Government Accounting for Fixed Assets

GASB guidelines for your organization

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To manage fixed assets for a governmental agency, you need to follow the guidance issued by the Governmental Accounting Standards Board (GASB). Established in 1984, GASB is the source of Generally Accepted Accounting Principles (GAAP) for state and local governments. Not only are governments fundamentally different from for-profit businesses, but the readers of government financial statements are different from those of private companies. Although GASB standards are not written into federal law, they are enforced either by state law or through the audit process. .

It is important to know that GASB's pronouncements apply not only to state and local government agencies but also to:

- Public benefit corporations and authorities.
- Public employee retirement systems.
- Public utilities.
- Public hospitals and other healthcare providers.
- Public universities and colleges.

Even though this paper refers to state and local governments throughout, it also applies to all of the above.

GASB statements improve financial reporting by reducing inconsistencies that may have developed among government agencies and provide more clarity. They make possible the comparison of the financial statements of various state and local governments and agencies.

The three principal GASB pronouncements that affect how such organizations manage their fixed assets are:

- GASB Statement No. 34: Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments (Issued 6/1999).
- GASB Statement No. 42: Accounting and Financial Reporting for impairment of Capital Assets and for Insurance Recoveries (Issued 11/2003).
- GASB Statement No. 51: Accounting and Financial Reporting for intangible Assets (Issued 7/2007).

Let's take a closer look at each of these pronouncements and how the guidance they contain should be implemented

GASB Statement No. 34: depreciating capital assets

Statement No. 34 requires, for the first time, that all government entities use accrual accounting and depreciate their capital assets. Its effective dates were based on the entity's annual revenues and were done in three phases: Those with total annual revenues of $100 million or more had to comply by the first fiscal year beginning after June 15, 2001, those with total annual revenues of at least $10 million but less than $100 million had to comply by the first fiscal year beginning after June 15, 2002, and those with annual revenues of less than $10 million had to comply by the first fiscal year beginning after June 15, 2003.

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Defining capital assets

Capital assets have a useful life beyond a single reporting period and include:

- Land and land improvements.
- Easements.
- Buildings.
- Vehicles.
- Machinery and equipment.
- Works of art and historical treasures.
- Infrastructure*.

*Infrastructure assets have long lives and are usually stationary. Examples are roads, bridges, tunnels, sewer systems, and lighting systems. Unless part of a network of infrastructure assets (such as a toll booth), buildings are not included in this category.

Reporting

Capital assets should be reported at historical cost (including freight and any installation charges). Donated assets should be recorded at their fair market value at the time received.

Depreciable assets should be reported net of accumulated depreciation on the Statement of Net Assets. Nondepreciable assets should be reported separately if there are enough of them to warrant this. Depreciation expense should be reported in the Statement of Activities.

Assets, less any liabilities attributed to them, should be displayed in the following three categories:

- Amounts invested in capital assets, net of any related debt
- Restricted assets*
- Unrestricted assets

*Restricted assets are those on which constraints are imposed on the assets' use, either by outside creditors or contributors or by legislation. Where there are permanent endowments, restricted net assets should be displayed in two additional groupings: expendable and nonexpendable. (Nonexpendable net assets are required to be retained in perpetuity.)

Depreciation expense for assets that can be identified with a specific function should be included in direct expenses. "Direct expenses" are those that are identifiable to a particular function and specifically associated with a service or department. If assets are shared among several departments, their depreciation expense should be appropriately allocated. If an asset serves all functions (such as the city hall), its depreciation expense is not included in direct expenses but rather is either a separate line in the Statement of Activities or is part of the "general government" function.

Depreciation expense on infrastructure assets is not to be allocated to the various functions but should be reported as a direct expense of the function associated with their maintenance or as separate line in the Statement of Activities.

Depreciation

Assets are depreciated over their estimated useful lives in any systematic and rational manner. Examples of depreciation methods that may be used are straight-line and declining-balance. Common declining-balance methods are double declining-balance and 150% declining-balance.

When determining the estimated useful life of an asset, the government agency can use:

- Published guidelines from professional organizations or industries.
- Available information for comparable assets used by other governments.
- Internal information based on past experience.

Always consider the asset's current condition and how long it is expected to be of service.

Depreciation may be calculated on individual assets, on classes of assets, on networks of assets, or on subsystems of a network of assets. A "network of assets" simply means a group of assets that together provide a specific type of service. A dam, for example, consists of a concrete dam, a spillway, and a series of locks. A "subsystem" of a network of assets consists of all the assets that make up a segment of a network of assets. For example, all government roads are a network of infrastructure assets, consisting of interstate highways, state highways, and rural roads, each of which is considered to be a subsystem of the network.

Infrastructure assets:

Infrastructure assets do not have to be depreciated and may instead use a "modified approach" if the following two conditions are met:

1. They are maintained at (or above) the condition established and disclosed by the government agency, and
2. They are managed as follows:

- A current inventory of the infrastructure assets is maintained.
- An assessment of the infrastructure assets' condition must be performed and reported on using a scale of measurement at least every three years.
- The amount needed to maintain and preserve the infrastructure assets in the specified condition is decided on annually.

