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Capital Assets

Dear Reader:

The following document was created from the CTAS website (ctas.tennessee.edu). This website is maintained by CTAS staff and seeks to represent the most current information regarding issues relative to Tennessee county government.

We hope this information will be useful to you; reference to it will assist you with many of the questions that will arise in your tenure with county government. However, the *Tennessee Code Annotated* and other relevant laws or regulations should always be consulted before any action is taken based upon the contents of this document.

Please feel free to contact us if you have questions or comments regarding this information or any other CTAS website material.

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Capital Assets

Reference Number: CTAS-1976

While Statement 34 does not give a complete definition of a capital asset, capital assets can be defined as major assets that benefit more than a single fiscal period. Capital assets include items such as land, land improvements, buildings, building improvements, construction-in-progress, vehicles, and equipment.

A county is responsible for capitalizing all county-owned assets above the capitalization threshold determined by the county's written capital asset policy. Creating and maintaining an accurate capital asset management system is one of the more time-consuming responsibilities for achieving GASB 34 compliance. With this in mind, county management must be responsible for providing adequate time, personnel, and resources dedicated to achieving this compliance.

Counties are required to prepare capital asset reports at least annually. These reports present capital assets and infrastructure by function (the description account as defined in the state uniform chart of accounts) and asset type (i.e. land, construction-in-progress, buildings and improvements infrastructure, and other assets). These reports should present all of the county's assets and infrastructure over a certain capitalization threshold, as well as the corresponding annual depreciation expense and accumulated depreciation for these assets. These reports are to be accurately prepared at the end of each fiscal year in a timely manner. Data from these reports will be included in the county's annual audited financial statements. Two required capital asset reports (by classification and by function and activity) Examples. It is important to become familiar with these two sample reports because the county's government-wide financial statements cannot be prepared until these reports can be generated accurately.

The first and possibly the most important step to creating and maintaining an accurate and complete asset management system is for a county to adopt a written capital asset policy. The policy should be descriptive enough that an auditor (or other individual who did not create the asset management system) would be able to read the policy and verify that the county had capitalized and maintained its capital assets in accordance with its adopted policy. While it is a good idea to acquire a copy of a capital asset policy from another county (one that has already complied with GASB 34) to have a "rough draft" for your own policy, a county should not merely copy another county's capital asset policy—asset management will differ from county to county. Sample capital asset policy. This sample policy is a compilation of best practices from numerous Tennessee counties that have complied with GASB Statement 34 and can be used as a "rough draft" for your county's policy.

Once a county adopts a capital asset policy for use, it is imperative that the county's asset management system is implemented and maintained in accordance with its adopted policy.

A written capital asset policy, at a minimum, should address the following:

- a. Capitalization thresholds
- b. Depreciation methods and rates
- c. Procedures to identify existing capital assets and infrastructure
- d. Methods to determine historical costs or estimated historical costs
- e. Procedures to tag and track movable assets
- f. Procedures to maintain capital assets records on a current basis
- g. Procedures for recording new/donated/transferred/disposed of assets
- h. Identification of available software to account for capital assets

Capitalization Thresholds

Reference Number: CTAS-1977

The management of the county must determine the capitalization thresholds for county-owned assets. There are no authoritative pronouncements as to the exact threshold amount or the manner in which a capitalization policy should be established and applied. However, management's capitalization policies should be adopted with the mindset that an appropriate balance should be achieved ensuring that all material capital assets, collectively, are capitalized while simultaneously being mindful to minimize the cost of recordkeeping for capital assets. Counties should strive to use the lowest reasonable capitalization threshold. Keep in mind that all debt issued will be reported without any type of threshold. If a county sets its capitalization threshold too high, it runs the risk of materially misstating its financial statements.

Counties should seriously consider capitalizing all county-owned land, regardless of the amount. Since

land does not depreciate, the capitalized land will generally be a permanent increase to the county’s total assets. Also, through GASB 34 implementation, numerous counties have been able to identify land that management was previously unaware it owned. These “newly found” assets were either used by management or were sold as surplus, providing funds for various county needs.

