



Capital Assets and Investment in Marketable Securities

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Textbook: Government and Not-for-Profit Accounting, Granof

- This presentation contains information, in addition to the material prepared and provided by the professor, from the book Government and Not-for-Profit Accounting, 7th. Ed., Granof which is the textbook assigned for the course CONT 4059 – “Contabilidad para Entidades que no son Negocios” at the University of Puerto Rico, Río Piedras Campus.



Capital Assets

General



Capital Assets General

1.1 GASB – Objectives of Financial Reporting

Capital Assets

General

1.1 GASB – Objectives of Financial Reporting

- *Concepts Statement No. 1 (Financial Reporting)* set forth the purpose of capital asset reporting and laid the foundation for the current provisions:
 - Financial reporting should provide information about a governmental entity's physical and other nonfinancial resources having useful lives that extend beyond the current year, including information that can be used to assess the service potential of these resources.
 - This information should be presented to help users assess long and short-term capital needs.



Capital Assets General

1.2 Accounting Practices

Capital Assets

General

1.2 Accounting Practices

- **Fund Accounting**

- General capital assets are excluded from governmental funds because the measurement focus of governmental funds is on financial resources.
- Therefore, in governmental funds, the costs of capital assets are reported as expenditures when the assets are acquired rather than capitalized as assets and subsequently written off as the assets are consumed.

Capital Assets General

1.2 Accounting Practices

- **Government-wide Statement**
 - To prepare their government-wide statement and a required schedule of capital assets activity, governments must maintain records of their capital assets (and the related accumulated depreciation) that are not recorded on the balance sheets of their governmental funds.

Capital Assets

General

1.3 Classification of General Capital Assets

Capital Assets

General

1.3 Classification of General Capital Assets

- The most common classification for general capital assets include:
 - Land
 - Buildings
 - Equipment
 - Improvements to land and building
 - Construction in progress
 - Works of art
 - Historical treasures
 - Infrastructure (road, bridges, tunnels, drainage systems)
 - Intangible assets

Capital Assets

General

1.3 Classification of General Capital Assets

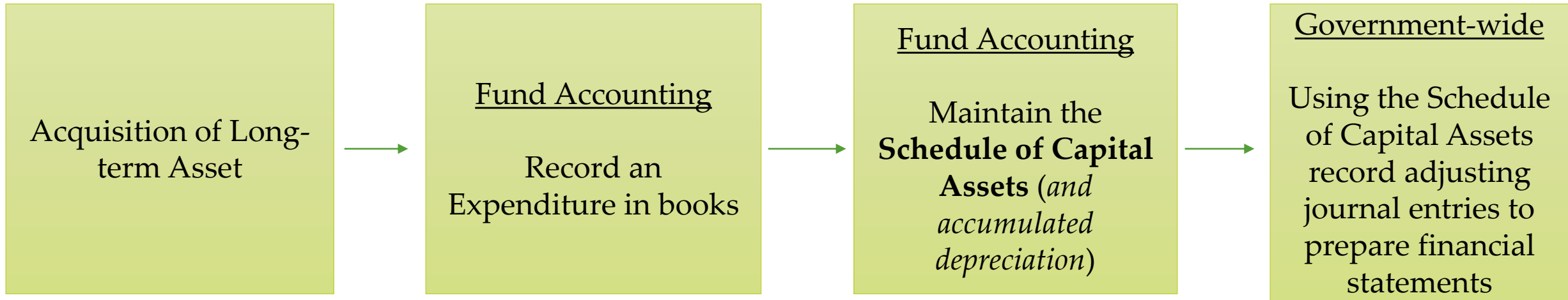
- Intangible assets
 - Library books and recordings
 - Computer software (purchased or developed in-house)
 - Water rights
 - Easements.



Capital Assets Summary

Capital Assets Summary

2.1 Summary





Capital Assets

Government-wide Statement



Capital Assets

Government-wide Statement

3.1 Acquiring and Placing Value on Capital Assets

Capital Assets

Government-wide Statement

3.1 Acquiring and Placing Value on Capital Assets

These rules applies to proprietary funds and the government-wide statements.