The idea behind using the modified approach is that if infrastructure assets are being so well maintained, they really don't depreciate in value.

If the modified approach is used, any additions or improvements made to the infrastructure assets that increase their capacity or improve their efficiency should be capitalized. All other expenditures made for these assets should be expensed as incurred.

If at any point the requirements for using the modified approach are not being met, then the assets should be depreciated on a prospective basis.

Works of art and historical treasures:
Works of art and historical treasures should be capitalized when held in a collection if:

- They are held for public exhibition, education, or research (that is, not for financial gain).
- They are protected and preserved.
- The proceeds from their sales must be used to acquire other items for the collection.

Only if works of art and historical treasures will wear out (for example, items are on either public display or are being used for research) and their useful lives are shortened should they be depreciated. This is true whether they are individual items or if they are held in a collection.

GASB Statement No. 42: impairment of capital assets and insurance recoveries

Statement No. 42 contains guidance for measuring impairment losses on capital assets. Governments are required to report the effect of impairments when they occur rather than through depreciation expense or when the asset is disposed. The Statement is effective for periods beginning after 12/15/04.

Prior to the issuance of Statement No. 42, governments were not required to report any decrease to an asset's carrying value except through depreciation. There was no published guidance for assessing and recording impairment losses. In addition, there was also no guidance for the proper treatment of insurance recoveries. This Statement provides guidance on both of these issues.

Statement No. 42 contains guidance for measuring impairment losses on capital assets.

An asset is considered impaired when its usefulness for service (AKA, “service utility”) decreases significantly and unexpectedly (that is, something occurs that is not within the normal life cycle of the asset).

Assessing impairment:

When deciding if an impairment has occurred, a two-step process is required:

1. Identify any potential impairment (by looking for one of the indicators below)
2. Test for impairment

The following are some common indicators that an impairment has occurred for which the asset should be tested:

- Physical damage to the asset
- The enactment of new regulations and standards (or changes in environmental factors) that the asset cannot meet (nor is capable of being modified to comply with)
- Technological advancement that makes an asset obsolete
- A change in manner or duration of the asset’s use
- The end of construction (usually due to lack of funding)

While a change in demand for the services of an asset is not considered a separate indicator of impairment, it may signify an indicator of another sort, and, therefore, impairment testing may be required.

When assessing for impairment, land is a separate capital asset and should not be grouped with buildings or depreciable improvements. This is important so that any unrealized gain in the fair value of the land will not offset any impairment found on buildings or other improvements.

Measurement of impairment:

The following are methods for measuring an impairment loss for assets that will continue to be used by the government:

- Restoration cost approach: The amount of impairment is the estimated cost to restore the utility of the asset. The estimated cost of the restoration is converted to historical cost either by:
  - -Restating the estimated restoration cost using an appropriate cost index.
  - - Applying a ratio of estimated restoration cost over the estimated replacement cost to the carrying value of the asset.
- Service units approach: Determine the amount of the historical cost of the asset’s service utility that cannot be used due to the impairment or change in circumstances. This is done by evaluating the service provided by the asset both before and after the impairment.

- Deflated depreciated replacement cost approach: Determine the cost of replacing the asset, taking into consideration the asset's current age and utility. To do this, first, estimate the cost of an asset that could replace the current level of service. Next, depreciate that current cost estimate to reflect the age of the asset. Finally, deflate the determined amount to convert it to historical dollars.

Statement No. 42 actually recommends one of the above measurement methods based on the type of impairment indicator:

- Use the restoration cost approach if physical damage to the asset has occurred.
- Use the service units approach if there was an enactment of new regulations, changes in environmental factors, or technological advancement has occurred.
- Use the deflated depreciated replacement cost approach or the service units approach if there has been either a change in manner or duration of use of the asset.

Impaired assets that will no longer be used by the government or have been affected by a construction stoppage should be reported at the lower of their carrying value or fair market value.

Reporting:
Impairment losses (unless considered to be temporary) should be reported in the:

- Statement of Activities.
- Statement of Revenues, Expenses, and Changes in Fund Net Assets.

If reported as a program expense, an impairment loss should be reported as a direct expense of the program that used the impaired asset.

The amount of the impairment loss, a general description, and the financial statement classification should all be disclosed in the financial statement notes if not readily apparent on the face of the statements.

Permanent versus temporary impairments:
Although generally an impairment loss is permanent, there are times it may be considered temporary. This occurs when the indicator of the impairment (such as a work stoppage or change in use) can be shown to be temporary in nature. When this is the case, the asset is not written down.

Once an impairment loss is recognized, however, it should not be reversed. This is true even if there is an unforeseen change in future years of the circumstances that caused the impairment.

Whenever there is an indication of an impairment but impairment testing indicates there is no impairment loss, it is still a good idea to reevaluate the asset's remaining estimated useful life and salvage value and change them if necessary.

