

**Manual of Accounting and Financial Reporting for
Pennsylvania Public Schools**

CHAPTER 11
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Chapter 11

Capital Assets And Infrastructure

**** Updated 3/4/05 ****

Local educational agencies (LEAs) must account for and report both current and non-current assets. Non-current assets are classified as capital assets. Capital assets are assets of a physical nature that have a long-term period of usefulness to an LEA. LEAs must maintain records of their capital assets (1) to enhance the LEA's management of those resources, (2) for sound budgeting of maintenance expenses and replacements, and (3) for insurance purposes. Capital asset records also enhance the LEA's stewardship of the assets by providing a mechanism to avoid waste and theft. Finally, such records can help to ensure compliance with State and Federal grants and other legal requirements, as well as, with meeting generally accepted financial accounting reporting requirements. Governmental Accounting Standards Board Codification Section 1400 addresses the general principles of accounting for capital assets of governmental funds, proprietary funds and fiduciary funds.

❖ *What Are Capital Assets?*

LEAs generally account for their capital assets based on asset class: land and land improvements such as pavements, gutters, fences and walking bridges; buildings and building improvements; machinery and equipment; construction in progress and intangibles. A capital asset generally is classified as equipment rather than as a building improvement if it retains its original shape, appearance and character with use and is an independent unit that does not lose its identity through fabrication or incorporation into a different or more complex unit or structure. An item generally is accounted for as a building improvement rather than as an operating expenditure or expense if it extends the useful life of the building beyond its original life expectancy or significantly increases its value.

Construction in progress is a temporary capitalization of the elements of a construction project. The amounts paid to contractors and expenditures incurred for employee

salaries, benefits, materials and supplies, etc. for use of the LEA staff all represent the total cost of the project and should be included in the Construction in Progress Account. Construction in Progress is a capital asset and is reported on the statement of net assets as a non-current asset not subject to depreciation.

Built-in equipment consists of: equipment built into the building, and equipment built into the grounds. Equipment built into buildings consists of equipment that is an integral part of the building. This equipment would be permanently fastened to the building, functioning as part of the building, having a useful life somewhat the same as the building's expected useful life, and would cause appreciable damage to the building and / or its functionality, if removed from the building. New and additional purchases as well as replacement purchase of equipment built into the building are capital asset additions and should be charged to Function 4000 – Facilities Acquisition, Construction and Improvement Services as Building Improvements. Ordinary and necessary repairs of built-in equipment items are considered maintenance expenditures and should be charged to Function 2600 – Operation and Maintenance of Plant.

GAAP requires all governments to account for and report infrastructure assets. Infrastructure assets are public domain assets such as roads, bridges, curbs and gutters, streets and sidewalks, drainage systems, lighting systems and similar assets that are immovable and of value only to a governmental entity. LEAs generally do not have a significant number of infrastructure assets, although they may have assets of a similar nature that are land improvements, such as roads and bridges that are part of a campus, rather than part of the public domain. Water and sewer systems are also infrastructure items that are reportable by an LEA if the LEA must maintain them.

❖ Valuation Of Capital Assets

Capital assets should be reported at historical cost. The cost of a capital asset should include ancillary charges necessary to place the asset into its intended location for use (e.g., freight and transportation charges, site preparation costs and professional fees). Capital assets of proprietary funds should also include interest expense incurred during construction. Interest expense should not be included in capital asset valuation for governmental fund assets, this expense is presented as a line item on the statement of activities.

Donated capital assets should be reported at their *fair value*, or estimated *fair value* (including ancillary charges, if applicable) at the time of receipt.

Fair value is the amount at which the asset could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Estimated fair value may also be calculated from manufacturers' catalogs or price quotes in periodicals, recent sales of comparable assets, or other comparative information. Professional assistance from an appraiser may be helpful but is not required.

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❖ Accounting For Capital Assets

GASB Codification Section 1400 states that there are two (2) methods of accounting for capital assets depending on the fund to which they relate.

