

FINANCIAL MANAGEMENT FOR GEORGIA LOCAL UNITS OF ADMINISTRATION

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INTRODUCTION

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 capital 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.

Also discussed in this chapter are Intangible Assets. Intangible Assets are those assets that lack a physical substance. However, because the benefit of intangible assets can extend more than one fiscal year, the intangibles are capitalized using the same methodology as other capitalized assets that are physical in nature. The 2015-2016 Codification, Section 1400.140 states, that intangible assets are classified as capital assets (except those explicitly excluded, such as those acquired through capital leases). Relevant authoritative guidance for capital assets should be applied to these intangible assets.

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.

Capital Asset Categories

Land and Land Improvements – land purchased or otherwise acquired by the LUA. Improvements include the cost of permanent attachments to land such as sidewalks, trees, drives, tunnels, sewers, etc.

Buildings - acquisition cost of permanent structures and permanent improvements thereto owned or held by an LUA. This account includes costs incurred in the acquisition of buildings (e.g., broker's fees).

Machinery and Equipment - Tangible property of a more or less permanent nature, other than land or buildings and improvements thereon (e.g., machinery, tools, trucks, and furnishings). This account includes costs incurred in the acquisition of machinery and equipment (e.g., transportation costs).

Construction in Progress - The cost of construction work for projects not yet completed.

Infrastructure - An asset, network, or subsystem that has a useful life that is significantly longer than those of other capital assets. These assets may include water/sewer systems, roads, bridges, tunnels and other similar assets. Technology cabling between schools. Ex. fiber optics installed between the schools for technology connectivity, if the district owns the fiber and it is not a lease.

Works of Art and Historical Collections - Individual items or collections of items that are of artistic or cultural importance.

Intangible Assets - an asset that possesses all of the following characteristics:

- It lacks physical substance – in other words, you cannot touch it, except in cases where the intangible is carried on a tangible item (for example, software on a CD or USB drive).
- It is nonfinancial in nature – that is, it has value, but is not in a monetary form like cash or securities, nor is it a claim or right to assets in a monetary form like receivables, nor a prepayment for goods or services.
- Its initial useful life extends beyond a single reporting period.
- Exceptions to Intangible Asset categories – Assets acquired or created primarily for the purpose of directly obtaining profit or income (these should be treated as investments) and Assets resulting from capital lease transactions.

Valuation of Capital Assets

The 2015-2016 *Codification of Governmental Accounting and Financial Reporting Standards Volume 1* (2015-2016 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:

- Freight and transportation charges
- Site preparation costs
- Professional fees

According to GASB Statement 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA statements*, 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.

Intangible Assets are recognized (capitalized) only if the asset is identifiable. It is considered identifiable when it is:

- Separate, or is capable of being separated or divided from the LUA and sold, transferred licenses, rented, or transferred to another party.
- If it is not separable, the asset has to arise from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

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. At the fund level, the construction, or capital outlay, is an expenditure of current resources. At the district level, the expenditure is

reclassified to an asset, as the asset is meant to benefit more than one reporting period. The asset is then expensed over the periods that are expected to benefit from the resource, through depreciation.

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:

<u>Description</u>	<u>Account No.</u>	<u>DR</u>	<u>CR</u>
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:

<u>Description</u>	<u>Account No.</u>	<u>DR</u>	<u>CR</u>
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:

<u>Description</u>	<u>Account No.</u>	<u>DR</u>	<u>CR</u>
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 GASB No. 62, paragraphs 272-279 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 additions to "construction in progress." The value of the construction-in-progress account on the government-wide statements is the total amount of expenditures incurred during the fiscal years during which the project is under construction. 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.

The 2015-2016 Codification Section 1400 indicates interest expense can be capitalized for assets "constructed or otherwise produced" for a government's own use. Three conditions must be met for the interest capitalization period to begin: outlays for the asset have been made, activities to get the asset ready for its intended use are in progress, and interest cost is being incurred.

Additionally, the section states the following, "The capitalization period should end when the asset is substantially complete and ready for its intended use. Some assets are completed in parts, and each part is capable of being used independently while work is continuing on other parts. For such assets, interest capitalization should stop on each part when its substantially complete and ready for use. Some assets need to be completed in their entirety before any part of the asset can be used. For such assets, interest capitalization should continue while the entire asset is substantially complete and ready for use. Some assets cannot be used effectively until a separate facility has been completed. For such assets, interest capitalization should continue until the separate facility is substantially complete and ready for use."

