

# **FIXED ASSET MANUAL FOR CITY OF OAK HARBOR**

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# Chapter 1

## ***INTRODUCTION***

The purpose of this manual is

- 1) Provide control and accountability over capital assets, and
- 2) Gather and maintain information needed for the preparation of financial statements.

These policies and procedures are the minimum requirements for capital assets that departments must meet. A department may maintain its capital asset inventory system in greater detail, or use additional supporting documentation, as long as they meet the required minimum standards.

The fixed asset accounting system is a system of policies, procedures and methods for recording and reporting monetary amounts associated with fixed asset transactions.

The fixed asset management system is a system of methods, policies and procedures which address the acquisition, use, control, protection, maintenance and disposal of assets.

Throughout this manual, the two subsystems will be discussed together as forming the City's fixed asset system.

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# Chapter 2

## ***FIXED ASSET DEFINITION***

A fixed asset is defined as a financial resource meeting all of the following criteria:

1. It is tangible in nature.
2. It has an extended useful life, which the City may identify as one year, two years or longer.
3. It is acquired for use in operations and held primarily for use, not for sale, and not a repair part or supply item.
4. It has a value greater than the capitalization threshold established by the City or is considered to be an asset for which control (accountability) is desirable.

The capitalization threshold dollar amount varies from city to city. Typically, a city with a budget of less than 1 million might choose a threshold amount in the range of \$100 to \$300; a city with a budget of more than 1 million might select a threshold amount of \$500 or more. The City of Oak Harbor's has set a threshold of **\$5,000** for their fixed assets.

A city may wish to identify specific assets solely for control purposes. These "controlled" or "critical nature" assets would include assets that are sensitive, portable or prone to theft. Examples might be calculators, tape players, telephones and audio-visual equipment.

During the initial fixed asset inventory, controlled assets must be identified and recorded, but, since they will not be reported as fixed assets on the financial statements, original or estimated historical cost figures need not be identified or calculated.

Items meeting the fixed asset criteria are classified by major categories such as land, buildings, improvements other than buildings, furniture and fixtures, machinery and equipment, and construction-in-progress. Other categories may be identified and reported if considered significant.

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# Chapter 3

## ***FIXED ASSET PURPOSES***

One of the first and most important decisions that must be made before a fixed asset system can be established is the identification by management of the purposes that the fixed asset system's information will be expected to accomplish. These purposes may include financial statement information, insurable values, control and accountability, maintenance scheduling and cost analysis, accounting for depreciation, preparation of capital and operating budgets, and debt management.

### **3.1 Financial Statement Information**

The Governmental Accounting Standards Board (GASB) requires fixed asset reporting in order for the City to be in conformity with generally accepted accounting principles. A primary objective in the development of any fixed asset system for governmental entities planning to prepare their financial statements according to generally accepted accounting principles is the ability to meet the various requirements for correct and complete presentation of fixed asset financial information.

Governmental entities offering securities must meet fixed asset disclosure requirements.

### **3.2 Insurable Values**

Complete fixed asset identification and valuation may prevent the City of Oak Harbor being over or under insured. In the event of a loss, property valuations, descriptions, and locations are necessary to insure full recovery under the policy. Insured losses are normally settled on the basis of reproduction cost new, less depreciation, less exclusions. Specific supportable insurable values are defined in the insurance policy in effect and are reviewed annually. In some instances, an in-house estimate of cost or insurable value may not be sufficient to substantiate the amount of a loss. Rather, an appraisal by an independent third party may be required.

### **3.3 Control and Accountability**

The fixed asset system can be used to maintain information regarding the location, responsible party and condition of public property. The system permits loss, theft, or damage to property to be identified by a comparison of the assets on hand and their present condition to the information found in the fixed asset records.

### **3.4 Maintenance Scheduling and Cost Analysis**

By maintaining records of maintenance costs and frequency of necessary repairs, decision relating to major overhauls or replacement can be made. By budgeting time and money for maintaining assets, the governmental entity may move from emergency maintenance to preventive maintenance.

### **3.5 Accounting for Depreciation**

Depreciation of fixed assets must be recorded to determine total expenses, net income and changes in fund equity of proprietary and nonexpendable trust funds. The amount of accumulated depreciation plus the amount of depreciation expense for the current period must be maintained for reporting purposes.

