For Financial Reporting Purposes

CAFR Group, State Auditor's Office—June 24, 2008

# Objective

To assist with the accounting for and reporting of the State's assets including new building construction and improvements in conformity with Generally Accepted Accounting Principles and in principal with Governmental Accounting Standards Board Statement 34.

### **Policy**

Governmental Accounting Standards Board (GASB) Statement 34 requires that all capital assets be reported in the government-wide balance sheet net of accumulated depreciation if applicable.

Each agency is responsible for reporting accurate, complete, and timely capital asset information to the State Auditor's Office (SAO) annually.

The CAFR Group of SAO is responsible for compiling the capital asset information from agencies for inclusion in the State's Comprehensive Annual Financial Report.

### **Capital Asset Definitions and Guidelines**

Capital assets are tangible and intangible assets acquired for use in operations that will benefit more than a single fiscal period. Typical examples are land, improvements to land, easements, water rights, buildings, building improvements, vehicles, machinery, equipment, works of art and historical treasures, infrastructure, and various intangible assets. (Land associated with infrastructure should be reported as land rather than as part of the cost of the related infrastructure asset).

A capitalized asset is a capital asset that has a value equal to or greater than the capitalization threshold established for that asset type. Capitalized assets are reported for financial reporting purposes.

### **Capital Asset Classification**

The State has invested in a wide variety of capital assets used in State operations. These assets are broadly classified as follows:

- Land/Land Improvements/Easements
- Buildings/Building Improvements
- Leasehold Improvements
- Equipment
- Other Tangible and Intangible Assets
- Infrastructure
- Assets Under Construction
- Capital Leases
- Works of Art/Historical Treasures

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### **Asset Class**

The asset class is used to organize capital assets in the broad classifications detailed above. An essential function of the asset class is to establish a link between the asset master record and the related posting to the accounting general ledger. Therefore, assets purchased, constructed or donated that meet or exceed the capitalization threshold or minimum reporting requirements must be uniformly classified, utilizing the existing Asset Class structure. Each asset class is further detailed into class codes. The class code breaks the asset class into groups of similar items. The class code also contains the recommended estimated useful life (expressed in years) for the group of assets.

### **Capital Asset Acquisition Cost**

Capital assets shall be recorded and reported at their historical costs. Historical cost includes the vendor's invoice (less the value of any trade-in), initial installation cost (excluding in-house labor), modifications, attachments, accessories or apparatus necessary to make the asset usable and render it into service. Historical costs also include ancillary charges such as freight and transportation charges, site preparation costs and professional fees.

The costs of capital assets for *governmental activities* do not include capitalized interest. Interest, however, is capitalized on assets that are constructed for an agency's enterprise fund or otherwise produced for an enterprise fund's own use (including assets constructed or produced for the enterprise by others for which deposits or progress payments have been made), and assets intended for sale or lease that are constructed or otherwise produced as discrete projects (for example, ships or real estate developments).

**PLEASE NOTE:** The book value of assets recorded at historical costs should never be increased to reflect appraised value, insurance value, replacement cost, etc.

When the sale is between state entities, the selling agency's historical cost of the asset and the accumulated depreciation will carry in WOLFS to the agency buying/receiving the asset. **A gain or loss is not recognized.** 

### **Capitalization Threshold**

Standard capitalization thresholds for capitalizing assets for each major class of assets are as follows:

<u>Threshold</u>
Capitalize All
\$ 500
Capitalize All
\$ 500
\$ 500
\$ 500
\$ 500
\$ 500
\$ 1,500,000
\$ 500
Not Applicable
Exemption

### **Capital Asset Donations:**

GASB Statement No. 33, Accounting and Financial Reporting for Non-Exchange Transactions, defines a donation as a voluntary non-exchange transaction entered into willingly by two or more parties. Both parties may be governments, such as the Federal Government, another state, a county or municipality, or one party may be a nongovernmental entity, including an individual.

