ACCOUNTING FOR CAPITAL ASSETS

Presented by:
Joel Knopp, CPA
Shareholder
Agenda

- Definition
- Reporting Capital Assets
- Questions from Implementation Guides
- Modified Approach
- Interest Capitalization
- Intangibles
- Impairment
- Impact of GASB 87
Definition
Definition of Capital Assets

● Includes land, improvements to land, easements, buildings, building improvements, vehicles, machinery, equipment, works of art and historical treasures, infrastructure and all other tangible or intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period.
Definition of Capital Assets

● Purpose for which an asset is held is key to classifying as a capital asset or an investment.

● The purpose is based on actions by a government’s management at acquisition (acquired for profit or to use in operations).

● Even if usage of the asset changes over time, the classification should be retained for financial reporting purposes.
Reporting Capital Assets
General Reporting Requirements

- Clear distinction between general capital assets and capital assets of proprietary and fiduciary funds

- Proprietary capital assets – report in both government-wide (GW) and fund financial statements
- Fiduciary capital assets – report only in the statement of fiduciary net position
- General capital assets – report only in the governmental activities column of the GW statement of net position
Reporting Capital Assets

- Should be reported at historical cost

- Include ancillary charges necessary to place the asset into its intended location and condition for use (ex. freight and transportation charges, site preparation costs, and professional fees)

- Report donated assets at their acquisition value plus ancillary charges
Reporting Capital Assets (cont)

- Should be depreciated over their estimated useful lives unless they are:
  - inexhaustible (ex. land, land improvements)
  - intangible assets with indefinite useful lives
  - infrastructure assets reported using the modified approach

- Should be evaluated for impairment when events suggest that the service may have significantly and unexpectedly declined.
Reporting in GWFS

- Report depreciable capital assets net of accumulated depreciation in the SNP

- Capital assets that not being depreciated should be reported separately

- May report by major class of assets (i.e. infrastructure, buildings and improvements, vehicles, machinery and equipment)
Depreciation

- Depreciation should be reported in the SOA.
- Depreciation should be measured by allocating the net cost of depreciable assets over their estimated useful lives in a systematic and rational manner.
- May be calculated for class, network, subsystems of networks, or individual assets.
Depreciation (cont)

- Depreciation expense on assets specifically identified with a function should be included in the direct expenses of the respective function in the SOA

- Depreciation on shared capital assets that serve all functions can be reported on a separate line in the SOA

- Depreciation can be used as a basis for setting capital-related charges to users or other funds
Reporting General Capital Assets

- Generally arise from governmental activities and result from the expenditure of governmental fund financial resources.

- General Capital Assets are not reported as assets in governmental funds but should be reported in the governmental activities column in the GW SNP.
Expenditures in governmental funds are classified by character, that is, on the basis of the fiscal period they are presumed to benefit. Accordingly, “Capital Outlay” should be classified separately from “Current Expenditures” in governmental funds because they are presumed to benefit both the present and future fiscal periods.
Conversion from government funds to GWS

- For SNP, specific adjustment required to include capital assets (net of depreciation) of the general government which are not reported in governmental funds
Conversion from government funds to GWS (cont)

For SOA, specific adjustment is required to:

- Eliminate expenditures that represent the acquisition of capital assets in governmental funds. (Note: This amount is excluded when calculating total noncapital expenditures in the statistical section)
- Recognize depreciation expense
- Include donations of capital assets
- Replace proceeds from sale of capital assets with gain or loss on transaction
Reporting in Proprietary Funds

- Capital assets of proprietary funds (enterprise and internal service) are reported in both the GW SNP and the Proprietary Fund SNP.
Reporting in Fiduciary Funds

- Capital assets of fiduciary funds and component units that are fiduciary in nature are reported in the Statement of Fiduciary Net Position.

- Fiduciary capital assets do not roll up to the GW SNP
Required Note Disclosures

- Should disclose policy for capitalizing assets and for estimating the useful lives of those assets.
- Should disclose the methods used in computing depreciation for major classes of depreciable assets.
- Should describe the modified approach for reporting eligible infrastructure assets if applicable.
Required Note Disclosures (cont)

- Should provide detail in the notes to the F/S about capital assets of the primary government that are reported in the SNP
- Should be divided into major classes of capital assets
- Should be divided between governmental activities and business-type activities
Required Note Disclosures (cont)

- Capital assets that are not being depreciated should be disclosed separately from those that are being depreciated.