- **Cost:** When a government acquires an asset by purchase, construction, or capital lease, it should follow the same general guidelines used by businesses to determine the costs to be capitalized (all costs necessary to bring an asset to a serviceable condition).

Capital Assets

Government-wide Statement

3.1 Acquiring and Placing Value on Capital Assets

- **Cost:**

- **Purchased assets:** Purchase price + (*transportation and installation costs*) or in case of real estate (*legal fees, appraisal cost, closing costs, demolishing existing structures*).
- **Construction:** Direct labor + material + overhead costs + architect fees + insurance during construction phase.
 - *Exception:* Unlike businesses, governments should NOT capitalize interest on general capital assets that they construct themselves (GASB No. 37). Interest expense on general long-term liabilities should be treated as an indirect expense, rather than being attributed to specific functions or programs, such as public works.

Capital Assets

Government-wide Statement

3.1 Acquiring and Placing Value on Capital Assets

- **Cost:**

- **Donated assets:** Government should report donated assets at their estimated acquisition value (replacement cost) at the time the gift is received. (*FMV*)



Capital Assets

Government-wide Statement

3.2 Special Rules

Capital Assets

Government-wide Statement

3.2 Special Rules

- **Accumulated Depreciation:**
 - Should be reported at historical cost net of accumulated depreciation.
 - Accumulated depreciation may be reported on the face of the balance sheet or disclosed in notes.
- **Infrastructure Assets**
 - Governments do not have to depreciate infrastructure assets if they can demonstrate that they are preserving the assets in a specified condition.

Capital Assets

Government-wide Statement

3.2 Special Rules

- **Depreciation Expense:**

- A government does not have to include a separate line item for depreciation on its government-wide statement of activity (statement of revenue and expenses).
- Inasmuch as the statement will typically report expenses by function (ex. Public safety, recreation, health), it may aggregate the depreciation charge applicable to each of the functions with other types of expenses.

Capital Assets

Government-wide Statement

3.2 Special Rules

- **Notes to Financial Statements:**

- A government must, however, include in its notes to the financial statements information on each of its major categories of capital assets.
- Usually presented in schedule format, this information would include:
 - Beginning and ending balances
 - Acquisitions
 - Sales and retirements
 - Current period depreciation.

See Example on page 288.

Capital Assets

Trade-Ins

3.3 Trade-Ins

Capital Assets

Trade-Ins

Example

A government trades in an old automobile for a new one. The old automobile had a cost \$30,000; FMV at the time of trade is \$12,000. To date the government has charged \$10,000 in depreciation. Therefore, the book value of the asset is \$20,000. FMV of new automobile is \$40,000. Hence, the government is required to pay an additional \$28,000 in cash.

Capital Assets

Trade-Ins

Example

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FUND ACCOUNTING

Date	DESCRIPTION	DR.	CR.
	Expenditure – acquisition of equipment	28,000	
	Cash		28,000
	<i>To record the trade-in transaction.</i>		

Capital Assets

Trade-Ins

Example

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GOVERNMENT-WIDE STATEMENT

Date	DESCRIPTION	DR.	CR.
	Equipment (new auto)	40,000	
	Loss on trade-in	8,000	
	Accumulated depreciation (old auto)	10,000	
	Equipment (old auto)		30,000
	Cash		28,000



Capital Assets

Government-wide Statement

3.4 Collectible

Capital Assets

Government-wide Statement

3.4 Collectible

- Collectible, most found in government museums, universities, libraries, and historical centers, includes:
 - Art
 - Rare books
 - Historical artifacts
- Government and not-for-profits have generally opposed both capitalizing the collectibles they hold and recognizing as revenue the collectible they receive as contributions. They contend that the value of such objects, like their beauty, is “priceless”.

Capital Assets

Government-wide Statement

3.4 Collectible

- GASB Standard

1. **Capitalizing the Asset**

- Encourages, but does not require, to capitalize their art and similar assets as long as they meet the following conditions:
 1. They are held for public exhibition, education, or research in furtherance of public services, rather than for financial gain.
 2. They are protected, kept unencumbered, cared for, and preserved.
 3. They are subject to an organizational policy that requires the proceeds from sales of collection items to be used to acquire other items for collections.
- Works of art and other collectibles that do not meet these conditions (investment or not accessible to the public or for research purposes) **must be capitalized**.

