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General Capital Assets, Capital Projects, General Long Term Liabilities and Debt Service

This paper covers the various topics included in general capital assets and capital projects as well as general long term liabilities and debt service. A general overview of the topic is presented followed by discussion of GASB 34 and it's application to capital assets. A discussion of GASB 42 and impairment follows. The discussion is closed with GASB 51 and intangible assets.

There is some accounting for capital assets used in operations in proprietary funds. Sometimes fiduciary funds use capital for the production of income. As a result these capital items are accounted for as property, plant and equipment in the fund. Funds account for current financial resources. Therefore funds do not account for capital assets they acquire. Instead, the capital assets are accounted for in the governmental activities general ledger at the government-wide level.

The GASB's requirement for capital assets is that they be required to be recorded at historical cost. Historical cost includes the cost of acquisition plus any costs to put the asset in place for use. As per GASB, capital assets are reported in the Governmental Activities column of the statement of net assets, net of accumulated depreciation. Any method of depreciation on the capital assets can be used as long as it is practical. As with other practices with assets, capital assets that are inexhaustible, such as land are not subject to depreciation. Infrastructure assets that use the modified approach are also not depreciated. As with other methods of accounting amortization is the terminology used to describe the depreciation process for intangible assets.

When it comes to good practice for accounting for capital assets, a record for each asset or group of assets should be kept. This record is kept based on a minimum threshold that the government keeps regarding the recording of inventory for capital assets. The purpose of keeping these inventory records is to maintain accountability, provide a basis for maintenance of the capital assets and provide information for the decision making process of replacement and additions of the capital assets. One example of useful information coming from the recording of capital assets is from the use of depreciation of the capital assets that have been recorded. Depreciation of the capital assets will help decision makers realize the full cost of providing a government function. Depreciation expense of capital assets may also help allocate costs to their necessary cost centers.

GASB requires certain disclosure requirements regarding capital assets. These disclosure requirements are in the notes to the financial statements. These standards apply to the governmental activities column of the financial statements and the business activities column of the government-wide financial statements. These requirements include the policies for depreciation of capital assets as well as their capitalization. For capital assets that are not being depreciated, they must be disclosed separately from the capital assets that are being depreciated.

A method that involves accounting for capital assets that goes beyond the general fund and special revenue funds is the a capital projects fund. The difference is that instead of accounting for capital projects on a year to year basis the capital projects fund accounts for the capital assets on a project-life basis. This is worth mentioning because the capital assets that are used in the capital projects fund are not accounted for within the fund unless they are liquidated by the resources in the capital projects fund. These capital assets that are not liquidated by the resources in the capital projects fund are accounted for on the governmental activities general ledger at the government –wide level.

A method used to finance the acquisition of capital assets for projects is the issuance of bonds. The governmental entity does not issue the bonds itself directly to the investors. The bonds are issued to an underwriter. At this point, the underwriter sells the bonds to the public at an agreed upon amount in advance. Another method used to finance projects is a bond anticipation note. A bond anticipation note is used to provide temporary financing before the issuance of a bond. After the bond is issued the proceeds from the bond will be used to retire the bond anticipation note. There is also an attraction to invest the proceeds of a bond in an investment. There are rules that govern this however. The Internal Revenue code restricts investing bond proceeds into investments. This restriction is that the investments yield must be more than the yield of the debt. Concerning interest on these types of investment, it is different depending on the jurisdiction. Some jurisdictions allow the interest to be used by the capital projects fund while others require it to be transferred to the debt service fund or general service fund.

Along with capital assets in governmental accounting there is accounting for general long term liabilities. Proceeds from long term debt can be placed in a capital projects fund. However, the long term debt should be accounted for in the governmental activities accounting records at the government wide level. If a fund is expected to service the debt of a liability, that liability should be placed on the face of the statement of the issuing fund. If that debt is backed by the full faith and credit of the government, this obligation should be disclosed in a note on the financial statements. Tax-supported debt such as bonds and other debt may reach a debt limit. If this happens the debt is recorded as a liability of the governmental activities at the government-wide level. Once this happens the fund that once housed the debt is relieved through an interfund transfer. This interfund transfer removes the unpaid debt from the original funds liability accounts.

Disclosure of long term liabilities is governed by GASB 34. According to Wilson, Reck, Kattelus, GASB 34 calls for the provision of details for the “beginning of period long term liabilities, additions to and reductions of those liabilities, ending liabilities, and the portion of the liabilities payable within one year” (2012, pp. 214). Debt schedules are also provided to provide information on debt principal and interest that will be due in future years. Long-term liabilities are also governed by debt limits and debt margins. According to Wilson, Reck, Kattelus, a debt limit is the total amount of indebtedness of specified kinds that is allowed by law to be outstanding at any one time (2012, pp 214). Also, according to Wilson, Reck, Kattelus, debt margin is the difference between the amount of debt limit calculated as prescribed by law and the net amount of outstanding indebtedness subject to limitation (2012, pp. 215).