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 2015-2016 Codification Section L20 provides the accounting treatment applied to these capital assets. This pronouncement provides that the lease capitalization and disclosure requirements of Statement Governmental Accounting Standards Board (GASB) No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, as amended and interpreted, are applicable to general capital assets. These requirements are illustrated in Chapter 10.

If the criteria of GASB 62 are met, 2015-2016 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 2015-2016 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 GASB 62, the capital asset acquired through the lease should be capitalized.

Internally Generated Intangible Assets

Intangible assets are considered internally generated if they are created or produced by the LUA or an entity the LUA contracted with, or acquired from a third party but require more than "minimal effort to begin to achieve the expected level of service capacity". Three circumstances must exist in order for outlays related to an internally generated intangible asset to begin to be reported as a capital asset:

- The government's specific *objective* for the project and the *service capacity* in which the asset is expected to be used upon the project's completion has been determined.
- The *feasibility* of completing the project so that it can be used in that capacity has been demonstrated.
- The government's *intention* to complete or to continue the development of the asset has been demonstrated.

Outlays incurred prior to meeting the above criteria should be expensed as incurred.

For internally generated computer software, the foregoing criteria should be considered to be met only when the activities in the preliminary project are completed, and management authorizes and commits to funding the software project.

Internally Generated Computer Software

Computer software should be considered internally generated if it is developed in-house or by a third-party contractor on behalf of the LUA. Commercially available software that is purchased or licensed by the LUA and modified more using more than minimal incremental effort before being put into operation should be considered internally generated.

The activities involved in developing and installing internally generated software can be grouped into the following stages:

- a. *Preliminary Project Stage* – Activities here include conceptual formulation and evaluation of alternatives, the determination of the existence of needed technology, and the final selection of alternatives for the development of the software.
- b. *Application Development Stage* – Activities in this stage include the design of the chosen path, including software configuration and interfaces, coding, installation to hardware, and testing, including the parallel processing phase.
- c. *Post-Implementation/Operation Stage* – Activities in this stage include application training and software maintenance.

Data conversion should be considered an activity of the application development stage only to the extent it is determined to be necessary to make the software operational, or in condition for use. Otherwise, data conversion should be considered an activity of the post-implementation/operation stage.

Outlays associated with activities in the preliminary project stage should be expensed as incurred.

Outlays related to activities in the application development stage should be capitalized, if all requirements qualifying the expenses for recognition as an internally generated intangible asset are met. Capitalization of these outlays should cease when the software is substantially complete and operational.

Outlays associated with activities in the post-implementation stage should be expensed as incurred, depending on the nature of the occurrence, and not the timing of the occurrence, for example, application training activities which should be expensed as incurred.

Outlays associated with an internally generated modification of software should be capitalized if any three of the following are met:

- a. An increase in the functionality (performance of tasks previously incapable of performing)
- b. An increase in the efficiency (level of service without the ability to perform additional tasks)
- c. An extension of the estimated useful life

Outlays not meeting any of the above outcomes should be considered maintenance, and expensed as incurred.

Illustration of Capitalization of Intangible Assets

Assumptions

In July 2010, the Somewhere School District identified the need for new enterprise management information software. A task force was identified with personnel from several of the departments in the financial services, student services, technology support, and human resource divisions. From July through October, 2010, the task force performed numerous tasks relating to the project including the following:

- Determined the performance requirements with operators and users
- Determined the system requirements including an assessment of existing hardware
- Assessed the feasibility of developing internally generated software, or seeking an outside provider
- Issued a request for proposals to outside vendors and reviewed these proposals

Based on the recommendation of the task force the board of education awarded a contract in the amount of \$15 million to RoadReady Software Corporation to acquire a perpetual license to use its integrated enterprise software. As a part of the contract, RoadReady agreed to modify, install, and implement the conversion. Three district employees were dedicated to the project. The district included \$16 million in the 2011 general fund budget to cover the cost of the project.

Installation occurred from January 2011 through July 2011. Modifications, data conversion, and testing of the software were completed in October 2011, at which time the software was considered to be substantially complete and operational.

The district determined that the aggregate outlays of the software project were \$17.15 million, composed of the following:

- Outlays associated with task force activities from July through October 2010: \$1.5million
- Outlays for RoadReady software and installation: \$14.6 million
- Outlays for three employees dedicated to the installation and testing: \$.5 million
- Outlays for training district operators and users: \$.55 million

Financial Reporting

The activities of the task force (\$1.5 million) should be considered preliminary project stage activities, expensed on the entity-wide statement of activities, and as an expenditure in the general fund statement of revenues, expenditures, and changes in fund balances.