Whatever capitalization threshold is decided upon, county management should remember that while it is their responsibility to determine threshold amounts, it is a responsibility of the independent auditor to determine if the county’s financial statements materially reflect the accurate financial position of the county.

Depreciation Methods and Rates

Reference Number: CTAS-1978

Depreciation is the process of allocating the cost of tangible property over a period of time, rather than deducting the cost as an expense in the year of acquisition. Typically at the end of an asset’s useful life the sum of the amount charged for depreciation will equal original cost less salvage value (if any). GASB Statement 34 allows a county to use any established rational and systematic method of depreciation. This includes such methods as straight-line, sum-of-the-years digits, double-declining balance, and declining balance. The use of straight-line depreciation—the most widely used and simplest method for calculating depreciation—is highly recommended.

Under the straight-line depreciation method, the basis of an asset is written off evenly over the useful life of the asset. The same amount of depreciation is taken each year of the asset’s useful life. In order to identify the annual depreciation expense for an asset using straight-line depreciation, the total cost of an asset (less the salvage value) is divided by the asset’s useful life.

Example of straight-line depreciation:

| | |
|-----------------------|----------|
| Original cost | \$10,000 |
| Salvage value | 500 |
| Adjusted basis | \$ 9,500 |
| Estimated life | 5 |
| Depreciation per year | \$1,900 |

Salvage Value

The salvage value of an asset is an estimate made by management of what the value of an asset will be at the end of its useful life. The GASB allows county management to determine salvage value from general guidelines from professional organizations such as the Government Finance Officers Association, information from other governments, professionals such as engineers, and by internal experience of what an asset is worth at the end of its useful life. Using the assumption that many counties in Tennessee tend to use capital assets until they are literally worthless, a county could assign a salvage value of zero (0) to its capital assets to help streamline recordkeeping. The CTAS sample capital asset policy uses this assumption.

Averaging Conventions

In order for management to avoid the complications of depreciating individual assets from the specific date that the asset was placed in service, GAAP supports the adoption of guidelines that assume assets are placed in service or disposed of at designated times of the year. These guidelines are known as averaging conventions. There are several types of averaging conventions (mid-quarter, half-year, modified half-year, etc.); however, it is highly recommended that counties adopt the full-month averaging convention. By using the full-month averaging convention, property placed into service at any time during a given month is treated as if it were placed in service at the first day of that month, regardless of the actual day of the month acquired. Likewise, when the asset is disposed of, the actual date of disposal is disregarded and the disposal date is the end of the month prior to the month of disposal (i.e. no depreciation is taken for the month of disposal).

Useful lives of assets

An asset’s useful life can be defined as the estimated number of months or years that an asset will be able to be used for the purpose for which it was acquired. GASB does not recommend any specific useful life schedule, but recommends several sources for a county to estimate the useful lives of their assets. These sources include general guidelines from professional organizations, information for comparable assets from other county governments, and internal experience. Counties should not merely copy the useful life

schedule of another county as conditions and asset usage may differ significantly from county to county.

Example:

Gray County assigns a useful life of six years to all sheriff pursuit cars. Blue County, which is located next to Gray County, is in the process of attempting to comply with GASB 34 and copies Gray County's useful life schedule without any modification. Blue County's management does not take into consideration that their county has rougher terrain and is three times larger than Gray County, meaning Blue County's deputies will drive their vehicles more and in rougher conditions than Gray County's deputies. After three years, as is typical in Blue County, the police cruisers are worn out and are taken out of service, even though on paper the vehicles should have three years of useful life left. Because of the inaccurate useful life estimate, Blue County could recognize a significant loss on the disposal of the vehicles.

Procedures to Identify Existing Capital Assets and Infrastructure

Reference Number: CTAS-1979

There are numerous ways for management to identify county-owned assets and infrastructure: county department inventories, county commission minutes, the current county road list, building and content insurance records, TDOT bridge inspection reports, and data from the county's register of deeds and tax assessor. Infrastructure is defined as long-lived capital assets that normally can be preserved for a significantly greater number of years than most capital assets. Infrastructure assets are normally stationary in nature: bridges, roads, dams, etc. Generally, county-owned buildings are considered capital assets, not infrastructure assets. See Infrastructure for more information.