- Information presented should include:
  a. Beginning-and-end-of-year balances with accumulated depreciation presented separately from historical cost
  b. Capital acquisitions
  c. Sales or other dispositions
  d. Current-period depreciation expense, with disclosure of amounts charged to each of the functions in the statement of activities
## Required Note Disclosures (cont)

<table>
<thead>
<tr>
<th></th>
<th>June 30, 2016</th>
<th>Additions</th>
<th>Reductions</th>
<th>Transfers</th>
<th>June 30, 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Infrastructure (non-depreciable):</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Right-of-way</td>
<td>$657,379</td>
<td>$1,593</td>
<td>$(32)</td>
<td>$45,151</td>
<td>$704,091</td>
</tr>
<tr>
<td>Highways and bridges</td>
<td>2,707,363</td>
<td>602</td>
<td>(728)</td>
<td>60,777</td>
<td>2,768,014</td>
</tr>
<tr>
<td>Total infrastructure (non-depreciable)</td>
<td>3,364,742</td>
<td>2,195</td>
<td>(760)</td>
<td>105,928</td>
<td>3,472,105</td>
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<tr>
<td><strong>Construction in progress (non-depreciable):</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Right-of-way</td>
<td>201,696</td>
<td>20,554</td>
<td>(154)</td>
<td>(45,151)</td>
<td>176,945</td>
</tr>
<tr>
<td>Highways and bridges</td>
<td>212,797</td>
<td>253,440</td>
<td>-</td>
<td>(59,457)</td>
<td>406,780</td>
</tr>
<tr>
<td>Buildings and toll facilities</td>
<td>996</td>
<td>2,483</td>
<td>-</td>
<td>(2,354)</td>
<td>1,125</td>
</tr>
<tr>
<td>Toll equipment</td>
<td>17,167</td>
<td>11,337</td>
<td>-</td>
<td>(2,724)</td>
<td>25,780</td>
</tr>
<tr>
<td>Furniture, equipment and other</td>
<td>2,467</td>
<td>16,573</td>
<td>-</td>
<td>(13,714)</td>
<td>5,326</td>
</tr>
<tr>
<td>Total construction in progress (non-depreciable)</td>
<td>435,123</td>
<td>304,387</td>
<td>(154)</td>
<td>(123,400)</td>
<td>615,956</td>
</tr>
<tr>
<td><strong>Property and equipment (depreciable):</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Toll equipment</td>
<td>99,969</td>
<td>503</td>
<td>(189)</td>
<td>2,723</td>
<td>103,006</td>
</tr>
<tr>
<td>Buildings and toll facilities</td>
<td>158,947</td>
<td>16</td>
<td>-</td>
<td>2,354</td>
<td>161,317</td>
</tr>
<tr>
<td>Furniture, equipment and other</td>
<td>61,243</td>
<td>211</td>
<td>(11,025)</td>
<td>12,395</td>
<td>62,824</td>
</tr>
<tr>
<td>Total property and equipment (depreciable)</td>
<td>320,159</td>
<td>730</td>
<td>(11,214)</td>
<td>17,472</td>
<td>327,147</td>
</tr>
<tr>
<td><strong>Less accumulated depreciation for:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Toll equipment</td>
<td>(79,900)</td>
<td>(5,814)</td>
<td>189</td>
<td>-</td>
<td>(85,525)</td>
</tr>
<tr>
<td>Buildings and toll facilities</td>
<td>(55,860)</td>
<td>(5,312)</td>
<td>-</td>
<td>-</td>
<td>(61,172)</td>
</tr>
<tr>
<td>Furniture, equipment and other</td>
<td>(38,664)</td>
<td>(2,639)</td>
<td>9,493</td>
<td>-</td>
<td>(31,810)</td>
</tr>
<tr>
<td>Total accumulated depreciation</td>
<td>(174,424)</td>
<td>(13,765)</td>
<td>9,682</td>
<td>-</td>
<td>(178,507)</td>
</tr>
<tr>
<td><strong>Total property and equipment being depreciated, net</strong></td>
<td>145,735</td>
<td>(13,035)</td>
<td>(1,532)</td>
<td>17,472</td>
<td>148,640</td>
</tr>
<tr>
<td><strong>Total capital assets</strong></td>
<td>$3,945,600</td>
<td>$293,547</td>
<td>$(2,446)</td>
<td>-</td>
<td>$4,236,701</td>
</tr>
</tbody>
</table>
Reporting in MD&A

- Describe significant capital asset activity during the year
- Summarize the detailed capital asset information reported in the notes
- Address commitments made for capital expenditures
- Refer readers to the notes to the F/S
Reporting in Statistical Section

Changes in Fund Balances for Total Governmental Funds –

- For purposes of calculating the Ratio of Total Debt Service to Noncapital Expenditures Presented, take total expenditures and subtract the capital outlay expenditures that are converted to capital assets for the GW SNP.
Reporting in Statistical Section (cont)

- Provide available information about the volume, usage, or nature of the government’s capital assets by function or identifiable activity, as applicable
Reporting Contributions of Capital Assets within the Primary Government

- Governments may elect to establish a new enterprise fund or internal service for an activity initially associated with governmental activities.