The acquisition of the license to use Road Ready software and the installation and testing should be considered application development stage activities. \$15.1 million should be capitalized in the entity-wide statement of net assets, evidenced by the completion of the preliminary project stage and the appropriation of \$17.15 million in the general fund budget.

The training activities (\$.55 million) occurring in 2013 should be considered post-implementation/operation stage activities and expensed as incurred in the entity-wide statement of activities and as an expenditure in its general fund statement of revenues, expenditures, and changes in fund balances.

Capitalization Policy

Capital Asset Threshold. Typically, two criteria are used to determine 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 spend 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 in financial statement reporting. It is common for a LUA to have different thresholds for different categories of capital assets. Buildings may be capitalized at \$100,000 and land will always be capitalized, regardless of cost.

Each LEA should consider the cost/benefit relationship to establishing capitalization thresholds. In considering what dollar amount of assets should be capitalized and maintained, the LEA should determine at what level of capitalization at least 80 percent of the districts total assets are capitalized and recorded on the financial statements.

Once a capitalization threshold is established, the LEA should further consider inventory procedures necessary to track small, pilferable, "walkable" items. Examples of such items that may not meet a capitalization threshold are iPads, laptops, and other mobile devices. While these items generally do not meet a capitalization threshold individually, the cost of maintaining technology for all users in a school system, including employees and students, is generally significant to the financial statements. For example, an LEA may adopt a General Fund budget of \$20M for one fiscal year. Of that \$20M, any purchases exceeding 1% of budgeted expenditures, or \$200,000, is considered significant for financial reporting purposes.

The primary advantage of a higher threshold for capitalization is a decrease in the burden on the accounting office for tracking, recording, and depreciating the assets on an annual basis. However, even if a capitalization threshold is set high, small value items such as technology devices should be inventoried and tracked per the LEA's local policy. See Inventoried Assets Section below.

Another consideration of a higher capitalization threshold is the effect on the Net Position reported by the LEA on the District-wide Statement of Net Position. Capitalized assets are not expended in the year of purchase, but are expended over the estimated useful life of the asset by means of depreciation expense. If an asset is fully expended in the year the asset is acquired, that entire expense will reduce the Unrestricted Net Position of the district. If the asset is capitalized, the cost of the asset increases the Net Investment of Capital Assets, and the Unrestricted Net Position is reduced only by the amount of the current year depreciation cost.

The primary advantage of a lower threshold for capitalization is the assets will be tracked in one inventory system regardless of funding source (i.e., state, local, or federal), and the cost of the assets will be allocated among the fiscal years that benefit from the use of the asset. Additionally, setting the same capitalization threshold for all assets reduces the burden of two sets of criteria when complying with the Uniform Administrative Regulations, 2 CFR §200.439 – Equipment and other capital expenditures. 2 CFR §200.33 – Equipment defines equipment as tangible personal property (including information technology systems) having a useful life of more than one year and a per-unit acquisition cost which equals or exceeds the lesser of the capitalization level established by the non-Federal entity for financial statement purposes, or \$5,000.

The GaDOE Financial Review Division recommends setting a capitalizable threshold of not more than \$5,000 for equipment, vehicles, and technology related purchases that have an estimated useful life of more than one year. If, based on the size of the LEA and the resources available, the LEA sets a capitalizable threshold greater than \$5,000, the LEA should ensure that procedures are in place to tag, track, and monitor small value items such as iPads, laptops, and other mobile devices.

Each LEA should consider the cost/benefit relationship in establishing capitalization thresholds. In considering the dollar amount for assets that should be capitalized and maintained, the LEA should determine at which level of capitalization are at least 80 percent of the districts total assets capitalized and recorded on the financial statements.

Inventoried Assets

Setting the capital assets threshold at \$5,000 for equipment does not preclude providing accountability for lower-cost items such as laptops, portable electronic devices (such as tablets), printers and similar items. The nature of these items makes them more susceptible to theft. Therefore, when setting a capital asset policy, it is recommended a threshold of \$500 be set for these items. These inventoried items will not be depreciated. However, they will be subject to periodic inventory.

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 current 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, however, only the straight-line method is recommended.

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 83 of GASB 62. 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.