Example:

Blue County is a small county with only a few schools and county-owned buildings. Per Blue's capital asset policy, building improvements have a useful life of 20 years. The county's capital asset manager spends a couple days scanning the county commission and school board minutes for the past 20 years, noting any building improvements (new roofs, additions, HVAC replacements, etc.) that exceed the capitalization thresholds. After verifying through an inventory that these improvements still exist (HVAC units, etc.), these items are then capitalized as building improvements and the minutes, if original invoices and warrants cannot be found, are copied and maintained as supporting documentation for each improvement's cost. By utilizing these procedures, management helps ensure that major capital assets are identified and recorded properly.

Methods to Determine Historical Costs or Estimated Historical Costs

Reference Number: CTAS-1980

Capital assets and infrastructure are to be reported at historical (acquired) cost. A county may use any established tool to accomplish GASB Statement 34 historical cost requirements; however, the mechanism for calculating historical costs for previously acquired assets should be (1) accurate, (2) able to be replicated, and (3) documented. An asset's total historical cost includes all costs of construction and/or installation and setup of the assets (i.e. shipping, engineering and architect fees, and capitalized interest during construction of a building). An asset's historical cost can be identified through deeds, bills of sale, county commission minutes, and/or invoices. If the actual historical cost of an asset cannot be identified, an estimated historical cost can be used. A county can estimate the historical cost of assets or infrastructure by identifying an accurate estimate of an asset's current replacement cost and then using a deflation calculator to arrive at an estimated historical cost. While there are a number of inflation/deflation calculators available, an excellent calculator that utilizes the consumer price index (CPI) is available on the Federal Reserve Bank of Minneapolis Web site.

Example:

A county identifies a 10-acre tract of land that it owns through the register of deeds office. Even though the county has the deed to the land, there is no price amount on the deed. Based on historical research, management ascertains that the land was donated to the county board of education in 1948. The county property assessor values the land (based on what a similar piece of

land in the county would cost today) at \$80,000. Using a deflation calculator, management calculates that the replacement cost of the land in 1948 would be \$9,568. The county would record the asset with an estimated historical cost of \$9,568 and print off the calculation, a copy of the deed, and documentation from the property assessor stating his/her estimate for backup documentation for the asset's cost.

Procedures to Tag and Track Movable Assets

Reference Number: CTAS-1981

A county must establish written procedures to tag and track all movable capital assets over the established capitalization threshold. The inventory tag should be numbered so that the asset can be traced back to the county asset records.

Example:

A county has recorded a front-end loader into its computerized capital asset database and assigned the vehicle the asset ID number 110. The county asset manager is doing an annual physical inventory of movable assets and is able to locate and identify the exact front-end loader at the county road department garage by the asset number tag affixed to the vehicle and by the information on the computerized capital asset database.

County management should insure that, at a minimum, a county-wide inventory of capitalized assets is performed annually and all purchased, donated, surplus, and/or transferred movable assets are accounted for and properly recorded in capital asset records. There are numerous bar-code inventory tag systems on the market today, some with UPC format to permit scanning by an electronic optical scanner. While these systems have proven helpful in several Tennessee counties with asset tracking, they are not required.

Procedures to Maintain Capital Assets Records on a Current Basis

Reference Number: CTAS-1982

Complying with GASB Statement 34 is not a "one time affair." Because counties are continuously acquiring and disposing of assets, a county must keep capital asset records updated after the initial capitalization of all county assets and infrastructure. It is highly recommended that a capital asset manager position be created for tracking assets for the county. In a mid-to-large size county, this position would be a full-time job. In smaller counties, this task could be accomplished on a part-time basis. While the assistance of all county officials and department heads is necessary to ensure that county assets are inventoried and tracked, numerous Tennessee counties have arrived at the conclusion that the best way to ensure that a county's GASB 34 compliance (in relation to capital asset management) is maintained is to have one individual who is responsible for maintaining the capital asset database and ensuring that the asset management system is complying with the county's adopted policies.