Capital Assets that relate to a specific proprietary fund such as an enterprise fund or internal service fund should be accounted through that fund. These are fund capital assets. An example would be the purchase of ovens for the food service fund. In the food service fund, capital assets are recorded in the fund's asset accounts and reported in the fund's balance sheet as capital assets. No expenditure is recorded in the fund's accounts or reported in the fund's operating statement when the purchase is made. The acquisition of the capital asset is reported in the fund's statement of cash flows. Depreciation, that is, an allocation of the cost of the capital asset over its estimated useful life using a systematic and rational method, is charged to the fund's operating statement as an expense. We recommend all LEAs use the straight-line method or another more logical method to measure and report depreciation of capital assets. Group and composite methods of depreciation are encouraged, when appropriate, to efficiently manage your depreciation efforts.

Resources contributed to a proprietary fund to acquire or construct capital assets – including grants, entitlements or shared revenues that are externally restricted to acquire or construct capital assets – are recorded as non-operating revenue reported as increases to net assets. Capital Assets of all proprietary and fiduciary funds will be capitalized as assets of the fund and proprietary capital assets will be reported in the LEA's Statement of Net Assets.

The purchase of capital assets in governmental funds are accounted for and reported as expenditures in the fund that pays for the asset in the year of purchase. General capital assets are not accounted for in the fund's balance sheet. The acquisition of a general capital asset through a capital lease is accounted for and reported as if it were a cash acquisition – that is, as an expenditure and other financing source, usually in the governmental fund. Other non-cash acquisitions of general capital assets - for example, through gift or by trading in another general capital asset – generally are not accounted for or reported as expenditures in governmental funds. Capital Assets of all governmental activities are reported in the statement of net assets at the school entity-wide level net of accumulated depreciation.

CAPITALIZATION POLICY

Each LEA school board should establish a formal written policy for the capitalization of capital assets and infrastructure. The board policy should list a monetary threshold for capitalization of assets for financial reporting purposes, for inventory purposes and for insurance purposes. The board may establish different policies and thresholds for inventory, insurance and financial reporting purposes. This policy should also list the assets or asset groups to be managed for these purposes and the estimated useful lives of each asset or asset system or group. The school's capitalization policy also should address whether the threshold for capitalizing asset purchases is to be based on individual equipment items or on systems / categories or

groups of assets. For example, individual pieces of computer hardware may fall below a capitalization threshold, but when purchased together as a system they may exceed the threshold. The board may also establish differing monetary, capitalization thresholds for each asset, asset group / class or system.

The LEA's capitalization policy should be consistently applied each year in making decisions concerning the capitalization and expensing of capital asset purchases. The original capitalization policy and any changes in policy must be disclosed in the notes to the Basic Purpose Financial Statements.

Generally, asset purchases are capitalized if the purchase price exceeds a minimum dollar value as mandated by State or Federal agencies or the LEA School Board, and the item can be expected to have a useful life that exceeds the LEA's current fiscal period.

An asset should be capitalized if (1) it has a greater useful life than a single reporting period and (2) meets your LEA capitalization policy unless grant requirements call for a lower capitalization threshold than that established by the LEA. Governmental standards do not list a monetary threshold because each LEA's size, philosophy and governance will have a direct influence on the LEA's preferred asset management levels. The Government Finance Officers' Association (GFOA) has recommended that capitalization policies be established that will capture at least 100 percent of all buildings and building improvements, land and land improvements, and 80 to 85 of all other LEA assets. This is a general guideline that you may choose to follow when reviewing your LEA's capitalization policy.

The following items are guidelines established in the Federal publication, *Financial Accounting for Local and State School Systems* in classifying a purchase as an equipment or supply item. Equipment items not meeting your LEA's capitalization policy should be recorded in the appropriate 700 object code series. Supply items should be recorded in the appropriate 600 object code series. Unless otherwise bound by federal, state or local laws, LEAs should use this criteria in their supply / equipment classification decisions. In cases where the distinction is unclear, the LEA, as always, must apply reason and good judgment in making its decision.

An item should be classified as an **equipment** item if **all** of the following conditions exist:

- ❖ The purchase can reasonably be expected to last more than the current fiscal period;
- ❖ It is more feasible to repair, rather than replace the item, when a failure occurs.
- ❖ The purchase is an independent unit, not a part of another unit item.
- ❖ The cost of tagging and inventory is a small percent of the purchase price.
- ❖ The purchase price exceeds the minimum dollar value mandated by your Board policy for capitalization of assets.

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An item should be classified as a supply if the purchase does not meet all of the conditions listed above.