- Report the capital assets in the recipient proprietary fund at the same net book value (cost less accumulated depreciation).
Reporting Contributions of Capital Assets within the PG (cont)

- Capital assets received from the general government are reported as capital contributions rather than as transfers in the proprietary fund operating statement.

- Reclassify as a transfer from governmental activities to business-type activities when reported in the GW SOA.
Reporting Contributions of Capital Assets within the PG (cont)

Example - A city contributes capital assets associated with its municipal airport to a new Airport enterprise fund effective 10/1/2017. The Airport operations were initially recorded in the city’s General Fund. The associated capital assets had a carrying cost of $5 million at the date of the contribution. How should this contribution be reported in the respective funds?
### Reporting Contributions of Capital Assets within the PG (cont)

<table>
<thead>
<tr>
<th>Airport Enterprise Fund</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Asset, Net</td>
<td>$5,000,000</td>
<td>$5,000,000</td>
</tr>
<tr>
<td>Capital Contribution</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**General Fund**

No entry required at governmental fund level.

<table>
<thead>
<tr>
<th>GWFS SOA – Govt Activities</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transfer to BTA</td>
<td>$5,000,000</td>
<td>$5,000,000</td>
</tr>
<tr>
<td>Capital Asset, Net</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>GWFS SOA – Bus-Type Activities</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Contribution</td>
<td>$5,000,000</td>
<td>$5,000,000</td>
</tr>
<tr>
<td>Transfer from Govt Activities</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Donations of capital assets to the general government from a proprietary fund would be reported as transfers in both the proprietary funds and the GW SOA.
Reporting Sale of Capital Asset in Governmental Funds

- Due to the risk of distorting normal revenue trends, proceeds of sales should be reported as other financing source
Reporting Trade-ins of Capital Assets in Governmental Funds

- Report any additional cash paid as a capital outlay expenditure. This follows typical budgetary reporting for the transaction.
Capital Assets Acquired through Special Assessments

● Should be reported at historical cost and depreciated, as appropriate

● Related revenues should be reported either as program revenues or general revenues in the GW SOA

● If capital assets are provided to proprietary funds, the proprietary funds should report the capital improvements as capital contributions in the Statement of Revenues, Expenses, and Change in Fund Net Position
Capital Assets Acquired through Grants and Contributions

- Should be reported at historical cost or acquisition value and depreciated, as appropriate

- Related revenues should be reported either as program revenues or general revenues in the GW SOA

- When related revenues are reported in proprietary funds, the capital contributions should be reported in the Statement of Revenues, Expenses, and Change in Fund Net Position
Capital Assets Acquired through Capital Leases

- Lessee records a capital asset at an amount equal to the present value at the beginning of the lease term of minimum lease payments during the lease term.

- Asset should be amortized in a manner consistent with the lessee’s normal depreciation policy for owned assets.
Capital Assets Acquired through Capital Leases (cont)

- Recording capital leases in governmental funds
- Report an other financing source and an expenditure equal to the net present value of the minimum lease payments
Example - A government enters into a capital lease for police equipment acquisition for $140,000. The lease agreement requires a down payment of $15,000. Payments are not due until the following year. What are the appropriate journal entries in the initial year in the government’s General Fund?
### Capital Assets Acquired through Capital Leases (cont)

<table>
<thead>
<tr>
<th>General Fund</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Outlay Expenditure-Police</td>
<td></td>
<td>$140,000</td>
</tr>
<tr>
<td>Other Financing Source-Capital Leases</td>
<td></td>
<td>$140,000</td>
</tr>
<tr>
<td>(To record capital lease acquisition)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>General Fund</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt Service Expenditure-Principal</td>
<td></td>
<td>$15,000</td>
</tr>
<tr>
<td>Cash</td>
<td></td>
<td>$15,000</td>
</tr>
<tr>
<td>(To record capital lease payment)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Works of Art & Historical Treasure

- Should capitalize works of art, historical treasures, and similar assets at their historical cost or acquisition value

- Conditions to consider:
  a. Held for public benefit rather than financial gain
  b. Protected and preserved
  c. Subject to policy that requires any sale proceeds to be used to acquire other collection items
Capitalized collections that are exhaustible (i.e. useful lives diminished by display or educational or research applications) should be depreciated over their estimated useful lives.