PLEASE NOTE: A voluntary contribution of resources between State agencies is not a donation. The timing of recognition of the asset and related revenue is outlined as follows:

When an asset has been received and the eligibility requirements to receive the asset **have** been met, capital assets are debited and revenue is credited in the *fund financial statements of an enterprise fund and the government wide financial statements for a governmental fund.* 

When an asset has been received but the eligibility requirements to receive the asset **have not** been met, capital assets are debited and deferred revenue is credited in the *fund financial statements of an enterprise fund and the government wide financial statements for a governmental fund.* 

# Appraisal of Assets (Gifts and Donations)

Donated property must be recorded at its estimated fair market value on the date of acquisition, using a reasonable market study.

The method used to appraise the value computed for gifts and donations should be based on a reasonable assessment. This method must be fully documented and maintained on file to support the value.

# **Capital Asset Categories**

### Land

Land is defined as the surface or crust of the earth, which may be used to support structures or grow crops, grass, shrubs, and trees. Land is characterized as having an inexhaustible life. All expenditures made to acquire land and to ready it for its intended use should be considered as part of the land cost

Examples of expenditures to be capitalized as land:

- Purchase price or, if donated, fair market value at time of donation
- Commissions
- Professional fees (title searches, architect, legal, engineering, appraisal, surveying, environmental assessments, etc.)
- Permanent landscaping such as land clearing, excavation, fill, grading, drainage (includes movement of earth in preparation for water impoundment)
- Demolition of existing buildings and improvements (less salvage)
- Removal, relocation, or reconstruction of property of others on the land so that the land may be used differently (railroad, telephone and power lines)
- Interest on mortgages accrued at date of purchase
- Accrued and unpaid taxes at date of purchase
- Other costs incurred in acquiring the land

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- Water wells (includes initial cost for drilling, the pump and its casing)
- Right-of-way.

### **Land Improvements**

Land improvements are defined as attachments to the land that have limited lives and therefore are recorded separately and are depreciable.

Examples of expenditures to be capitalized as land improvements:

- Fencing and gates
- Landscaping of temporary nature
- Parking lots/driveways/parking barriers/roadway
- Outside sprinkler systems
- Recreation areas & athletic fields (including bleachers)
- Golf course
- Paths and trails
- Septic systems
- Swimming pools, tennis courts
- Fountains
- Plazas, pavilions
- Retaining walls
- Lighting systems
- Water impoundment structures or attachments (dam, liner, other water control structures)

# **Buildings and Building Improvements**

A building is defined as a structure that is permanently attached to the land, has a roof, is partially or completely enclosed by walls, and is not intended to be mobile.

Building improvements are defined as capital events that increase the value of a building, materially extend the useful life of a building, or both. A building improvement should be capitalized as a sub-asset of the building and recorded as an addition of value to the existing building if the expenditure for the improvement is at the capitalization threshold and the expenditure increases the life or value of the building by 25 percent of the original life period or cost.

Examples of expenditures to be capitalized as buildings

# **PURCHASED BUILDINGS**

- Original purchase price
- Expenses for remodeling, reconditioning or altering a purchased building to make it ready to use for the purpose for which it was acquired
- Environmental compliance (i.e., asbestos abatement)
- Professional fees (sales commission, legal, architect, inspection, appraisal, title search, etc.).
- Payment of unpaid or accrued taxes on the building at the date of purchase

- Cancellation or buyout of existing leases on the building
- Other costs required to place or render the asset into operation

### CONSTRUCTED BUILDINGS

- Completed project costs
- Interest accrued during construction for enterprise type activities
- Cost of excavation or grading or filling of land for a specific building
- Expenses incurred for the preparation of plans, specifications, blueprints, etc.
- Cost of building permits
- Professional fees (architect, engineer, management fees for design and supervision, legal)

Note: Architect fees are expensed if a decision is made to not proceed with the construction of the building.

- Costs of temporary buildings used during and for the construction
- Unanticipated costs such as rock blasting, piling, or relocation of the channel of an underground stream

Examples of Expenditures to be Capitalized as Building Improvements:

**Note:** For a replacement to be capitalized, it must be a part of a major repair or rehabilitation project that increases the value and/or useful life of the building (such as renovation of a student center) and meets the capitalization threshold. A replacement may also be capitalized if the new item or part is of significantly improved quality and higher value compared to the old item or part (such as replacement of an old shingle roof with a new fireproof tile roof). Replacement or restoration of an item to its original utility level is not capitalized. Determinations must be made on a case-by-case basis.