Regardless of how this procedure is addressed, counties should have a system in place to: (1) identify and capitalize all new assets over the threshold limits, (2) identify and remove from capital asset records all assets declared surplus, destroyed, stolen, and missing, (3) record any gain or loss on the disposal of individual assets, (4) perform a county-wide inventory of capitalized assets at least once a year, and (5) have all capital asset reports that are required by the county's auditors prepared and available on a timely basis. Sample job description for a capital asset manager.

Procedures for Recording New/Donated/Transferred/Disposed of Assets

Reference Number: CTAS-1983

Counties must have an effective system in place to ensure accurate recording of new and donated assets. Numerous counties have accomplished this by having all accounts payable clerks make a copy of all invoices that are over the capitalization threshold. This documentation can assist in the recognition of new capital assets. Most large donations tend to be to the county school system from booster clubs,

parent-teacher organizations, and other similar groups, so all school principals should be made aware of GASB 34 capitalization requirements for donated assets. It also is recommended that the capital asset manager (or his/her equivalent) be notified whenever the county receives a sizable donation so that the current value, and supporting documentation of the asset's value, at the time of donation to the county can be recorded, as this is the amount that will be capitalized.

Example:

TRW Industries is donating new playground equipment to Jere Whitson Elementary School. Upon receipt of the playground equipment, the principal contacts the county's capital asset manager, who speaks with TRW to determine a fair value for the asset. TRW provides a copy of the invoice for the cost of material that was purchased at the time of donation and installation of the playground equipment. The county records the donated playground in its capital asset records and maintains the invoice and any official minutes where the donation was accepted as backup documentation.

The transferring of assets between county departments and/or disposal of assets, whether that is through surplus, destruction, or theft, should be reported promptly to the capital asset manager. Asset tags should be removed from movable assets that are being disposed of. Likewise, the function of transferred assets should be, if applicable, reclassified in the county's capital asset records.

Example:

Blue County's solid waste department agrees to transfer a pickup truck to the county's jail in exchange for \$1,000. The net value (cost less accumulated depreciation) of the asset is reclassified in the county's capital asset software and records from asset function #55710-Sanitation Management to #54210-Jail. The \$1,000 is not added to the asset's depreciable basis as this transaction is an intergovernmental exchange (i.e. between two departments of the same county government).

Department heads and officials should ensure that the capital asset manager is alerted whenever assets are declared surplus so any capitalized assets can be identified, have inventory tags removed, and any applicable funds received for surplus asset sales are recorded. Sample spreadsheet for tracking disposed of assets, and the related gain or losses from these assets.

Example:

Gray County declares a small school bus surplus and sells the bus at public auction. The bus is totally depreciated and has no salvage value recorded. However, lately this type of school bus has become very popular among the local farmers, who use them to haul hay. The bids come hard and fast at the auction, and the bus is sold for \$1,800. Since the net book value of the bus is zero (0), the \$1,800 is recorded as a gain on the sale after the bus and its accumulated depreciation is removed from the county's capital asset software.

As some officials and department heads will prove better than others on reporting purchased, donated, transferred, and surplus assets, it is necessary to ensure a thorough physical capital asset inventory is performed on at least an annual basis.

Identify Available Software to Account for Capital Assets

Reference Number: CTAS-1984

Capital asset software that can produce needed reports must be obtained and utilized so all county assets that are above capitalization thresholds can be accurately reported through software-generated reports. There are several vendors that currently have various capital asset software programs available; however, the software must be able to prepare the necessary capital asset reports and information included in the county's annual financial statement. County management should show potential software vendors the Sample Required Capital Asset Reports to ensure that the software is capable of producing such reports. Management also should consider the level of support that the vendor will provide after the sale, such as software updates and assistance that may be needed after the original system has been purchased and installed.

Capitalization of Library Books

Considered individually, library books usually have a historical cost well below a county's threshold for capitalizing assets. However, when valued together as a collection, the cost of library books can be significant in some counties. County management should consider if the cost of a county-owned library collection is of material enough value to capitalize. If management makes the decision to capitalize a library collection, the collection should be depreciated using a composite depreciation method.

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