Depreciation is not required for collections or individual items that are inexhaustible.
Questions from GASB
Implementation Guides
Q - Should a government’s capitalization policy be applied only to individual assets or can it be applied to a group of assets acquired together (i.e. $5,000 capitalization threshold for equipment vs. 100 computers costing $1,500 each)?
A – Not addressed by GASB. Policies include many considerations including ensuring all significant capital assets are capitalized and minimizing the cost of recordkeeping.

It may be appropriate to establish a policy that requires capitalization of certain types of assets whose individual acquisition costs are less than the threshold.
Road Resurfacing (.702-15)

Q – If a road is being depreciated, how should the cost of a project to remove and replace or to resurface the road be reported?
Road Resurfacing (.702-15) (cont)

A – If the project is considered maintenance-a recurring costs that does not extend the road’s original useful life or expand its capacity-the cost of the project should be expensed.

On the other hand, if the project increases the serviceability-increases load capacity or extends the original useful life, the cost of the project should be capitalized. The cost and A/D of the replaced roadway surface should be removed.
Q – A city purchased land from another government for $1. How should the city report this acquisition?
A – The purchase price of $1 does not meet the definition of an exchange transaction. The substance of the transaction is that the city received a donation of land (a nonexchange transaction), and the city should report the land at acquisition value.
Modified Approach
Definition of 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. (ex. roads, bridges, tunnels, drainage systems, water and sewer systems, dams, and lighting systems).

- Not buildings
Modified Approach

- Applies to infrastructure assets that are part of a network
- Not required to be depreciated as long as two requirements are met:
  
  1. Infrastructure is managed using an asset management system that meets certain criteria.
  2. Preserved approximately at (or above) a condition level established and disclosed by the government
Asset management systems should:

- Have an up-to-date inventory of eligible infrastructure assets
- Perform condition assessments and summarize the results using a measurement scale
- Estimate each year the annual amount to maintain and preserve at the approved condition level
Modified Approach (cont)

Documentation required:

- Complete condition assessments of eligible infrastructure assets are performed in a consistent manner at least every 3 years.
- Results of the 3 most recent complete condition assessments provide reasonable assurance that the infrastructure is being preserved at (or above) the condition level.
Modified Approach (cont)

• If modified approach requirements are met then all expenditures made for the infrastructure assets (except for additions and improvements) should be expensed in the period incurred.

• Additions and improvements to infrastructure are capitalized because they increase capacity or efficiency rather than preserve useful life.
The following schedules should be presented:

- Assessed condition for at least the 3 most recent complete condition assessments, indicating the dates of the assessments

- Estimated annual amount to maintain and preserve at (or above) the condition level established compared to actual amounts expensed
The following disclosures should accompany the RSI schedules:

- Basis for the condition measurement and measurement scale
- Condition level at which the government intends to preserve its infrastructure
- Factors that significantly affect trends in the information reported in the schedules (i.e. changes in basis for condition measurement)
Intangible Assets
Intangible Assets

Possesses all the following characteristics:

a. Lack of physical substance
b. Nonfinancial nature (not in monetary form)
c. Initial useful life extending beyond a single reporting period

• Does not apply to assets acquired for obtaining profit or assets resulting from capital lease transactions by lessees
Intangible Assets (cont)

- All intangible assets should be classified as capital assets

- Recognize in the SNP only if it is identifiable:
  
  a. The asset is separable (capable of being separated or divided from the government and sold, transferred, licensed, rented, etc.)
  
  b. The asset arises from contractual or other legal rights
Intangible Assets (cont)

- Useful life of an intangible asset that arises from contractual or other legal rights should not exceed the period defined by the contractual or legal provisions.

- Consider the likelihood of renewal periods.
Intangible assets should be considered to have an **indefinite** useful life if there are no legal, contractual, regulatory, technological, or other factors that limit the useful life of the asset (ex. permanent right-of-way easement).

