substance purchases being financed under installment contracts. The 2014 Codification Section L20 provides the accounting treatment applied to these capital assets. This pronouncement provides that the lease capitalization and disclosure requirements Statement of Financial Accounting Standards (SFAS) No. 13, Accounting for Leases (SFAS No. 13), as amended and interpreted, are applicable to general capital assets. These requirements are illustrated in Chapter 10.

If the criteria of SFAS No. 13 are met, 2014 Codification Section L20.111 provides that these capital assets should be capitalized in the LUA's capital asset system at the inception of the agreement at the net present value of future minimum lease payments.

The 2011 Codification Section L20.110 provides that if a fiscal funding clause or cancellation clause has an effect on the lease term, these clauses should not prohibit lease agreements from being capitalized. If it is determined after evaluation of the clause that the possibility of cancellation is remote and the lease meets the criteria of SFAS No. 13, the capital asset acquired through the lease should be capitalized.

Capitalization Policy

Although Chapter 37 discusses how to determine an LUA's capitalization policy, this chapter provides a summary of this determination.

Capital Asset Threshold. Typically, two criteria are apparent when determining the LUAs capitalization policy, the cost of the asset and its estimated useful life. Determining the dollar threshold level for capital assets is a very important element in an LUA's capital asset system.

There is a direct relationship between the number of assets and the dollar threshold. Typically, the largest percentage of total dollar value can be attributed to land, buildings, and vehicles that are not affected by the lower capitalization threshold. It is better to control the big dollar items than to waste a lot of time and effort in attempting to track low cost equipment.

LUAs should consider two threshold levels:

- GAAP reporting
- Control purposes

Because GASBS 34 requires LUAs to depreciate their capital assets and recognize gains and losses on their disposition of capital assets, an LUA should consider a higher threshold for GAAP reporting. The national Government Finance Officers Association recommends that governments use a $5,000 threshold for GAAP reporting. This level would substantially reduce the number of assets that the LUA would have to account for.

Both the Federal and State requirements for those capital assets and LUA purchases with Federal monies and State monies is currently $5,000.

As long as an LUA maintains a property record of these assets, it meets the stewardship requirements. As a result, the LUA would not need to include them in the capital asset database for GAAP accounting information.

Depreciating Capital Assets

In the governmental funds, LUAs do not depreciate their capital asset as these funds use a “current financial resources” measurement focus. This non-recognition of depreciation is a result of the current financial resources measurement focus applied to governmental funds (i.e., governmental fund types are intended to account for and report the sources and uses of financial resources). At the government-wide reporting level, the GASB requires LUAs to depreciate all capital assets. In order to depreciate capital assets, the LUA needs to consider the following items:

- The capital asset cost
- The depreciation method
- The estimated useful life
- A residual value (i.e., a salvage value)

Chapter 37 provides a discussion on valuing capital assets.

Depreciation Methods. LUAs may use any established depreciation method. Any rational and systematic method may be used. Some of the common categories of depreciation methods include:

- The straight-line method
- Decreasing-charge methods, which include declining balance, double-declining balance, sum-of-the-years’-digits, among others
- Increasing-charge methods, which include sinking fund and annuity methods
- Unit of production/service methods, which allocate the depreciable cost of an asset over its expected output.

Estimated Useful Lives. In determining estimated useful life, an LUA should consider an asset’s:

- Present condition
- The intended use of the asset
- Construction type
- The maintenance policy used

- How long the LUA expects the capital asset to meet service and technology demands

LUAs should base their useful lives upon their own experience and plans for the assets. Although comparisons with other LUAs may provide some guidance, property management practices, asset usage, and other variables (such as weather) may vary significantly between LUAs.

Schedules of useful lives recommended by professional organizations (e.g., the Association of School Business Officials International), 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, particularly those that include accelerated lives.