The calculation for straight-line depreciation is as follows

$$\text{(Purchase Price of the Asset - Residual Value)} \div \text{Estimated Useful Life} = \text{Annual Depreciation Expense}$$

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.

Amortization of Intangible Assets

The useful life of an intangible asset should not exceed the period that its service capacity is limited by contractual or legal provisions.

If there are no legal, contractual, regulatory, technological, or other factors limiting the useful life, an intangible asset should be considered to have an indefinite useful life. Intangible assets with an indefinite useful life should *not* be amortized. Should changes in factors and conditions render an intangible asset’s useful life as no longer being indefinite, the asset should be tested for impairment as a change in the expected duration of use has occurred. The carrying value of the asset, if any, should be amortized in subsequent reporting periods over the remaining estimated useful life of the asset. A common indicator of impairment for internally generated intangible assets is development stoppage, such as computer software, due to a change in management. Internally generated intangible assets impaired from development stoppage should be reported at the lower of carrying value or fair value.

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.

Retroactive Reporting of Intangible Assets

For LUA's with revenues greater than \$10 million, retroactive reporting is required for intangible assets except for those considered to have an indefinite useful life and those internally generated. If the actual historical cost is not available, the estimated historical cost should be used for intangible assets acquired after June 30, 1980. For LUA's with revenues less than \$10 million, retroactive reporting is encouraged, but not required. Retroactive reporting of intangible assets with an indefinite useful life is not required, but is permitted, using the amounts determined in the application development stage as the appropriate historical cost.

No specific disclosures are required for intangible assets, as these will be included with the capital assets in the entity-wide statement of activities.

Dispositions of Capital Assets

The accounting for the disposition of general capital assets often is overlooked. Capital assets are disposed 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 GASB 62, paragraphs 272 – 281. 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 2015-2016 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

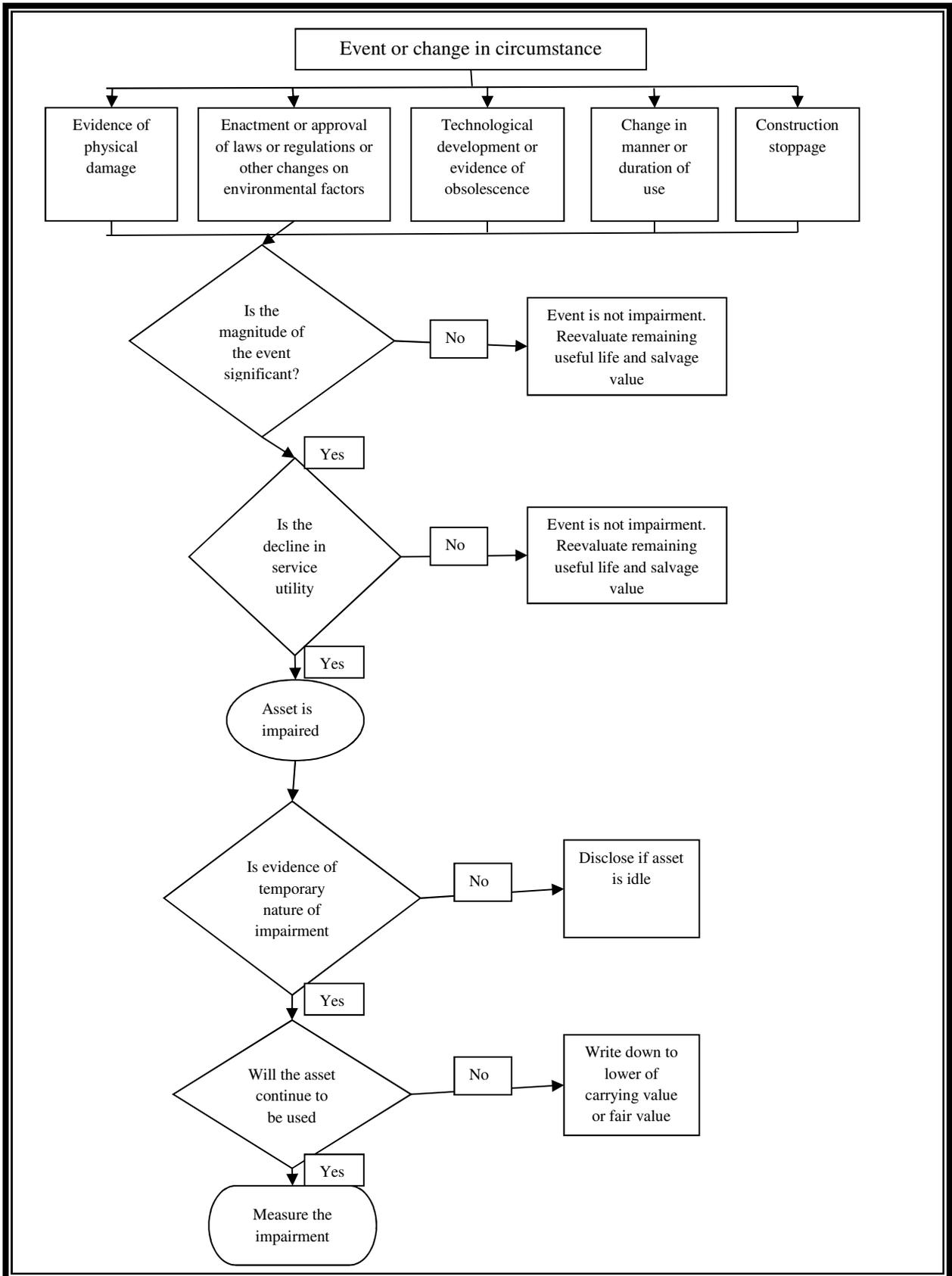
of the service currently being provided by the capital asset and converts that cost to historical cost.