- No amortization if considered indefinite
- Still need to consider changes in factors and conditions that could result in asset no longer being indefinite
Intangible Assets (cont)

- Some intangible assets are internally generated, meaning they are created or produced by the government or an entity contracted by the government, or if acquired from a third party require more than a minimal incremental effort on the part of the government to begin to achieve their expected level of service capacity.
Intangible Assets (cont)

- Outlays incurred related to the development of an internally generated intangible asset should be capitalized only upon the occurrence of all of the following:
  a. Determination of the specific objective of the project
  b. Demonstration of the feasibility of completing the project
  c. Demonstration of the current intention and ability to complete the project
Internally Generated Computer Software

- Common type of intangible asset that is often internally generated

- Examples include:
  - Software developed in-house by the government’s personnel or by a third-party contractor on behalf of the government
  - Commercially available software that is purchased but then modified with significant effort before being put into service
Activities involved in developing and installing internally generated computer software can be grouped in the following stages:

a. Preliminary Project Stage – conceptual formation and evaluation of alternatives
b. Application Development Stage – design, software configuration, interfaces, coding testing, parallel systems
c. Post Implementation/Operation Stage – application training and software maintenance
Internally Generated Computer Software (cont)

<table>
<thead>
<tr>
<th>Stage</th>
<th>Expense Treatment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Preliminary Project Stage</strong></td>
<td>• Expense as incurred</td>
</tr>
<tr>
<td><strong>Application Development Stage</strong></td>
<td>• Capitalize as long as criteria for project completion is met</td>
</tr>
<tr>
<td></td>
<td>• Include data conversion if necessary for software to be operational</td>
</tr>
<tr>
<td><strong>Post-Implementation/Operation Stage</strong></td>
<td>• Expense as incurred</td>
</tr>
<tr>
<td></td>
<td>• Include data conversion if not necessary for software operation</td>
</tr>
</tbody>
</table>
Internally Generated Computer Software (cont)

Capitalize costs for modifications to software if it results in the following:

a. Increase in the functionality of the software (i.e. can perform more tasks)
b. Increase in the efficiency of the software (new level of service)
c. Extension of the useful life of the software
Capitalization of Interest Cost
Capitalization of Interest Cost

Why capitalize interest cost?

- Historical cost of acquiring an asset includes the costs necessarily incurred to bring it to the condition and location necessary for its intended use.

- If this requires a period of time, the interest cost incurred during that period as a result of the outlays for the asset is a part of the historical cost of acquiring the asset.
Capitalization of Interest Cost (cont)

- Applies only to interest costs reported for business-type activities and enterprise funds

- Interest costs include interest on obligations having explicit interest rates, interest imputed on certain types of payables, and interest related to capital leases
Assets Qualifying for Interest Capitalization

Interest should be capitalized for the following types of assets:

a. Assets constructed or otherwise produced for a government’s own use
b. Assets intended for sale or lease that are constructed (ex. Real estate development)
c. Investments accounted for by the equity method before principle operations begin
d. Assets that are donated or granted to other entities
Interest **should not** be capitalized for the following types of assets:

a. Assets that are in use or ready to be used
b. Assets that are not undergoing activity to get them ready for use
c. Assets not included in the financial statements
d. Investments accounted for by the equity method after principle operations begin
e. Investments in regulated investees that are capitalizing both the cost of debt and equity capital
f. Assets acquired with gifts and grants that are restricted by the donor or grant
Assets Qualifying for Interest Capitalization (cont)

- Land that is not undergoing activities necessary to get it ready for its intended use is not a qualifying asset.
- Interest on outlays to acquire land is considered part of the acquisition cost and capitalizable if:
  - The resulting asset is a structure.
  - The resulting asset is developed land, such as land that is to be sold as developed lots.
Amount of Interest Cost to be Capitalized

That portion of the interest cost incurred during the assets’ acquisition periods that theoretically could have been avoided if outlays for the assets had not been made by:

a. Avoiding additional borrowings
b. Using the resources to repay existing borrowings
Amount of Interest Cost to be Capitalized (cont)

- Amount capitalized in an accounting period should be determined by applying an interest rate ("capitalization rate") to the average amount of accumulated outlays for the asset during the period.

- Capitalization rate should be based on the rates applicable to the borrowings outstanding during the period.
Amount of Interest Cost to be Capitalized (cont)

● If there is a specific new borrowing associated with the asset, then use the rate on that borrowing.