Sometimes, LEAs raise the minimum dollar value for capitalizing assets. Subsequent changes in an LEA's capitalization threshold generally are accounted for retroactively by removing previously capitalized assets that do not meet the revised capitalization threshold from the capital asset records. For example, if an LEA decides to raise its capitalization threshold from \$500 to \$1,000, all assets valued between \$500 and \$1,000 should be removed from the school's capital asset records for financial reporting purposes. This change in the capitalization threshold should be reported as an adjustment to the beginning balance of capital assets reported in the notes to the LEA's financial statements.

MAINTAINING CAPITAL ASSETS

LEAs must maintain a Capital asset Management System that will provide asset maintenance data, accountability and control information, information for insurance purposes, data for capital expenditure planning and budgeting, cost accounting, internal as well as external financial reporting, and federal program reporting requirements. Capital asset records must also be maintained to obtain an unqualified audit opinion from your independent auditor. Capital asset control can be costly, time-consuming and requires the commitment of the entire school staff.

An LEA should maintain a detailed listing of the capital asset that includes, at a minimum, the date acquired, item description, property inventory, tag number (if assigned), serial number (if available), original cost or other historical cost estimate, estimated useful life, annual depreciation and accumulated depreciation (if applicable), the fund or account group that accounts for the asset, and building / room assignment. State and Federal regulations may require that additional information be maintained for capital assets acquired with grant funds. That listing should be updated for capital asset additions and deletions and should agree with the capital asset accounts in the proprietary and fiduciary, as well as those reported on the Statement of Net Assets.

LEAs should perform a periodic inventory of their capital assets. An annual inventory is recommended, although some Federal regulations do not require capital asset inventories more frequently than once every two (2) years. Appropriate internal controls should be developed to ensure that the inventory taken is complete and accurate, the actual results are compared to the capital asset records, and necessary adjustments to the capital asset records are appropriate and approved.

❖ **Depreciation And Accumulated Depreciation**

Depreciation is a method of spreading the loss in value of a capital asset over several periods and is necessary to measure net income and capital maintenance. Although the generally accepted accounting principles for governmental entities do not prescribe a method of depreciation accounting, it is implied in *GASB Codification*, Section 1400.114, that the straight-line method of depreciation accounting is most applicable to governments. This section states that, "depreciation is an element of

expense resulting from the use of long-lived assets. It is conventionally measured by allocating the expected net cost of using the asset (original cost less estimated salvage value) over its estimated useful life in a systematic and rational manner.” Since methods of depreciation, other than the straight-line method, do not necessarily consider estimated salvage value (such as the double declining balance method of depreciation), it is assumed herein that GASB advocates the use of the straight-line method of depreciation by governments. However, if the LEA finds another depreciation method to be more rational and logical, it may use another acceptable method.

Annual depreciation using the straight-line method is determined by taking actual cost, subtracting estimated salvage value, and dividing by the number of years that the asset is expected to be used. Accumulated depreciation for an asset is the annual depreciation times the number of years the asset was actually used. For example, assume that a capital asset costing \$11,000.00 is expected to be used for ten (10) years, and at the end of ten (10) years, the salvage value is estimated to be \$1,000.00. Annual depreciation is \$1,000.00, which is determined by taking the actual cost of \$11,000.00, subtracting the estimated salvage value of \$1,000.00, and then dividing by the estimated life of ten (10) years. Accumulated depreciation at the end of five (5) years, for example, is \$5,000.00. This is determined by multiplying annual depreciation of \$1,000.00 by five (5) years. In accounting, depreciation of capital assets is usually determined at the close of each fiscal period. Once a method of depreciation is placed into use by a school entity, it should be consistently and systematically applied.

Capital assets should be depreciated and reported on the statement of net assets and the statement of activities over their estimated useful lives unless they are (1) inexhaustible (such as land or land improvements); (2) non-capitalized collections of works of art, historical treasures, and similar assets discussed in GASB Statement #34; or (3) infrastructure assets using the modified approach as set forth in *Codification* Section 1400. Depreciation expense should be reported in (1) the government-wide Statement of Activities, (2) the proprietary fund Statement of Revenues, Expenses and Changes in Fund Net Assets, and (3) the Statement of Changes in Fiduciary Net Assets.

Depreciation expense should be measured by allocating the net cost of depreciable assets (historical cost less estimated salvage value) over the estimated useful life. It may be calculated for:

- ❖ *A class of assets* (for example, infrastructure, buildings and improvements, vehicles, machinery and equipment);
- ❖ *A network of assets* – All assets that provide a particular type of service for a government. For example, a network of infrastructure assets may be a dam composed of a concrete dam, a concrete spillway and a series of locks.