Once the LUA estimates its depreciable asset's useful life, it is necessary for LUAs to review these estimates in later years. Since 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. The LUA should apply any change in useful life prospectively in accordance with paragraph 10 of APB Opinion No. 20, Accounting Changes. As many factors may affect the useful life of an asset, periodic reassessment of estimated useful lives may be appropriate. For example, an LUA may not replace equipment according to property management policies if the school board does not make appropriations for the replacement costs available. 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.

Residual Values. Since most LUAs use their capital assets for long periods, the use of residual values is limited. For example, an LUA might only use a residual value when the LUA estimates the residual value to be at least 15% of the original cost. LUAs report residual values most commonly with their buildings.

Classifying Depreciation Expense - At the government-wide financial reporting level, LUAs should charge depreciation as a direct expense of its functions on the statement of activities. In other words, an LUA needs to classify its capital assets by reporting function that uses the asset.

The GASB indicates that if a capital asset is used by a few functions, the depreciation expense should be allocated appropriately. If an LUA reports a capital asset that essentially serves all functions, it need not allocate the depreciation expense to each function, rather it may be reported as a separate line item on the statement of activities as "unallocated". If the LUA utilizes the GADOE portal's spreadsheets for its external financial reporting, depreciation is allocated to each function through formulas in these spreadsheets.

In determining whether to charge depreciation as a direct expense of an LUA's functions, the LUA needs to distinguish between a "shared" capital asset and one that "essentially serves all functions." The difference is generally in the number of functions that share the asset. As the number of functions increases, the ease, practicality, and usefulness of assigning depreciation to those functions decreases. Therefore, depreciation of assets that serve many, or "essentially all," functions is not required to be included in the direct expenses of those many functions. A shared capital asset is generally used by only a few functions, and its use can be specifically identified to those functions. Usage of a shared asset is generally such that an objective measurement can be made for the assignment of costs—based on square footage for a building or mileage for a vehicle, for example.

Generally, LUAs should allocate the depreciation expense on school buildings to the appropriate functions since the majority of the expense relates to instructional functions.

Changes in Carrying Values

A change in the carrying value of capital assets which results from a revaluation of the estimated historical cost occurring during the year should be adjusted within the LUA's capital asset system. At the fund reporting level, the operating statements should not include any results of this transaction since it is not classified as an "exchange transaction." In the notes to the financial statements, the changes in any asset values may be presented in the "changes in capital assets" disclosure as a separate column with a narrative explaining the nature and purpose of the change.

At the government-wide reporting level, the LUA must reflect the change in the values. Normally, the change in the values would be reflected as a prior period adjustment and the beginning equities would be restated on the government-wide statement of activities.

If a government increases its capital asset threshold (e.g., increasing the amount from $2,000 to $5,000), the LUA should remove all items between these two thresholds. On the government-wide statement of activities, this change would be reflected as a "special item" if material.

Dispositions of Capital assets

The accounting for the disposition of general capital assets often is overlooked. Capital assets are disposed of for the following reasons:

- To replace them with assets of similar function but with longer lives and greater value
- The asset no longer may be needed and may be declared surplus
- It may wear out or become obsolete
- A governmental fund may sell or transfer the asset to a proprietary fund
- Trade the asset to another government for a similar or dissimilar asset.

When an LUA disposes of assets, the LUA should remove the capital asset from its capital asset system. No reporting would be made at the governmental fund reporting level unless the asset is sold. If the capital asset was a normal disposal and the amount the LUA received was immaterial, they could simple report the proceeds as miscellaneous revenues. If the amounts are material, GASBS 34 requires LUAs to report the proceeds as an "other financing source." If the sale meets the following criteria for a special item, the LUA would report the proceeds as a special item on its governmental fund type operating statement:

- Unusual in nature
- Or infrequent in occurrence
- And within the control of management

For example, if an LUA sells land that they previously purchased for a government site, the LUA would classify the sale as a special item as it would be unusual and infrequent, but within the LUA management control.

At the government-wide financial reporting level, an LUA would follow APB Opinion 29, Accounting for Nonexchange Transactions. The accounting principles differ for exchanges involving similar and dissimilar capital assets.