- Conversion of attics, basements, etc., to usable office, clinic, research or classroom space
- Structures *attached* to the building such as covered patios, sunrooms, garages, carports, enclosed stairwells, etc.
- Installation or upgrade of heating and cooling systems, including ceiling fans and attic vents
- Original installation/upgrade of wall or floor covering such as carpeting, tiles, paneling, or parquet.
- Structural changes such as reinforcement of floors or walls, installation or replacement of beams, rafters, joists, steel grids, or other interior framing
- Installation or upgrade of windows or door frames, upgrading of windows or doors, built-in closets and cabinets
- Interior renovation associated with casings, baseboards, light fixtures, ceiling trim, etc.
- Exterior renovation, such as installation or replacement of siding, roofing, masonry, etc.
- Installation or upgrade of plumbing and electrical wiring
- Installation or upgrade of phone or closed circuit television systems, networks, fiber optic cable, wiring required in the installation of equipment (that will remain in the building)
- Permanently attached fixtures or machinery that cannot be removed without impairing the use of the building
- Additions to buildings (expansions, extensions, or enlargements)

• Other costs associated with the above improvements

# **Building Maintenance Expense:**

Maintenance costs allow an asset to continue to be used during its originally established useful life. Maintenance costs are expensed in the period incurred.

The following are examples of expenditures **not** to be capitalized as building improvements. Instead, these items should be recorded as repair and maintenance expense:

- Adding, removing and/or moving of walls relating to renovation projects that are not considered major rehabilitation projects and do not increase the value of the building
- Improvement projects of minimal or no added life expectancy and/or value to the building
- Plumbing or electrical repairs
- Cleaning, pest extermination, or other periodic maintenance
- Interior decoration, such as draperies, blinds, curtain rods, wallpaper
- Exterior decoration, such as detachable awnings, uncovered porches, decorative fences, etc.
- Maintenance-type interior renovation, such as repainting, touch-up plastering, replacement of carpet, tile, or panel sections; sink and fixture refinishing, etc.
- Maintenance-type exterior renovation such as repainting, replacement of deteriorated siding, roof, or masonry sections
- Replacement of a part or component of a building with a new part of the same type and performance capabilities, such as replacement of an old boiler with a new one of the same type and performance capabilities
- Any other maintenance-related expenditure which does not increase the value of the building.

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# Repairs (Ordinary and Major):

Repairs maintain the asset in its original operating condition.

Ordinary repairs are expenditures made to maintain plant assets in operating condition. Preventive maintenance, normal periodic repairs, replacement of parts, structural components, and other activities such as repainting, equipment adjustments, that are needed to maintain the asset so that it continues to provide normal services should not be capitalized but rather charged to an expense account. Ordinary repairs should be expensed.

Examples of ordinary repairs include:

- roof and/or flashing repairs
- window repairs and glass replacement
- tuck-pointing
- painting
- · masonry repairs
- floor repairs

Major repairs are relatively large expenditures that benefit more than one operating cycle or period. If a major repair, e.g., an overhaul, occurs that benefits several periods and/or extends the useful life of the asset, then the cost of the repair should be handled as an addition, improvement, or replacement, depending upon the type of repair made.

Examples of major repairs include:

- roof replacement
- window replacement
- repairs to bring up to code (including ADA)

In some instances, implementation of this policy may be difficult due to the unique nature of the acquisition. In these cases, professional judgment should be exercised in determining whether the efforts outweigh the benefits derived from applying capitalization criteria.

**Improvements and Replacements:** The distinguishing feature between an improvement and a replacement is that an improvement is the substitution of a better asset -- having superior performance capabilities -- (e.g., a concrete floor for a wooden floor) for the one currently used, whereas a replacement is the substitution of a similar asset (a wooden floor for a wooden floor).

In both of these instances, agencies should determine whether the expenditure increases the future service potential of the asset, or merely maintains the existing level of service. When the future service level has been increased, the new cost is capitalized.