### **3.6 Preparation of Capital and Operating Budgets**

Fixed asset information regarding asset condition, scheduled maintenance, useful life and repair costs permits management to prepare long-term capital budgets, make informed repair or replace decisions, and generate reasonable estimates of repair and maintenance costs for the current operating budget.

### **3.7 Debt Management**

Being able to prepare a long-term capital budget allows management to identify both long and short term financing needs and to prepare to meet those needs.

The purpose(s) selected by the governmental entity's management determines the information that must be maintained within the fixed asset system, and should be determined before a system is implemented. This is because the data to be developed will differ depending on the uses or purposes selected; if the uses or purposes were to be

identified after the data gathering process has been completed, the data may prove to be insufficient, thereby necessitating duplication of some of the work.

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# Chapter 4

## ***FIXED ASSET POLICIES AND PROCEDURES***

Based upon the identified purposes of the fixed asset system, management decisions on certain major issues must be documented if the fixed asset system is to be properly established and maintained. This documentation informs staff and other interested parties of management's expectations. Management's decisions on major fixed asset issues are referred to as fixed asset policies. The following are representative areas in which fixed asset policies and procedures could be established and, where applicable, questions that must or should be addressed in each:

**FIXED ASSET POLICY** - an overall statement indicating that the legislative authority and the management of the governmental entity want a fixed asset system established and maintained.

**CAPITALIZATION CRITERIA** - what criteria must be met before an asset will be accounted for as a fixed asset.

**FIXED ASSETS UNDER CONSTRUCTION** - what costs are to be included in the cost of constructing the fixed asset and when is the fixed asset to be recognized.

**ADDITIONS** - what constitutes an addition to a fixed asset (as opposed to routine maintenance and repairs) and when and how is it to be recorded in the financial records.

**TRANSFER OF ASSETS** - is the transfer of assets permitted and, if so, under what conditions, with whose approval, and which report forms are required.

**RETIREMENTS** - who is responsible for disposing of a fixed asset, under what conditions, and who must provide prior approval.

**CAPITAL LEASES** - under what conditions will the governmental entity report a leased asset as a fixed asset of the entity with a corresponding liability for the lease payments.

**ASSET NUMBER** - a policy stating that asset numbers will be assigned and recorded (where practical) to insure that specific assets can be identified. This policy may require tagging assets if an alternative, such as a serial number, is not available or cannot be used by the system.

**DEPARTMENT** - each asset will be assigned to a specific organizational unit which will be responsible for the asset's location, condition and safekeeping.

**BASIS OF ASSETS** - how will the cost of a fixed asset be determined i.e., what costs associated with the acquisition of the asset will be included in the recorded cost.

**REPLACEMENT COST** - whether the cost of replacing a fixed asset should be maintained by the system, how it should be determined, how often it should be revised, and by whom.

**SALVAGE VALUE** - when salvage value is to be maintained, how it is to be determined and by whom.

**ACCUMULATED DEPRECIATION** - when is accumulated depreciation to be calculated, how it is to be computed and reported.

**MAINTENANCE AGREEMENT COST** - is the existence of a maintenance agreement to be included in the fixed asset information.

**INSURABLE COST** - is the fixed asset value for insurance purposes to be maintained and who is responsible for maintaining the information.

**ASSET TYPE** - how are the major classes of fixed assets to be categorized (land, building, improvements other than buildings, etc.)

**DESCRIPTION** - an indication that each of these attributes will be maintained for each asset entered into the system.

**VENDOR HISTORY** - is the identity of the vendor to be maintained by the system.

**ACCOUNT NUMBER** - what information is to be maintained that identifies the source of the money used to acquire the asset.

**INFRASTRUCTURE FIXED ASSETS** - are infrastructure fixed assets to be identified and costed within the system or are they to be omitted.

**JOINTLY OWNED PROPERTY** - how is jointly owned property to be identified, and at what cost will it be recorded in the fixed asset records.

**FORECLOSED FIXED ASSETS** - how fixed assets that come into the governmental entity's possession are to be accounted for if the entity decides to keep the fixed asset or if the fixed asset is to be sold. This list may vary depending on the purposes(s) that the fixed asset system is intended to accomplish.