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- ❖ *A subsystem of a network* – All assets that make up a similar portion or segment of a network of assets. For example, all the roads of a government could be considered a network of infrastructure assets. Interstate highways, state highways and rural roads could each be considered a subsystem of that network.
- ❖ *Individual assets*

Capital assets that are being or have been depreciated should be reported net of accumulated depreciation in the Statement of Net Assets. The accumulated depreciation is disclosed in the notes and is reported for all governmental as well as business-type capital assets.

Capital assets that are **not** being depreciated, such as land, or infrastructure assets reported using the *modified approach*, should be reported separately from depreciable assets on the Statement of Net Assets if your LEA has a significant amount of these assets.

LEAs should capitalize works of art, historical treasures, and similar assets at their historical cost or fair value at date of donation. Monuments are capital assets that may qualify as works of art or historical treasures if they meet the requirement of paragraph 27 in GASB Statement #34. Monuments that are inexhaustible need not be depreciated.

Modified Approach

The modified approach is an alternative to reporting depreciation that may be applied for eligible infrastructure capital assets that meet the two (2) requirements discussed below. Under the modified approach, depreciation expense is not recorded for these assets. Costs associated with maintenance and preservation of these assets should be expensed in the period incurred. However, additions, improvements and preservation costs extending the useful life of an asset would be capitalized.

The modified approach may not be applied to an individual infrastructure asset. Infrastructure assets that are part of a network or subsystem of a network are not required to be depreciated as long as two (2) requirements are met:

1. The LEA documents that the eligible infrastructure assets are being preserved at (or above) a level established and disclosed by the LEA. The condition level should be established and documented by administrative or executive policy or by legislative action.
2. The LEA manages the eligible infrastructure assets using an asset management system that has the characteristics listed below:
 - ❖ Has an up-to-date inventory of eligible infrastructure assets;
 - ❖ Performs condition assessments of the eligible infrastructure assets and summarizes the results using a measurement scale. Condition

assessments should be documented in a way that they can be replicated. Documentation could include details of statistical; and

- ❖ Estimates each year the annual amount to maintain and preserve the eligible infrastructure assets at the level disclosed.

Because of variations among LEA asset management systems and assessment methods, LEAs need to use professional judgment in determining adequate documentation discussed in the second bullet above. LEAs should document that:

1. Complete condition assessments of eligible infrastructure assets are performed in a consistent manner at least every three (3) years. These assessments may be performed using statistical samples. Cyclical assessments (where one-third is assessed each year) may also be performed.
2. The results of the three (3) most recent complete condition assessments provide reasonable assurance that the eligible infrastructure assets are being preserved approximately at (or above) the condition level established and disclosed by the LEA.

Note: If eligible infrastructure assets meet the requirements of the modified approach, but are not depreciated, all expenditures made for those assets (except for additions and improvements) should be expensed in the period incurred. Additions and improvements to eligible infrastructure assets should be capitalized.

If the assets no longer meet the requirements of the modified approach (for example, the LEA fails to perform a condition assessment at least every three (3) years, fails to document the condition assessment, fails to estimate the annual amount needed to maintain and preserve the asset, or receives a condition assessment that the asset was maintained below the condition level established), the assets should be depreciated in the subsequent reporting periods.

ADDITIONS, DELETIONS AND RETIREMENTS

Any additions to or deletions in assets are to be recorded by direct adjustments to the appropriate accounts. These transactions should also be disclosed in the notes to the financial statements.

It is important that “effective retirements” which result from loss, theft or obsolescence are not overlooked. Accounting system records and inventories should be established in order to ensure that these retirements are included with the deletions of capital assets reported in financial statements.

Note: Additions, deletions and effective retirements must be evaluated and adjusted at June 30th each year for governmental funds. Adjustments should be done on an ongoing basis for proprietary funds and fiduciary funds.

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TRADE-INS AND DISPOSALS

When a capital asset is disposed of, the LEA should remove it from the accounting records. The amount and nature of the necessary accounting entries depends on where the asset is recorded and the nature of the disposal – that is, whether the asset is sold, given away or traded in for another asset.