Insurance recoveries:
When an impairment loss and an insurance recovery occur in the same year, the impairment loss should be reported net of the insurance recovery. However, insurance recoveries in subsequent years should be reported as program revenue, nonoperating revenue, or as an extraordinary item, according to the circumstances. Insurance recoveries are not reported until they are realized or realizable (meaning the insurance company has agreed to the claim).

GASB Statement No. 51: accounting for intangible assets

Statement No. 51 provides guidance for the accounting and financial reporting of intangible assets.

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Defining intangible assets:
When defining intangible assets, Statement No. 51 lists the following characteristics:

- Lack of physical substance.
- Nonfinancial nature (that is, receivables or prepayments are not intangible assets).
- Initial useful life extends beyond a single reporting period.

Some common types of intangible assets are patents, copyrights, trademarks, easements, licenses, and computer software.

Statement No. 51 does not apply to the following intangible assets:

- Intangible assets either acquired or created for the purpose of obtaining income or profit (for example, an item that is held for sale and is part of inventory)
- Assets from capital lease transactions as reported by lessees
- Goodwill created through a combination of a government and another entity

An intangible asset should be recognized in the Statement of Net Assets if it can be identified. This is the case when either of the following conditions is met:

- The asset is capable of being separated from the government and sold, transferred, licensed, or exchanged.
- The asset arises from contractual or other legal rights.

Internally generated intangible assets:
An internally generated intangible asset is either created or produced by the government or is acquired from a third party but needs “more than minimal incremental effort” to achieve an expected level of service capacity. Expenditures for internally generated intangible assets should be capitalized if all of the following three criteria are met:

1. The specific objective of the project can be determined, as well as the intangible asset’s expected service capacity once the project is completed.

2. The technological feasibility of the project can be demonstrated, showing that the expected service capacity of the asset will be achieved.

3. The current intention, ability, and presence of effort needed to complete the project can be demonstrated.

Until the above three criteria have been met, any expenditures on the project to create

the intangible asset should be expensed as incurred.

Computer software is often internally generated. Software is considered to be internally generated if it is developed by either the government's own personnel or by a third-party contractor on behalf of the government. The Statement groups the activities for software development into three stages:

- Preliminary project stage, which includes the formulating and evaluation of alternatives, as well as the determination of what technology is needed. Expenditures during this stage should be expensed as incurred.
- Application development stage, which includes the design and configuration of the software, user interface, coding, installation, and testing. As long as management has committed to the project's funding and the three criteria outlined above have been met, expenditures during this stage should be capitalized.
- Post-implementation/operation stage, which includes training on the application and software maintenance. Expenditures during this stage should be expensed as incurred.

Sometimes the government purchases software that needs to be significantly modified before it can be used. Such software is also considered to be internally generated. Expenditures on such software should be considered part of the application development stage and, therefore, capitalized once the modifications made to the software result in any of the following:

- An increase in the software's functionality
- An increase in the software's efficiency
- An extension of the software's estimated useful life

If none of the above occurs, the expenditures on the software should be considered maintenance costs and expensed as incurred.

When dealing with internally generated intangible assets and deciding whether an impairment has occurred, an additional indicator of an impairment is the possibility of a development stoppage. This often occurs with internally generated intangible assets due to a change in management's priorities.

Estimated useful life:
If an asset is under contract, its useful life should not exceed the contractual obligation. Any renewal periods may be considered as long as it can be determined the government will seek and achieve the contract's renewal.

At times, an intangible asset is considered to have an indefinite useful life. A permanent easement is one example. When this is the case, the asset should not be amortized. If conditions occur that change the asset's life, however, it should be tested for impairment. Whether or not an impairment loss is recorded, once the asset's life can be determined, amortization should then be claimed. The asset's current carrying value should be amortized over its remaining useful life. (This would be considered a change in accounting estimate.)

Conclusion

The benefits of implementing GASB pronouncements far outweigh the challenges posed by the tasks of documenting, tracking, and managing your valuable assets. Having good and readily accessible information about your fixed assets enables you to better understand the actual cost of services your organization is providing. Whether you are depreciating your organization's capital assets, measuring impairment losses, or accounting for your intangible assets, it is important to remember that the GASB pronouncement guidelines apply to all government agencies and organizations.

One solution for handling your organization's fixed assets is to invest in fixed assets management software. With a sophisticated fixed asset management solution, calculations will be handled for you, and the reporting headache will disappear, as all of the necessary information for your financial statements becomes easily accessible. As an added bonus, increased comparability of financial statements with other organizations will help give you a clearer picture of how your organization is doing and whether there are areas that need improvement.

Detailing important information about your organization's capital assets provides valuable insights for future planning that not-for-profit organizations rely upon. Not only will this keep you in compliance with government guidelines and mandates, you will also know what capital assets you own, how old they are, and what future purchases may be needed. With so many benefits to precise fixed asset management, compliance to GASB becomes second nature, and budgeting decisions become easier when they are based on sound data.

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