In order to repay the long term debt that is incurred to finance capital or other purposes, there is the use of debt service funds. Revenues from taxes can be used for debt service funds. These restricted taxes are usually recorded in the debt service fund. This fun d is used only for general long term liabilities. Debt that is not a general long term liability is to be reported in a fund other than the debt service fund. As far as the number of debt service funds are concerned, there should only be one. This is because subsidiary records can be used to provide the necessary information to manage any debt associated with the fund. Not only is the debt service fund a place to allocate debt, it also serves as a budgeting device. This is done by preparing a budget from the debt service fund. Taxes that are recorded directly in the debt service fund for payment of interest can principal can be use for budgeting along with estimated revenues. The interest resulting from investments made from the issuance of debt can also be budgeted as revenue. Transfers from other funds can also be used to budget. Premiums on debt sold is also considered a revenue source and can be used in the budgeting. Residual equity may also be transferred to a debt service fund and budgeted. Recall that residual equity is the result of less expenditure than revenues in a capital project.

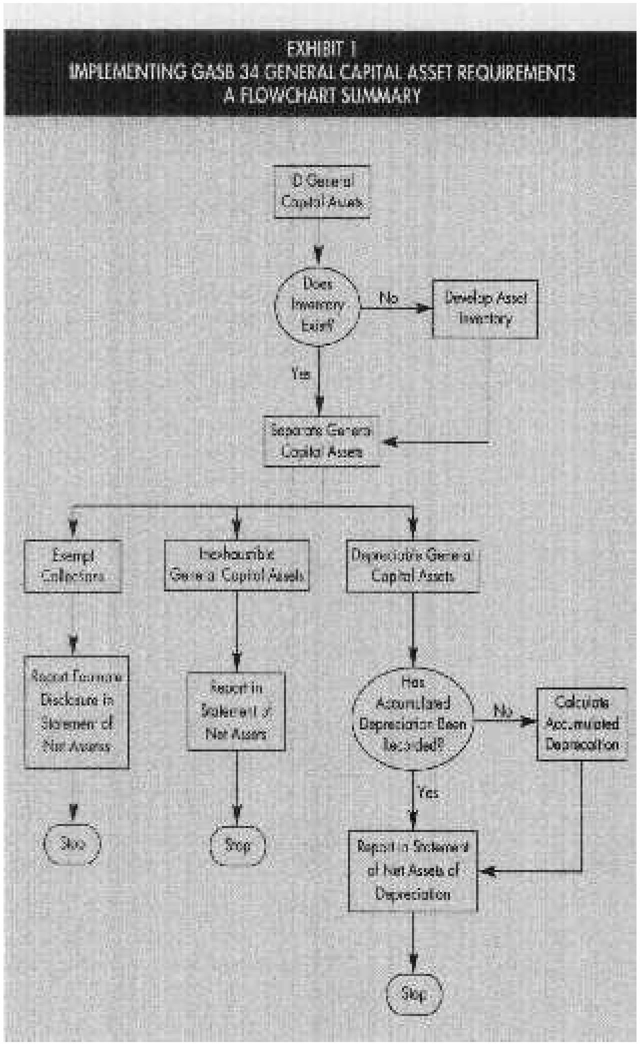
Further discussion on bonds and their types provide us with the topic of serial bonds. There are four types of serial bonds. Wilson, Reck, Kattelus discusses regular serial bonds as a bond which has a "total principal issue repayable in a specified number of equal annual installments over the life of the issue" (2012, pp. 222). Wilson, Reck, Kattelus also discusses a differed serial bond, which has "the first installment delayed for a period of more than one year after the date of issue but thereafter installments fall due on a regular basis" (2012, pp. 223). Annuity serial bonds are when the debt service remains even over the term of issue. Irregular serial bonds have erratic patterns of payment.