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.

The following decision tree should be utilize to determine if an asset impairment exists:



The following flowchart should assist the user in selecting a method of measuring an impairment:

Indicator of Impairment	Method Generally used in Measuring Impairment
Evidence of physical damage	<p>~If the capital asset will continue to be used by the LUA (or will be upon restoration of the capital asset), use the restoration approach.</p> <p>~If the capital asset will no longer be used by the LUA, use lower of carrying value or fair value.</p>
Enactment or approval of laws or regulations or other changes in environmental factors.	<p>~If the capital asset will continue to be used by the LUA, use the service units approach.</p> <p>~If the capital asset will no longer be used by the LUA, use lower of carrying value or fair value.</p>
Technological development or evidence of obsolescence	<p>~If the capital asset will continue to be used by the LUA, use service units approach.</p> <p>~If the capital asset will no longer be used by the LUA, use lower of carrying value or fair value.</p>
Change in manner or duration	<p>~If the capital asset will continue to be used by the LUA, use deflated depreciated replacement value.</p> <p>~If the capital asset will no longer be used by the LUA, use lower of carrying value or fair value.</p>
Construction stoppage	Use lower of carrying value or fair value.

The Appendix to the Financial Management Handbook includes flowcharts for determining the valuation of impaired assets. Below are two illustrations of accounting for an impaired asset:

Illustration 1: Physical Damage – School with Mold Contamination

Assumptions

The ABC School District has identified extensive mold contamination at one of its elementary schools. Management considers this event to be unusual in nature but not infrequent in occurrence, as defined by APB Opinion 30, and does not consider the event to be within control of management. The elementary school was constructed in 1973 at a cost of \$1.3 million, including \$100,000 for acquisition of the building site. The school had an expected useful life of sixty years. During its life a few improvements were made: a small renovation costing \$135,000 in 1988 and a classroom addition and air conditioning \$1.1 million in 1993. These improvements did not extend the useful life of the building. In 2003, the district became aware of extensive mold contamination in the walls of the school, and closed the school due to concerns for the health of the students. The mold remediation

involves removal and rebuilding of the interior walls and site drainage improvements costing \$4 million. In accordance with the capitalization policies of the ABC School District, 40 percent of the remediation cost is allocable to demolition and mold removal, and 60% is allocable to rebuilding the walls of the school. The estimated replacement cost of the school is \$6.2 million.

Evaluation of Impairment

The mold contamination is the evidence of the physical damage providing the indication of impairment. The magnitude of the event would be evaluated as significant. The ongoing costs of the school, especially depreciation and operating costs, would be viewed as significant in relation to the zero utility it was providing. The circumstance is not part of the normal life cycle of a school. Impairment loss using the restoration cost approach is determined as follows:

	Historical Cost	Estimated Useful Life	Accumulated Depreciation, 2003	Carrying Amount, 2003
Land	\$100,000			
Building acquisition, 1973	\$1,200,000	60	\$600,000	\$600,000
Renovation, 1988	\$135,000	45	\$45,000	\$90,000
Classroom addition/air conditioning, 1993	<u>\$1,100,000</u>	40	<u>\$275,000</u>	<u>\$825,000</u>
Total buildings	<u>\$2,435,000</u>		<u>\$920,000</u>	<u>\$1,515,000</u>
Total mold remediation cost	\$4,000,000			
Percentage rebuilding cost	60%			
Restoration Cost	<u>\$2,400,000</u>			
Restoration cost (current dollars)	\$2,400,000			
Replacement cost (current dollars)	<u>\$6,200,000</u>			
Restoration cost ratio	38.7097%			
Carrying amount (historical cost)	<u>\$1,515,000</u>			
Impairment loss	<u>\$ 586,452</u>			

Reporting

The impairment loss and mold remediation expenses would be allocated to the applicable programs and be reported as program expenses in the statement of activities. The following disclosure would be presented in the notes to the financial statements:

Program expenses include an impairment loss of \$586,452 due to mold contamination at an elementary school and also include \$1,600,000 in mold remediation costs as follows:

	Impairment Loss	Mold Remediation
Regular instruction	\$322,550	\$ 880,000
Special education instruction	87,967	240,000
Pupil support services	58,645	160,000
Instructional staff services	58,645	160,000
School administration services	<u>58,645</u>	<u>160,000</u>
	<u>\$586,452</u>	<u>\$1,600,000</u>

Illustration 2: Change in Manner or Duration of Use – School Used for Storage

Assumptions

In 2003, XYZ School District closed an elementary school because enrollments in the district declined unexpectedly due to bankruptcy of the major employer in the area. The closed school has been converted to use as storage. Management does not consider this event to be unusual in nature or infrequent in occurrence, as defined by APB Opinion 30. This elementary school was constructed in 1991 at a cost of \$10 million. The estimated useful life of the school is fifty years. XYZ School District has no evidence that enrollments will increase in the future such that the building would be reopened for use as a school. The current replacement cost for a warehouse of the same size is \$4.2 million. A commercial index construction was at 100 and 150 in 1991 and 2003, respectively.

Evaluation of impairment

Impairment is indicated because the manner of use of the school has changed from educating students to storage. The situation passes the magnitude test because the

ongoing costs of the school – depreciation, insurance, utilities, security – would likely be considered high in relation to the benefit it is providing – storage. The circumstance also passes the test of not being predicted because it seems likely that if management had known that they needed space for students for only twelve years, they would have selected a less expensive method of providing classrooms for those twelve years. Impairment loss using deflated depreciation replacement cost would be determined as follows:

Historical cost	\$10,000,000
Accumulated depreciation (12/50 years)	<u>2,400,000</u>
<i>a</i> Carrying amount, 2003	<u>\$ 7,600,000</u>
Replacement cost of warehouse	\$ 4,200,000
Accumulated depreciation (12/50 years)	<u>1,008,000</u>
<i>b</i> Depreciated replacement cost	<u>\$ 3,192,000</u>
<i>c</i> Commercial construction index, 1991	100
<i>d</i> Commercial construction index, 2003	<u>150</u>
<i>e</i> Deflation factor (<i>c</i> / <i>d</i>)	<u>0.667</u>
<i>f</i> Deflated depreciated replacement cost (<i>b</i> x <i>e</i>)	<u>\$ 2,128,000</u>
Impairment loss (<i>a</i> – <i>f</i>)	<u>\$ 5,472,000</u>

Reporting

The impairment loss of \$5,472,000 would be allocated to the applicable programs and reported as program expenses in the statement of activities. The following disclosure would be presented in the notes to the financial statements.

Program expenses include an impairment loss of \$5,472,000 due to the change in use of an elementary school from education to storage as follows:

	<u>Impairment Loss</u>
Regular instruction	\$3,009,600
Special education instruction	820,800
Pupil support services	547,200
Instructional staff services	547,200
School administration services	547,200

SUMMARY

1. Categories of capital assets included land and land improvements, buildings, machinery and equipment, construction in progress, infrastructure, works of art and historical collections, and intangible assets.
2. 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.
3. Typically, two criteria are used to determine the LUAs capitalization policy: the cost of the asset and its estimated useful life. Once a capitalization threshold is established, the LEA should further consider inventory procedures necessary to track small, pilferable, "walkable" items.
4. At the government-wide reporting level, the GASB requires LUAs to depreciate all capital assets. LUAs may use any established depreciation method. Any rational and systematic method may be used.
5. 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.