The LEA Board should give prior approval for disposal of capital assets. There are several methods by which assets may be disposed:

1. Assets with no value remaining may be thrown out, burned, hauled to a landfill, or donated to a charitable organization.
2. Assets may be sold at a public auction. The terms of sale should be defined before the sale, including whether items are being sold “as is,” all sales final and so forth. General Capital assets sold for significant dollar values should be recorded to Revenue Account 9400 – Sale or Compensation for Loss of Capital assets. Proprietary and Fiduciary Fund Capital assets sold for significant dollar values should be recorded to Revenue Account 6930 – Gain or Loss on Sale of Capital assets.
3. Assets may be sold for salvage value, in a negotiated sale, through sealed bids, or as a pre-priced sale. Immaterial amounts realized on the sale of capital assets may be recorded to Revenue Account 6990 – Miscellaneous Revenue.

When trading in an old capital asset for a new one, the book value of the old has no effect upon the value of the new asset. The old asset is simply removed from the records, and the new asset is recorded at its fair value. These assets may no longer be in service due to loss, theft or obsolescence. If they are not removed from the books, an overstatement of assets occurs.

ACCOUNTING FOR CATASTROPHIC GAINS AND LOSSES TO CAPITAL ASSETS

Damages to capital assets caused by tornadoes, wind and rainstorms (and other acts of God), fire, theft and vandalism should be recorded so as to reflect the difference between the cost of replacement or restoration and the insurance or other contributions or subsidies received as reimbursement. Partial losses or damages that are replaced or repaired should be recorded at cost and treated as an expense. The original value of such assets should be retained, unless additions or enhancements are made in conjunction with the repairs.

The following example illustrates journal entries necessary to record transactions related to catastrophic gains or losses.

1. A classroom is destroyed by fire and a gain will be realized from the resulting repair.

Insurance Recovery	\$20,000.00
Cost of Building Repair	\$17,000.00
Cost of Equipment Repair	\$ 2,000.00

A.

Cash And Temporary Investments	\$	20,000.00	
Revenues – Insurance Recovery			\$ 20,000.00
<i>To record receipt of insurance proceeds.</i>			

B.

Expenditures – Building Purchase, Construction And Improvement	\$	17,000.00	
Expenditures – Furniture And Equipment	\$	2,000.00	
Cash And Temporary Investments			\$ 19,000.00
<i>To record payment for contract repair of classroom.</i>			

CAPITAL LEASE – PURCHASE AGREEMENTS

Certain leases of capital assets – capital leases – should be accounted for as purchases of capital assets for accounting and financial reporting purposes. Generally the criteria of FASB Statement No. 13, *Accounting for Leases*, as amended and interpreted, provides guidance for determining whether a capital asset acquired through a lease should be capitalized. A capital lease is one that essentially transfers the benefits and risks of ownership of the leased asset to the LEA. FASB Statement 13 generally provides that such a situation has occurred if any one of the following four (4) criteria is met:

- 1) The lease transfers ownership of the property to the LEA by the end of the lease term. (This criterion must always be met for the capital lease of land.)
- 2) The lease contains a bargain purchase option.
- 3) The lease term is equal to seventy-five percent or more of the estimated economic life of the leased asset.
- 4) The present value of the minimum lease payments exceeds ninety percent of the fair value of the leased asset at the inception of the lease.

The capital lease should be recorded at an amount equal to the present value of the minimum lease payments but this cannot exceed the fair value of the leased property. The long-term obligation and the asset acquired should be reported in the government wide financial statements.

❖ **Other Accounting Issues**

JOINT VENTURES

Sometimes governments participate in a joint venture in which they retain an explicit measurable equity interest. In most cases, this equity interest relates directly to the capital assets of the joint venture. Please read GASB Statement No. 14, *The*

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Financial Reporting Entity, for more information concerning joint ventures. This situation may exist between some school districts and their vo-tech school.

❖ **Note Disclosures For Capital Assets**

In the summary of significant accounting policies note disclosure, an LEA should disclose information about its policies for accounting for capital assets, such as how capital assets are valued, the depreciation method used, and the policy for capitalizing interest costs incurred during construction. Generally Accepted Accounting Principles also requires particular disclosures for specific capital asset transactions, such as capital leases. The capital asset disclosure generally is accomplished with a schedule-type presentation of the opening balances, additions, deletions, transfers, and ending balances of those assets by class.