When accounting for exchanges involving dissimilar assets and no cash paid, an LUA would:

- Value assets at the market value of the asset surrendered or the asset received, whichever is more clearly determinable.

- When the market value of both the asset surrendered and the asset received is determinable, the value of the asset surrendered should be used.

- Recognize any resulting gain or loss

When accounting for exchanges involving dissimilar assets with cash paid, an LUA would:

- Value assets at the market value of the asset surrendered plus the cash paid

- Recognize any resulting gain or loss

When accounting for exchanges involving similar assets and no cash paid, an LUA would:

- Value assets at the book value when a gain is involved, thus, no gain is recognized

- Value assets at market value when a loss is involved and the LUA reports the loss

- This treatment is the same as that for dissimilar assets

When accounting for exchanges involving similar assets and cash paid, an LUA would:

- Value assets at the book value plus cash paid when a gain is involved, thus, no gain is recognized

- Value assets at market value when a loss is involved and the LUA reports the loss

Asset Transfers

Often, activities accounted for in proprietary fund types are discontinued or transferred to a governmental fund type (e.g., the general fund). In these instances, any capital assets transferred should be reported at gross (i.e., original cost) in the capital asset system since 2011 Codification Section 1400.102 requires capital assets to be valued at historical cost or estimated historical cost. At the governmental fund reporting level, no entry is necessary in the governmental fund type operating statement using the flow of current financial resources measurement focus. The lack of reporting is consistent with the receipt of donated capital assets, which LUAs normally do not report in a governmental fund type operating statement.

At the government-wide financial reporting level, the LUA would recognize the book value of the capital asset they received as a contribution on the statement of activities.

Impaired Assets

A capital asset is considered impaired when its service utility has declined significantly and unexpectedly.

Annually, Georgia LUAs are required to evaluate prominent events or changes in circumstances affecting capital assets to determine whether the impairment of a capital asset has occurred. Such events or changes in circumstances that may be indicative of impairment include:

- Evidence of physical damage,
- Enactment or approval of laws or regulations or other changes in environmental factors,
- Technological changes or evidence of obsolescence,
- Changes in the manner or duration of use of a capital asset, and
- Construction stoppage.

A capital asset generally should be considered impaired if 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.

Impaired capital assets that will no longer be used by the school district should be reported at the lower of carrying value or fair value. Impairment losses on capital assets that will continue to be used by the district should be measured using the method that best reflects the diminished service utility of the capital asset. Impairment of capital assets with physical damage generally should be measured using a restoration cost approach, an approach that uses the estimated cost to restore the capital asset to identify the portion of the historical cost of the capital asset that should be written off. Impairment of capital assets that are affected by enactment or approval of laws or regulations or other changes in environmental factors or are subject to technological changes or obsolescence generally should be measured using a service units approach, an approach that compares the service units provided by the capital asset before and after the impairment event or change in circumstance. Impairment of capital assets that are subject to a change in manner or duration of use generally should be measured using a service units approach, as described above, or using deflated depreciated replacement cost, an approach that quantifies the cost of the service currently being provided by the capital asset and converts that cost to historical cost.

If not otherwise apparent from the face of the financial statements, the description, amount, and financial statement classification of impairment losses should be disclosed in the notes to the financial statements and discussed in the management discussion and analysis. If evidence is available to demonstrate that the impairment will be temporary, the capital asset should not be written down.

Impaired capital assets that are idle should be disclosed, regardless of whether the impairment is considered permanent or temporary.

An insurance recovery associated with events or changes in circumstances resulting in impairment of a capital asset should be netted with the impairment loss. Restoration or replacement of the capital asset using the insurance recovery should be reported as a separate transaction, as an Other Financing Source. Insurance recoveries should be disclosed if not apparent from the face of the financial statements. Insurance recoveries for circumstances other than impairment of capital assets should be reported in the same manner.

Appendix M provides additional guidance to Georgia LUAs in accounting and financial reporting standards for impairment of capital assets.