**Additions and Improvements:** For additions and improvements reported in the governmental or proprietary funds, the carrying amount of the old assets and associated accumulated depreciation, if applicable, should be removed from the accounting records, if the amount is known. The cost of the new asset should be capitalized. If the original cost and accumulated depreciation are not known, capitalize the additional cost.

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Additions (Extensions, Enlargements or Expansions): Any addition to an asset should be capitalized since a new asset has been created. For example, the addition of a wing to a hospital or the addition of an air conditioning system to an office building increases the service potential of that facility and should be capitalized. Other examples of additions include:

- elevator or dumbwaiter
- fire alarm systems
- security windows
- sprinkler systems (internal)
- acoustical treatment

**Impairment of Capital Assets:** A capital asset is considered to be impaired when its service utility has permanently declined significantly and unexpectedly. Events or changes in circumstances that may be indicative of impairment include evidence of physical damage, changes in legal or environmental factors, technological changes or evidence of obsolescence, changes in the manner or duration of use of a capital asset and construction stoppage.

Generally an asset would be considered impaired if both:

- the decline in service utility of the asset was large in magnitude and
- the event or change in circumstances was outside the normal life cycle of the asset.

In the event a reportable capital asset is impaired, there are two options for reporting the impairment:

- If the asset will no longer be used, the asset should be written down to the lower of carrying value or fair market value.
- If the asset will continue to be used, the asset should be written down by the estimated impairment loss, as defined in GASB Statement No. 42, "Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries."

### **Leasehold Improvements**

Leasehold improvements are defined as improvements made to leased property that will revert to the lessor at the expiration of the lease. Leasehold improvements include construction of new buildings or improvements made to existing structures by the lessee, who has the right to use these leasehold improvements over the term of the lease. Moveable equipment or office furniture that is not attached to the leased property is not considered a leasehold improvement.

### **Easements**

An easement is defined as an interest in land owned by another that entitles its holder to a specific limited use or enjoyment (right to use the land). Easements are characterized as having an inexhaustible life.

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### **Equipment**

Equipment is defined as fixed or movable tangible assets to be used for operations. Improvements or additions to existing equipment that constitute a capital outlay or increase the value or life of the asset by 25 percent of the original cost or life should be capitalized and recorded as sub-asset of the existing asset.

Examples of expenditures to be capitalized as equipment include:

- Original contract or invoice price
- Freight charges
- Import duties
- Handling and storage charges
- In-transit insurance charges
- Sales, use, and other taxes imposed on the acquisition
- Installation charges
- Charges for testing and preparation for use
- Costs of reconditioning used items when purchased
- Parts and labor associated with the construction of equipment

**Note:** If incidental items, such as extended warranties or maintenance agreements, are included with the capital asset upon receipt and are not listed as a line item on the purchase order or on the invoice, then the incidental charges are considered a part of the capital asset.

**Infrastructure** - Long lived capital assets that normally are stationary in nature and normally can be preserved for a significantly greater number of years than most capital assets. Those assets with a cost greater than \$1,500,000 must be reported to the CAFR Group.

Examples of expenditures to be capitalized as equipment include:

- Highway and rest areas
- Roads, streets, curbs, gutters, sidewalks, fire hydrants
- Bridges, railroads, trestles
- Canals, waterways, wharf, docks, sea walls, bulkheads, boardwalks
- Dam, drainage facility
- Radio or television transmitting tower
- Electric, water, and gas (main lines and distribution lines, tunnels, etc.)
- Fiber optic and telephone distribution systems (between buildings)
- Light system (traffic, outdoor, street, etc.)
- Signage
- Airport runway, strip, taxiway or apron

# Modified Approach vs. Depreciation

The Modified Approach is an alternative to reporting depreciation for infrastructure assets that meet the following criteria:

- Assets are managed using a qualifying asset management system, and
- Documentation shows that the assets are being preserved at or above a condition level established by the government.

Depreciation is not reported for infrastructure assets reported using the modified approach. Only infrastructure assets that comprise a network or subsystem of a network can be reported using the modified approach. The state highway system (excluding bridges), administered by WYDOT, is the only network reported by the state using the modified approach.