Once policies have been established, procedures must be defined to insure that each policy is implemented. For example, if policies regarding fixed asset disposal state that

the asset is not to be sold without the approval of both the responsible department manager and the mayor/city manager and, further, that the treasurer must be notified of the disposition, then a form should be designed and circulated to accomplish the recording of the approvals and the notification of the treasurer. In this example, the procedures would direct the reader to the fact that the form was to be completed, the approvals of the department head and the mayor/city manager obtained, and then a copy sent to the treasurer. Other procedures could inform the reader how to proceed when disposing of an asset. For example, if there is to be a public auction to dispose of the fixed asset(s), the procedure could state who is to be responsible for placing the public notice of the auction in the newspaper, how many times it is to be run, and how far in advance of the auction it is to be run.

Once the fixed asset policies and procedures have been established and documented, the remainder of the fixed asset system can be developed and implemented.

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# Chapter 5

## ***ACCOUNTING FOR FIXED ASSETS***

The appropriate accounting treatment for the acquisition of a fixed asset is governed by the fund type from which the fixed asset was purchased and the ultimate use of the asset.

### **5.1 Fund Categories**

There are three categories of funds employed in governmental accounting which are Governmental, Proprietary and Fiduciary funds.

#### **1. Governmental Funds**

Often called "source and disposition" funds, governmental funds are those funds through which most governmental functions typically are financed. A government's expendable financial resources and related liabilities, except those accounted for in proprietary funds, are accounted for through governmental funds. The four governmental fund types are: general, special revenue, capital projects and debt service.

#### **2. Proprietary Funds**

Sometimes called "commercial-type" funds, proprietary funds are used to account for a government's ongoing organizations and activities that are similar to those found in the private sector. All assets, liabilities, equities, revenues, expenses and transfers relating to the government's business activities are accounted for through proprietary funds.

Proprietary fund are of two types: enterprise and internal service funds.

- a. Enterprise Funds account for operations that are financed and operated in a manner similar to private business enterprises, i.e., where the intent is that the costs of providing goods or services to the general public on a continuing basis be financed through user charges.
- b. Internal Service Funds account for the financing of goods or services provided by one department or agency to other departments or agencies of the governmental unit, or to other governmental units, on a cost reimbursement basis.

### **3. Fiduciary Funds**

Fiduciary Funds are of two types, trust funds and agency funds. They are used to account for assets held by governmental unit in a trustee capacity and/or as an agent for individuals, private organizations, other governmental units or other funds.

## **5.2 Fixed Asset Categories**

Fixed assets may be classified in three categories: general fixed assets, fund fixed assets and infrastructure, depending on whether the asset is associated with a governmental or proprietary fund type operation.

### **1. General Fixed Assets**

Fixed assets associated with governmental functions are known as general fixed assets. General fixed assets are not included in the balance sheet of governmental funds, but rather are reported as historical cost in a separate, self-balancing account group called the General Fixed Assets Account Group. The cost of general fixed assets is summarized in the General Fixed Assets Account Group by categories such as Land, Buildings, Machinery and Equipment, and Construction in Progress. The source of the money used to acquire general fixed assets is recorded in an account known as "Investment in General Fixed Assets". Sources may include individual funds, federal or state grants, taxes, debt proceeds, etc. Source disclosure for general fixed assets is only required if a comprehensive annual financial report is prepared. If the governmental entity is unable to identify sources from prior years, source disclosure may begin with the year for which the statements are prepared.

### **2. Fund Fixed Assets**

Fixed assets utilized in proprietary (Enterprise and Internal Service) fund activities or in trust funds are accounted for in the appropriate fund, and are referred to as fund fixed assets.

Enterprise fund fixed assets are capitalized (recorded) in the fund because the fixed assets are used in the production of the goods or services provided and sold. In order to determine profit or loss, the expense of using these assets (depreciation) must be included as an operating cost.

Internal Service fund fixed assets are recorded in the fund accounts for similar reasons. These assets are also directly related to fund operations, as in the case with enterprise fund fixed assets. Depreciation must be recorded to determine fund expenses, charges to departments, and changes in fund equity.

The identification of the source of fixed assets associated with an enterprise or internal service fund is required in order for the entity to be able to properly prepare financial statements in accordance with generally accepted accounting principals. Sources may include federal grants, special assessments, property taxed, contributions from other funds or developers, and purchase or construction by the enterprise or internal service fund itself.