● If the accumulated outlays on the asset exceed the specific new borrowing, then use the weighted average of the rates applicable to the other borrowings of the government.
Amount of Interest Cost to be Capitalized (cont)

- Total amount of interest cost capitalized in an accounting period should not exceed the total amount of interest cost incurred by the government in that period
Capitalization Period

Capitalization period for interest costs should begin when three conditions are present:

1. Outlays for the asset have been made
2. Activities that are necessary to get the asset ready for its intended use are in progress
3. Interest cost is being incurred

Interest capitalization should continue as long as those 3 conditions are present.
Capitalization Period (cont)

- Capitalization period should end when the asset is substantially complete and ready for its intended use
  
- Consider whether asset is ready in parts or needs to be completed in its entirety
Interest Capitalization - Situations Involving Tax Exempt Borrowings

- For assets acquired with proceeds of tax-exempt borrowings, the amount of interest cost capitalized should be all interest cost of the T/E borrowing less any interest earned on related interest-bearing investments acquired with the proceeds from the date of the borrowing until the assets are ready for use.
Disclosures for Interest Cost

- For an accounting period in which no interest cost is capitalized, disclose the amount of interest cost incurred and charged to expense during the period.

- When some interest cost is capitalized, disclose the total amount of interest cost incurred during the period and the amount thereof that has been capitalized.
Impairment of Capital Assets
Impairment of Capital Assets

- Asset impairment is a significant, unexpected decline in the service utility of a capital asset (its usable capacity)

- Not considered normal and ordinary

- At time of acquisition, the event or change in circumstance would not have been expected to occur during the useful life
Assessment of Impairment

Assessment of impairment is a two-step process of:

a. Identifying potential impairments

a. Testing for impairment
Identifying Potential Impairments

- Identification of events or changes in circumstances that may indicate impairment are prominent, conspicuous, known to government.

- Not required to perform additional procedures to identify potential impairment.

- Generally expected to have prompted discussions by governance, management, or the media.
Indicators of Impairment

Common indicators of impairment include:

a. Evidence of physical damage (ex. fire or flood)
b. Enactment or approval of new laws (ex. new standards that asset does not meet)
c. Technological development or evidence of obsolescence
d. Change in manner or expected duration of use (ex. school closure)
e. Construction stoppage or development stoppage
Impairment Test

Two factors must be present:

a. The magnitude of the decline in service utility is significant (ex. management actions to no longer put money into an asset indicate expenses are too high in relation to the benefit)
b. The decline in service is unexpected (i.e. not part of the normal life cycle of the capital asset)
Measurement of Impairment

For capital assets that will continue to be used by the government:

• Write off a portion of the historical cost of the asset measured using the most appropriate method:
  a. Restoration cost approach (physical damage)
  b. Services unit approach (new laws)
  c. Deflated depreciation replacement cost approach (change in manner or duration of use)
Reporting Impairment Losses

- When reporting in the GW SOA or proprietary funds, loss could be reported as a program or operating expense, special item, or extraordinary item, as appropriate.

- Report the impairment loss net of the associated insurance recovery when recovery and loss occur in the same year.
Reporting Impairment Losses (cont)

- Insurance recoveries are reported as an other financing source in governmental funds, unless they meet criteria for extraordinary item.

- Disclose a general description, the amount, and the financial statement classification of the impairment loss in the notes.
Two ways to adjust capital asset accounts for an impairment loss per implementation guide

1. Increase the accumulated depreciation account by the amount of the loss (i.e. additional years of useful life were used up)
2. Decrease both the cost and A/D proportionately so the net decrease equals the impairment loss (i.e. dispose a portion of the capital asset)
Impact of New Lease Standard
GASB 87 - Leases

- Requires recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and expensed (lessee).

- Single model for lease accounting based on principle that leases are financings of the right to use an underlying asset.

- Effective for FYE 6/30/21 and 9/30/21
Lessee Accounting

- Lessee recognizes a lease liability and an intangible right-to-use lease asset at the commencement of the lease.

- Lease asset is the amount of the lease liability plus any payments made to the lessor before the start of the lease.

- Amortize the lease asset in a systematic and rational manner over the shorter of the lease term or the useful life of the underlying asset.
Amortization of the lease asset should be reported as an outflow of resources (for example, amortization expense) which may be combined with depreciation expense.

Disclosures in the notes to the F/S should include a description of leasing arrangements, the amount of lease assets recognized, and a schedule of lease payments to be made.
Lessee Accounting (cont)

- The total amount of leased assets and related accumulated amortization should be disclosed separately from other capital assets.

- The amount of leased assets by major classes of underlying assets should be disclosed separately from other capital assets.
Questions or Comments