Capital Assets

Government-wide Statement

3.4 Collectible

- GASB Standard

2. **Depreciation:** Those collectible capitalized should be depreciated but not those that are not expected to decline in value with time.
3. **Revenue:**
 - Government should recognize contributions of collectible as revenues just as if they had received other assets (see chapter 4).
 - If the items were to be added to non capitalized collections, then the governments should offset the revenue with a charge to a program expense rather to an asset.



Capital Assets

Government-wide Statement

3.5 Infrastructure Assets

Capital Assets

Government-wide Statement

3.5 Infrastructure Assets

- A government's infrastructure is its capital that are immovable and can be preserved for a significantly longer period than most other assets.
- Although many citizens take the nation's infrastructure for granted, public officials, investors, and economics are expressing serious concern over it.
- Governments are accountable for infrastructure assets, and it is difficult to see how the objectives of financial reporting can be fulfilled without comprehensive information regarding not only expenditures for infrastructure but also the assets' status.

Capital Assets

Government-wide Statement

3.5 Infrastructure Assets

- GASB Standard:

- The GASB acknowledge the limitation of depreciation as a measure of the cost of using infrastructure assets.
- However, the Statement No. 34 permits governments to avoid charging depreciation if they can demonstrate that they incur the costs necessary to preserve the assets in a specified conditions. This method is known as the Modified Approach.

Capital Assets

Government-wide Statement

3.5 Infrastructure Assets

- GASB Standard:

- To use this modified approach on all or some of its infrastructure assets, a government would have to assess periodically (at least every three years) the condition of its infrastructure assets and estimate the annual amount necessary to maintain and preserve the assets at the specified “condition level”.
- In addition, it would have to document that the assets are, in fact, being maintained at or above that level.

Capital Assets

Government-wide Statement

3.5 Infrastructure Assets

- GASB Standard:
 - Under the Standard Approach (full accrual basis) both the initial cost and the subsequent preservation costs are capitalized and depreciated over their expected useful life.

Capital Assets

Government-wide Statement

Example - Infrastructure Assets

- Suppose, that to preserve a road at a specified condition, a government must repave it every five (5) years at a cost of \$200,000.
 - **Modified Approach:** The government would report the \$200,000 as an expense when incurred. This approach, for a particular road, would result in a charge of \$200,000 every five years.
 - **Standard Approach:** The government would capitalize the \$200,000 and depreciate it over a period of five (5) years. This approach, for a particular road, would result in a charge of \$40,000 per year plus the depreciation on the initial cost of the road.

Capital Assets

Government-wide Statement

Example - Infrastructure Assets

- Suppose, that to preserve a road at a specified condition, a government must repave it every five (5) years at a cost of \$200,000.
 - Under the **Modified Approach**, the government must disclose (as “required supplementary information”) the assessed condition of the assets and the basis on which it made that assessment.
 - The basis would ordinarily be an engineering measurement scale, such as one that ranks pavements from zero (unsafe) to 100 (perfect).
 - The government must also report, for the latest five (5) years, the estimated cost of maintaining the assets at the specified condition as compared to the amounts actually expensed. (**Deferred Maintenance Cost**)
 - See example on page 292 (State of Minnesota).



Capital Assets

Government-wide Statement

3.6 Intangible Assets

Capital Assets

Government-wide Statement

3.6 Intangible Assets

- Government have intangible assets that are becoming an increasingly large proportion of their assets.
 - *Example: e-government.* Governments use computers not only to account for financial transactions, but also to regulate traffic flow, dispatch emergency personnel, and read utility meter. Much of this software is internally generated by the government itself.

Capital Assets

Government-wide Statement

3.6 Intangible Assets

- GASB Standard

- GASB mandates that intangible assets be accorded accounting recognition (capitalized) if:
 - They are separable, that is, they are capable of being separated or divided from the government and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract, asset, or liability.
 - They arise from contractual or other legal rights.

Capital Assets

Government-wide Statement

3.6 Intangible Assets

- GASB Standard

Expense

Cost incurred before the advance stage are classified as expense.