Fixed assets associated with trust funds are also accounted for in those funds. This requirement assists in assuring compliance with the terms of the trust instrument, provides a deterrent to mismanagement of trust assets, and facilitates accounting for depreciation where the trust principal must be maintained intact.

### **3. Infrastructure**

According to the "Codification of Governmental Accounting and Financial Reporting Standards" section 1400.109, "Reporting public domain or 'infrastructure' fixed assets - roads, bridges, curbs and gutters, streets and sidewalks, drainage systems, lighting systems, and similar assets that are immovable and of value only to the governmental unit - is optional." Therefore, an early determination of the treatment of infrastructure fixed assets needs to be made by the management of the governmental entity.

Those fixed assets belonging to an enterprise, internal service or trust fund must be recorded and reported within the fund, and this is not optional. As an example, if the governmental entity had a sewer enterprise fund, then the underground sewer lines are to be considered fund fixed assets and must be identified and reported. If an entity does not have a sewer fund, then the reporting would be optional.

Once the determination whether or not to report infrastructure has been made, the specific asset classes to be recorded and reported can be determined.

### **4. Leased Assets**

A review of each lease is necessary to determine whether the lease should be classified as an operating lease or a capital lease. There are four criteria used to make this classification, the underlying issue being whether the benefits and risks of ownership are transferred from the lessor to the lessee.

The purpose of the criteria is to establish the substance of the transaction and determine whether the lease is merely an extended rental agreement or actually an installment purchase in the form of a capital lease.

If a lease is classified as a capital lease, the asset and a corresponding liability for the lease payments will be reported on the financial statements of the lessee. A further discussion of leases is beyond the scope of this manual.

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# Chapter 6

## **VALUING FIXED ASSETS**

As per the "Codification of Governmental Accounting and Financial Reporting Standards" section 1400.111, fixed assets will be reported at cost or, if the cost is not practicably determinable, at estimated cost. Donated fixed asset shall be recorded at their estimated fair value at the time received.

Cost is defined as the cash price, or its equivalent, plus all other costs necessary to place the asset in its intended location and condition for use.

### **6.1 Sources of Cost Data**

Sources of acquisition cost include: vendor invoices, vouchers, canceled checks, check copies, check registers, expenditure journals, construction contracts, purchase contracts, contract payment records, real estate closing documents, purchase requisitions, purchase orders, general ledger accounts, inventory cards, legislative minutes, maintenance records, annual and capital budgets, appropriation documents, insurance values, price lists, certificates of title, and, for land and buildings, the county auditor.

Expenditure vouchers, real estate closing documents, construction contracts and canceled checks are the most reliable cost sources.

Legislative minutes and appropriation and budget documents are good sources of data, particularly for land, buildings, and other costly assets. Adjustments must be made for amounts budgeted but not spent. This data should be supported by other documents, such as vouchers.

### **6.2 Existing Cost**

There are many acceptable direct and indirect costing methods for property. Initial costs of fixed assets are usually ascertainable from contracts, canceled checks and other transaction documents at the time of acquisition or construction, called direct costing.

However, governmental units are sometimes faced with the task of establishing fixed asset records after many years of operation without such records, therefore being necessary to estimate the cost of such assets.

When it is necessary to estimate cost data, indirect costing methods must be used. Two indirect costing methods are the standard costing method and the normal costing method. The standard costing method uses an average of original costs of similar assets that were acquired and installed at the time the asset in question was acquired. Such information may come from catalogues, price lists, consultants, or trade publications. The normal costing method first determines the cost to reproduce the asset at current prices then using published indices, indexes the reproduction cost back to the acquisition date.

The extent to which fixed asset costs have been estimated, and the methods of estimation, should be identified and maintained as part of the fixed asset records, and will be disclosed in the notes to financial statements prepared using generally accepted accounting principles. Estimates must have some reasonable authoritative basis. Merely guessing may result in a qualified auditor's opinion.

### **6.3 Cost of Land**

Items that are included as part of acquisition cost for land are: purchase price, legal and title fees, appraisal fees, site preparation, including demolition of existing buildings.

Sometimes the purchaser of land assumes certain obligations related to the land, such as liens on the property. In such situations, the cost of the land is the cash paid for it, plus the liens or other liabilities. In addition, if an improvement is permanent in nature, such as landscaping, then the item is properly chargeable to the land account. Improvements with limited lives, such as driveways, walks, fences, and parking lots, are best recorded separately as land improvements so they can be depreciated (expensed) over their estimated lives, if appropriate.