### **Capital Leases:**

Capital leases transfer virtually all rewards and risks that accompany ownership of property to the lessee. A capital lease is a means of financing property acquisitions and has the same economic impact as a purchase made on an installment plan. Thus, the lessee in a capital lease must record the leased property as an asset and the lease obligation as a liability.

A lease agreement entered into by a State agency is a capital lease and should be capitalized only if the lease agreement meets **one** of the following criteria:

- The lease transfers ownership of the property to the lessee by the end of the lease term.
- The lease contains a bargain purchase option.
- The lease term is equal to 75 percent or more of the estimated economic life of the leased property.
- The present value of the minimum lease payments at the inception of the lease, excluding administrative costs, equals at least 90 percent of the fair value of the leased property.

Leases that do not meet any of the proceeding criteria should be recorded as an operating lease and reported in the notes of the financial statements.

### **Asset under Construction:**

Asset under construction reflects the economic construction activity status of buildings and other structures, infrastructure (highways, energy distribution systems, pipelines, etc.), additions, alterations, reconstruction, installation, and maintenance and repairs which are substantially incomplete.

Because an asset under construction is not complete or being used, depreciation shall not be recorded. The asset under construction should be capitalized to its appropriate capital asset category upon the earlier occurrence of substantial completion, occupancy, or when the asset is placed into service

**Intangible Assets:** Governments possess many different types of assets that may be considered intangible assets, including easements, water rights, timber rights, patents, trademarks, and computer software. Intangible assets, and more specifically easements, are referred to in the description of capital assets in

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Statement No. 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments

### **Other Capital Assets**

### **Works of Art and Historical Treasures:**

Works of Art and Historical Treasures are collections or significant individual items that are owned by a state agency and are not held for financial gain but rather for public exhibition, education or research as part of a public service. Collections or individual items that are protected and cared for or preserved are subject to an organizational policy that requires the proceeds from their sales to be used to acquire similar items.

Exhaustible collections or items are items whose useful lives are diminished by display or educational or research applications.

Inexhaustible collection or items are items whose economic benefit or service potential is used up so slowly that the estimated useful lives are extraordinarily long. Because of their cultural, aesthetic or historical value, holders protect and preserve these assets more than they do for similar assets without such value.

All works of art and historical treasures acquired or donated are capitalized unless held for financial gain.

If a collection is held for financial gain and is not capitalized, disclosures must be made in the notes that describe the collection and the reasons these assets are not capitalized. Agencies should recognize program expense equal to the amount of revenues when donated collection items are added to noncapitalized collections.

GASB 34 Option for Works of Art and Historical Treasures

GASB 34 provides states an option to not capitalize works of art and historical treasures. To use this option a state's works of art and historical treasures must meet all of the following:

*Optional* capitalization of collections (and later additions to those collections) that meet <u>all</u> of the following conditions:

- a. Held for public exhibition, education, or research in furtherance of public service, rather than financial gain
- b. Protected, kept unencumbered, cared for, and preserved
- c. Subject to an organizational policy that requires the proceeds from sales of collection items to be used to acquire other items for collections.

The State of Wyoming has opted to not capitalize works of art, historical treasures and artifacts contained in the collection of the Wyoming State Museum. The collection is held for public exhibition, education, or research in furtherance of public service. The collection is protected, kept unencumbered, cared for, and preserved. The collection is subject to an organizational policy that requires the proceeds from sales of collection items to be used to maintain the existing collection.

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### Miscellaneous Asset Issues

Software Licenses and Maintenance Agreements related to software licenses:

Maintenance agreements associated with technology hardware or software cannot be depreciated. Rather, such agreements are expensed over the period of benefit, and if paid upfront they are recorded as prepaid assets and amortized over the period of benefit, generally one or two years, as called for in the agreement. These software licenses and maintenance agreements are deemed to be a type of "operating lease." The agreements generally do not confer any ownership rights nor does the State acquire any asset at the end of the agreement period. The State is simply obtaining a "right" to use the software and possibly receive any upgrades made to the software over time.

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