Capitalized

Outlays (payments) for internally generated intangible assets only when the resultant project reaches a fairly advanced stage of completion (technologically feasible)



Expense

Cost incurred after the advance stage are classified as expense.

Ex. Training and maintenance costs.



Capital Assets

Government-wide Statement

3.7 Impairment

Capital Assets

Government-wide Statement

3.7 Impairment

- A capital asset is considered impaired when both:
 1. its service utility has declined significantly and
 2. the event or change in circumstances is outside the normal life cycle of the capital assets.
- Impairment can be a consequence of physical damage, technological obsolescence, changes in laws or regulations, changes in manner or duration of use, or construction stoppage.

Capital Assets

Government-wide Statement

3.7 Impairment

- GASB Standard

- Government should test a capital asset for impairment whenever a prominent change in circumstances indicates that its service utility has declined.
- If it determines that the reduction in service utility is both significant and unexpected, then a portion of the asset's historical cost representing the impairment should be written off.

Capital Assets

Government-wide Statement

3.7 Impairment

- GASB Standard

- The amount of the impairment may be measured by one of three methods:
 1. **Restoration cost approach:** The cost to restore the utility of the assets (converted to historical cost).
 2. **Service units approach:** Calculating the percentage decline in number of service units (years, unit of outputs). This method is appropriate for impairments caused by technological obsolescence, changes in environmental or legal factors, and changes in manner or duration or use.
 3. **Deflated depreciated replacement cost approach.**

See *examples* on pages 297 to 299.



Marketable Securities

Marketable Securities

4.1 GASB Standard

Marketable Securities

4.1 GASB Standard

- Both FASB and GASB require that all debt and equity securities held by not-for-profit and government as investments (with a few exceptions) be “market-to-market” that is, reported at **Fair Value**.
- See pages 300 and 301 for the reason for reporting investment at Fair Value for governments and not-for-profit.

Marketable Securities

4.1 GASB Standard

- The GASB's approach to investments has been extremely controversial and unpopular among many government officials. It widens the gap between financial reporting and budgeting.

Marketable Securities

4.2 Determining Fair Value

Marketable Securities

4.2 Determining Fair Value

- Statement No. 72 defined Fair Value as “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.”
- The amount at which a security can be traded in a marketplace (no dependent on the value to any particular entity).
- Statement No. 72 specified that Fair Value would be considered an exit price (the amount for which an asset could be sold as opposed to the amount that would have to be paid to acquire it).

Marketable Securities

4.2 Determining Fair Value

- Statement No. 72 establishes a hierarchy of the inputs used to establish fair values:
 - LEVEL 1: Quoted prices in an active market for identical assets or liabilities.
 - LEVEL 2: Quoted prices for similar assets or liabilities.
 - LEVEL 3: Best information available in the circumstances.



Marketable Securities

4.3 Recognizing Income on Fair Value Measurement

Marketable Securities

4.3 Recognizing Income on Fair Value Measurement

- GASB Standard:
 - Statement No. 31 requires governments to recognize gains and losses from changes in all marketable securities, including held-to-maturity debt securities that have a maturity greater than one year.

Marketable Securities

Example – Page 303

- Increase in fair value on investment of \$55,000.

Date	DESCRIPTION	DR.	CR.
	Investments	55,000	
	Revenue – Increase in Fair Value of Investment		55,000
	<i>To record the increase in the fair value of the investments.</i>		



Marketable Securities

4.4 Disclosure Requirements

Marketable Securities

4.4 Disclosure Requirements

- GASB Standard:
 - Statement No. 40 requires governments to organize this disclosures by investment type (U.S. Treasury, corporate bonds, or commercial paper) and should make separate disclosures for:
 - governmental activities,
 - business-type activities,
 - major funds and nonmajor funds in the aggregate, and
 - under certain circumstances, fiduciary funds.

Marketable Securities

4.4 Disclosure Requirements

- GASB Standard:
 - Describe their deposit and investment policies related to the various types of risks they assume. (ex. Concentration of investment).
 - Investment in foreign currencies, it should describe its policies.

Marketable Securities

4.4 Disclosure Requirements

- GASB Standard:
 - Additional disclosure as to specific types of risks:
 - Credit risk.
 - Concentration of credit risk
 - Interest rate risks
 - Foreign currency risks