### **6.4 Cost of Buildings**

The cost of buildings should include all expenditures related directly to their acquisition or construction. These costs include (1) purchase price, (2) direct materials, direct labor and overhead (indirect) costs incurred during construction, (3) fees, such as attorneys, architects and building permits, and (4) interest charges incurred during construction. Financial Accounting Standards Board (FASB) Statement No. 34, "Capitalization of Interest Cost", requires the capitalization of material interest charges incurred when constructing a fixed asset or preparing it for its intended use.



## **6.5 Cost of Machinery and Equipment**

The cost of machinery and equipment includes the purchase price, freight and handling charges, insurance on the equipment while in transit, cost of special foundations if required, assembling and installation costs, and costs of conduction trial runs. Costs thus include all expenditures incurred in acquiring the machinery or equipment and preparing it for use, plus the market value of any trade-ins or exchanges. (See section entitled Special Cost Considerations).

## **6.6 Individual Item VS. Group Costing**

Fixed asset items may be capitalized in the following ways:

### **1. Capitalized - Individual Control:**

Those items which can be identified by manufacturer, model and serial number, and, as such, are identifiable from other like items should be listed individually. Generally, examples of this classification include business machines, major machinery and equipment, audio visual equipment, communication equipment, etc.

### **2. Capitalized - Group Control:**

Those items which (a) are homogeneous and not individually identifiable; (b) may or may not have a unit cost meeting the threshold level for capitalized assets but the practice is to purchase in groups and capitalize the total group cost; and, (c) will be maintained together or in the same general area, should be listed by homogeneous grouping.

## **6.7 Special Cost Considerations**

Special cost considerations arise when dealing with group purchases, trade-ins, gifts, cash discounts and purchases on deferred payment plans:

### **1. Group Purchases**

If several dissimilar assets are purchased for a lump sum, the total amount paid should be allocated to each individual asset on the basis of its fair market value (FMV). This is accomplished by use of the equation:

ASSET Y = (TOTAL COST OF ASSETS) \* (TOTAL FMV/FMV OF Y)

## **2. Trade-Ins**

The cost of the asset acquired when payment includes both cash and a trade-in is the sum of the cash paid plus the fair market value of the asset traded-in. If the fair market value of the asset being traded-in is not readily determinable, cost may be recorded as the cash paid plus the book value (cost minus accumulated depreciation) of the asset traded-in.

## **3. Gifts**

Assets acquired by gift should be recorded on the basis of their estimated fair market value at the time of acquisition.

## **4. Cash Discounts**

Assets should be recorded net of any quantity or trade discounts received. The asset is recorded at a cost equal to the amount of cash paid, not the gross amount of the invoice.

## **5. Purchase on Deferred Payment Plan**

Assets purchased on long-term credit contracts should be recorded at the present value of the payments to be made - the cash equivalent price of the asset. An asset, therefore, that requires five annual payments of \$1,000 should not be recorded originally at \$5,000. The cash equivalent price (present value) would be an amount less than \$5,000 because of the time value of the money involved. This value of money over time is represented by the interest rate.

## **6. Sources of Fund Fixed Assets**

If an entity wishes to prepare financial statements in accordance with generally accepted accounting principles, it is essential to identify the source of proprietary fund fixed assets. Sources may include taxes, contributions from other funds, debt proceeds, donations from developers, federal or state grants, and revenue generated by the operation of the proprietary fund itself.

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# Chapter 7

## ***COSTS SUBSEQUENT TO ACQUISITION***

After fixed assets are acquired and made ready for use, additional costs are incurred that range from ordinary repair costs to significant additions. Accountants for the most part have adopted the position that costs incurred to achieve greater future benefits should be capitalized, whereas expenditures that simply maintain a given level of services should be expensed. In addition, most expenditures below the capitalization threshold are not capitalized.

The distinction between a capital expenditure and an expense is not always quickly determinable. Generally, the major types of expenditures incurred relative to existing assets are:

- A. Additions - Increase or extension of existing assets.
- B. Improvements and Replacements - Substitution of an improved asset for an existing one.
- C. Repairs - Expenditures that maintain assets in condition for operation.