To further the discussion of capital assets, a bit of light should be shed on GASB 34. According to Patton and Bean, GASB 34 requires that all capital assets be recorded conceptually. Capital assets include land, land improvements, buildings, furniture and fixtures, vehicles, machinery, equipment and infrastructure assets (2001, pp. 31). According to Robbins and Baldwin, GASB 34 defines capital assets as "capital assets of the government that are not specifically related to activities reported in proprietary or fiduciary funds" (2002, pp. 49). All capitalized general fixed assets should be reported on the government wide statement of net assets. Inexhaustible capital assets should be reported separately. According to Robbins and Baldwin capital assets that require capitalization such as works of art, historical treasures, and other similar assets (exhibits and monuments) have special rules for capitalization and depreciation. For capitalized collections, governments should separate them from those that are not being depreciated (2002, pp. 50). Collections that are considered inexhaustible are those that have extraordinary long lives, such as government preservation of collections with cultural or aesthetic value. To be more precise, Robbins and Baldwin state that a collection is exempt from capitalization if it is:

- Held for public exhibition, education, or research in furtherance of public service rather than financial gain
- Protected, kept unencumbered, cared for and preserved; and
- Subject to an organizational policy that requires the proceeds from sales of collection items to be used to acquire other means of collection (evidence must support such policy) (2002, pp.50 - 51)

GASB 34 requires the depreciation of all capital assets in the government wide statement of activities. This requirement did not exist prior to GASB 34, neither did the requirement to report capital assets exist, although most governments reported them, making the switch to reporting them not much of a change.

The reason that the change was made to reporting in this manner was to use a measure that went beyond reporting the economic outflows and inflows of governmental funds in the short term. There was a desire to report the operational efficiency of government in the long term. This meant using the financial resource flows measurement focus, which was being used prior to the implementation of GASB 34 along with an economic flows resource measurement focus. As a result of this change it was required to change from a method of reporting only current assets and liabilities under the financial resource flows measurement focus to all assets and liabilities under the economic flows resource measurement focus. As a result of this the governmental fund statement used the financial resource flows measurement focus and the government wide statements used the economic flows resource measurement focus. In order to provide an accurate cost for goods and services that the government was providing it was decided to use depreciation expenses.



The flowchart to the left provided by Robbins and Baldwin details the process of identifying and accounting for capital assets under GASB 34 (2002, pp. 50).

Along with the capitalization of general capital assets that we have discussed thus far, infrastructure assets are long lived capital assets that must also be accounted for. Long lived infrastructure capital assets include roads, bridges, dams and lighting systems. These infrastructure assets can be reported in networks of assets and subsystems of those assets. Networks of assets provide a particular type of service to the governments. An exmaple provided by Robbins and Baldwin include a dam composed of a concrete dam, a concrete spillway and a series of locks (2002, pp. 52). To describe a subsystem we can think of all of the roads in a government. A subsystem of those roads would be interstate highways, state highways and rural roads (Robbins and Baldwin, 2011, pp. 52).

Along with the proper accounting for capital assets, these capital assets must be tested for impairment. GASB 42 indicates the situations when a capital assets meets certain criteria for impairment. Impairments result because a capital asset looses service potential in a manner that substantially reduces or eliminates the potential. Gauthier, gives us five indoicators of impairment:

- Evidence of physical damage. Examples include an office building damaged in a windstorm or a school building requiring mold remediation.
- Changes in legal or environmental factors. An undergroud storage tank that is no longer usable as a result of changes in environemental standards is one example of this criteria.
- Technological changes or obsolescence. For example, consider medical equipment that can still be used, but for which demand is expected to signifcantly decrease with the advent of additional , more attractivef treament options.
- Changes in manner or duration of use. Sometimes a capital asset is put to a significantly less valuable use than the one for which it was originally intended. One example of this is a superfluous school building being used instead as a wharehouse.
- Construction stoppage. A construction project may need to be abandoned for legal or practical reasons. Examples include highway construction that threatens the habbitat of an endangered species or runway construction for the bennefit of an airline that goes subsequently bankrupt. (2003, pp. 57)

Another area of capital assets to explore is that of intanglible assets. Before the GASB issues Statement 51, the requirements for identifying intangible assets were vague. To calrify what an intangible asset is, McSwain, Patton and Benco enlighten us with these characteristics that are necessary for an asset to be intangible:

- Not have a physical (tangible) substance
- Be nonfinacial in nature; and
- Have an initial useful life that is greater than one reporting period (2008, pp. 40)

An example of application of intangible assets at the government level would be of an easement for the use of a road. An easement is a contractural right for the government to use land for a road. The tangible asset in this case is the land. The intangible asset in this case is the easement. Other intangible assets that the government may have include water rights. According to McSwain, Patton and Benco, government powers such as the abiltiy to tax and eminent domain are not considered intangilbe assets because they do not have present service capacity. In an example of taxation, the power to tax does not exist until the government exercises it's power and asseses a property tax (2008, pp 41). It is also important to not that any intangible assets that governments aquire or create to directly obtain a profit should be accounted for as investments (to McSwain, Patton and Benco, 2008, pp. 41).

The disccusion on general capital assets and capital projects as well as general long term liabilities and debt service includes various topics. The most important of them were touched upon in this paper. There were some details concerning these topics that were left out as they went beyond the scope of this paper such as report formatting that is concerns some of the topics in this paper.

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