### **7.1 Additions**

Any additions to assets are capitalized because a new asset has been created that increases the ability to provide service.

Accounting for changes related to the existing structure must also be considered. The cost that is incurred to tear down a wall of the old structure to make room for the addition would normally be expensed and the cost of the wall subtracted from the cost of the original structure. Although theoretically correct, this may not be possible or necessary due to the inability to establish a cost for the wall being torn down or because the cost would be immaterial to the total cost of the old structure. However, when significant changes to the existing structure are made as the result of an addition, a determination should be made whether to capitalize the cost of the changes. If a significant portion of the old structure is torn down, the cost of the demolished portion should be removed from the fixed asset records.

## **7.2 Improvements and Replacements**

An improvement is the substitution of a better asset for the one currently used, while a replacement is the substitution of a similar asset for the one being used.

Sometimes it is difficult to differentiate improvements and replacements from normal repairs. If the expenditure increased the future service potential of the asset, it should be capitalized. If the expenditure maintains the existing level of service, it should be expensed/expended as a normal repair.

To capitalize an expenditure as an improvement or replacement, record the new asset being acquired and remove the old asset from the fixed asset records.

## **7.3 Repairs**

Ordinary repairs are expenditures made to maintain assets in operating condition; they are charged in the period in which they are incurred on the basis that it is the only period benefited. Replacement of minor parts, lubricating and adjusting of equipment, repainting, and cleaning are examples of the type of maintenance charges that occur regularly and are treated as ordinary operating expenses. It is often difficult to distinguish a repair from an improvement or replacement. The major consideration is whether the expenditure increases the future service potential. If a major repair, such as an overhaul, occurs, several periods will benefit and the cost should be handles as an addition, improvement, or replacement, depending on the type of repair made.

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# Chapter 8

## **DEPRECIATION**

The usefulness of most assets, other than land, declines over time and some type of write-down or write-off of cost is needed to indicate that the usefulness of an asset has declined. Depreciation is the term most often used to indicate that tangible assets have declined in service potential. Where natural resources, such as oil, natural gas, timber and coal are involved, the term depletion is used.

### **8.1 Depreciation of Fund Fixed Assets**

An entity purchased a truck to be used in the sewer operation which is accounted for as an enterprise fund. The cost of the truck was \$10,000, its estimated useful life is four years and its salvage value is estimated at \$1,000. The truck was purchased on January 1, 2000. On December 31, 2000, the depreciation expense is calculated in the following manner:

#### **Example 8-1 Depreciation Expense**

$$\begin{aligned} \text{Depreciation Expense} &= (\text{Cost} - \text{Salvage value}) / \text{Estimated useful life} \\ &= (10,000 - 1,000) / 4 \\ &= \$2,250 \end{aligned}$$

The book value of an asset is the original cost minus accumulated depreciation. At December 31, 2000, the truck's book value is \$7,750.

This method of calculating depreciation is called straight line. Depreciation expense is the same for each year of the estimated useful life. Accelerated methods of depreciation such as sum of the year's digits or declining balance may also be used when appropriate.

## **8.2 Depreciation of General Fixed Assets**

When general fixed assets are depreciated, no depreciation expense is reported. Rather, a reduction in the "Investment in General Fixed Assets" account is recorded. Reporting depreciation for general fixed assets is not required but is permitted.

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# Chapter 9

## ***DISPOSITION OF FIXED ASSETS***

According to the Revised Code of Washington 3313.41 when a government decides to dispose of property that it owns, and exceeds a value of two thousand dollars, it shall sell the property at public auction, after giving at least thirty days notice of the auction. The auction must be publicized in a newspaper of general circulation or by posting notices in five of the most public places in the city. After the entity has twice offered the property for sale at public auction and the property has not been sold, the City may sell it at a private sale.

If a government decides to dispose of property that it owns, it may sell the property to any municipal corporation, county or township, to a wholly or partially tax-supported university, university branch, or college, to any board of education, or to the board of trustees of a school district library, upon sale terms as are agreed upon.

When a government decides to trade as a part or a entire consideration, an item of property on the purchase price of an item of similar property, it may trade the same upon such terms as are agreed upon by the parties to the trade.

The Mayor and/or City Supervisor and the Finance Director shall execute and deliver the necessary instruments of conveyance to complete any sale or trade.

Regardless of the time of disposal, depreciation expense for fund fixed assets should be taken up to the date of disposition and all amounts related to the retired asset should be removed from the accounts. Ideally, the book value of the specific asset would be equal to its disposal value. This is generally not the case, however, and a resulting gain or loss occurs.

Gains or losses on the retirement of assets should be shown in the income statements along with other non-operating revenues/expenses that arise from ordinary business activities.

Retirement of fixed assets by sale, trade or scrapping will require approval by the City Council to guard against illegal unauthorized disposition.

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# Chapter 10

## ***INVENTORYING FIXED ASSETS***

Any physical inventory is time consuming and can be costly. An initial inventory is the most time consuming and costly because of the large number of assets to be recorded, coded, tagged and valued. Several ways are available to reduce the time and cost of inventorying. First, the inventory can be conducted in phases - by department, location, or asset type. Inventorying in phases requires specific cutoff times and accurate documentation of the location of assets at the cutoff. Such documentation may be difficult if there are frequent departmental transfers of assets. Second, the inventory can be done by entity personnel during normally slack (or at least less busy) periods. Third, the inventory can be done using temporary help, provided sufficient direction and supervision is provided. A valuable source of such assistance for many entities has been college accounting students during the summer months.

Fixed asset control can be maintained by making four comparisons of fixed assets on hand and fixed asset records. They are:

1. Compare a sample of fixed asset purchases to the fixed asset list to make sure they were properly recorded;
2. Compare a sample of fixed assets sold to the fixed asset list to insure that the asset records now indicate that the asset was sold;
3. Compare a sample of assets selected by observation from throughout the entity to the fixed asset list to make sure first that the assets are on the list and second that other attributes such as department, location, etc. have been properly recorded;
4. Select a sample of assets from the fixed asset list, go to the location indicated in the record, and make sure that the asset is really there.

Making the comparisons by themselves is not sufficient. Any time a comparison indicates that a problem exists or is beginning to develop, additional steps should be taken. This may mean implementing better controls to insure all purchases and sales are recorded, tracking assets that are not at the listed location, retraining inventory takers so that all assets are listed, etc. The follow-up that is necessary will depend on the problem(s) identified by making the comparisons.

"Critical nature" fixed assets that cost less than the capitalization threshold are called controlled assets and are inventoried despite their low cost. Although they are part of the fixed asset record, controlled assets are not reported as fixed assets on the entity's financial statements. Controlled assets should be either generally defined or specifically

identified when fixed policies are initially established. Controlled assets may differ from one department to another.

Inventorying is necessary for accountability and control. Inventorying establishes a direct relationship between actual and recorded fixed assets. An inventory insures that fixed asset transactions have been and are being recorded properly; and, the inventory provides the data base for fixed asset accounting and management systems.

## **10.1 Analysis and Review**

Information development begins with an analysis or survey of potential fixed asset information necessary to derive the final product(s), use(s), or output(s), such as financial statements, cost accounting, or risk management.

It is also necessary to review accounting, statutory, management, and auditing requirements to determine what fixed asset information must be maintained by the fixed asset subsystem.

Special audit problems sometimes arise when historical cost records are incomplete for older fixed assets. In such instances, best available estimates of historical costs should be used. The notes to the financial statements may present fixed assets in two parts: 1) fixed assets acquired prior to the date when appropriate fixed asset accounting was implemented, and 2) those acquired after that date. As time passes, those older assets will become a smaller and smaller portion of total reported fixed assets.

## **10.2 Output**

After the fixed asset subsystem users have been surveyed and the requirements analyzed, the output is designed. Output design is determined by the intended use of the output. Uses may include risk management, financial statement preparation, capital improvement budgeting, cost accounting, and fixed asset management and control.

## **10.3 Input**

The third step in information development is input design. Input design includes all activities that are necessary to capture data and enter it into the fixed asset subsystem. The main source of data should be the physical inventory.

(See Valuing Fixed Assets - Sources of Cost Data).

Although it is important to determine the original cost of assets, it is necessary to input and maintain other data in the fixed asset subsystem to enable preparation of asset retirement or disposal reports, transfer reports, damage forms, and to document asset loss or theft.

## **10.4 Processing**

The fourth step in information development is processing the data. The processing that occurs will depend upon the desired output.

Once output, input, processing and other requirements have been determined, cost estimates, work schedules, and timetables can be prepared.