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Capital Assets: Acquisition, Impairment, and Accounting Policy

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Executive Summary

The following policy applies to the acquisition of capital (fixed) assets, including durable commodities ("goods"), by all branches of state government. Acquisition includes cash purchase, receipt of a donation, construction, rental, license, lease or eminent domain, regardless of funds used. This policy provides capital asset category definitions, capitalization thresholds, and depreciation/ amortization methodologies.

Policy

All assets, whether they are capitalized or not and regardless of acquisition method, must be accounted for, managed, and reported in accordance with all applicable laws and regulations of the Commonwealth. The method used to account for capital assets can vary, based upon the type of asset and/or the cost of the fixed asset.

Capital Asset Definition

Capital assets are defined as tangible or intangible assets used in operations and that have initial useful lives extending beyond a single reporting period. Typical examples of capital assets are land, construction in progress, buildings and building improvements, vehicles, machinery, equipment, software, works of art and historical treasures, and infrastructure.

Note: The Commonwealth's enterprise financial accounting and reporting system continues to use the term "fixed assets" instead of the more appropriate term "capital assets". This policy, with the exception of transaction descriptions for the Commonwealth's enterprise financial accounting and reporting system, uses the term "capital assets."

Acquisition of Capital Assets

The Commonwealth defines acquisition as the obtaining of a capital asset. Acquisition can be done by, but is not restricted to, a cash purchase, receipt of a donation, construction, rental, license, lease or eminent domain, regardless of funds used. The Commonwealth owns an asset when the full title of the asset rests with the Commonwealth.

The cost of purchasing an asset includes all costs necessary to put that asset into existing use and location including, but not limited to, freight, insurance, and installation (i.e., ancillary costs). These costs may include legal costs, eminent domain costs, or environmental remediation. The custodial responsibilities of an asset will reside within a particular department. All GAAP capital asset transactions must be entered into and verified in the Commonwealth's enterprise financial accounting and reporting system.

Historical Cost

The cost of an asset will be recorded as the historical cost of the asset, unless otherwise mentioned below. Historical cost can be determined by any of the following methods:

- The amount of cash paid for the entire purchase of the asset.
- The fair market value of a donated asset at the time of donation.
- The sum of all construction costs, including design of an asset.

Capitalization Thresholds

GAAP Capital Assets

GAAP capital assets are defined as singular assets (including infrastructure) with the following characteristics:

- **All land**, regardless of cost. The cost at which a capital asset is entered in the Statewide Enterprise Accounting and Financial Reporting System ("Mosaic") is either the historical acquisition cost, or the appraised, fair market value at date of donation.
- **Vehicles, equipment, furniture, computer software, and all electrical and computer components** with a useful life in excess of one year and with an historical cost of **$50,000 or more**.
- **All computer software**, whether internally or externally developed, should be capitalized depending on its cost. It is important that software be inventoried for license purposes. Departments may be subject to liability if they install non-purchased or non-licensed software. Therefore, departments should maintain close scrutiny on software that is installed on every computer.
- Software costs **above $49,999, but below $1,000,000**, are considered a GAAP fixed asset, and must be reported on the Fixed Assets component of the Commonwealth's enterprise financial accounting and reporting system, as Asset Type K. This software is depreciated over three years.
- Software costs **above $999,999** are also a GAAP fixed asset, and should be recorded as Asset Type S. This software is depreciated over seven years.
- **Buildings purchased or constructed,** and all other infrastructure assets such as dams, boardwalks, fishing, boating and shipping piers, beaches, seawalls, paved bike trails and pedestrian paths, other recreational infrastructure, dam and lock systems, water systems, sewer systems, other utilities, with an historical cost of **$100,000 or more**.
- **All road infrastructure** with an historical cost of **$50,000 or more** per lane mile for road assets. These include interstate roads and bridges, arterial roads and bridges (major non-interstate roads), collector roads and bridges (major non-limited access roads), local roads and bridges, and parkways.

All activities in these groups and other long-lived assets must be capitalized for GAAP purposes. All activity for infrastructure must be recorded in the Commonwealth's enterprise financial accounting and reporting system if the Commonwealth retains ownership of the infrastructure. If the infrastructure is deeded to another government, authority, or municipality, the activity is recorded as a grant expenditure. All costs, from initial design and permitting to point of in-service, must be included in the cost of the infrastructure assets.

Non-GAAP Capital Assets

Non-GAAP capital assets are defined as singular assets (including infrastructure) with the following characteristics:

- **Vehicles, equipment, furniture, computer software, and all electrical and computer components** with (1) a useful life of more than one year, and (2) **an original cost between $1,000 and $49,999**
- Software costs **below $50,000**. It is important that software be inventoried for license purposes. Departments may be subject to liability if they install non-purchased or non-licensed software. Therefore, departments should maintain close scrutiny of software that is installed on every computer.
- **Buildings and other infrastructure** with an **original cost between $1,000 and $99,999**.
- **Road infrastructure** with a **cost of below $100,000 per lane mile** for roads and bridges.
- **All works of art and historical treasures,** regardless of cost, acquired or donated to a department. The cost at which it is entered is either the historical acquisition cost or the appraised value at date of donation.

The Office of the Comptroller (CTR) has adopted the guidance contained in paragraph 27 of Statement No. 34: Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments – effective July 1, 2001, in regards to works of art and historical treasures. As long as the department can clearly document that an individual item or a collection of works of art and/or historical treasure meets all of the following criteria, then capitalization is not required:

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

NOTE: A work of art and/or historical treasure must meet all three of the above requirements in order to waive capitalization.

Non-GAAP capital assets must be recorded in a department's inventory and reconciled at least annually. This inventory can be either electronic or on paper, as long as it records the date of purchase, amount, description, location, and disposition of an item. Non-GAAP capital assets inventory is subject to review in the audit process by the Office of the State Auditor and/or the Commonwealth's independent auditors.

Acquisition Methods

Eminent Domain

Eminent domain is the governmental process of taking an asset it doesn't currently own from a private individual or other entity, in exchange for legally determined consideration. The asset taken is then used for a governmental function. The entire cost of eminent domain, including legal fees, should be included as part of the inclusive historical cost of the new asset being constructed.

Razing a Building

When a building is razed in order to clear the area for the construction of another building, the cost of razing the original building is recorded to land improvements. This will be entered in the Commonwealth's enterprise financial accounting and reporting system as an FA (Fixed Asset Acquisition or Betterment) transaction. The cost will then be associated with the parcel of land, not any future building. The disposal of the original building will be recorded in the Commonwealth's enterprise financial accounting and reporting system on an FD (Fixed Asset Disposal) transaction. When property has been purchased for the purpose of constructing a building, all costs incurred up to the excavation of the new building are considered land costs.

Razing of old buildings and reshaping of the land are considered costs of the land, because these costs are necessary to get the land in condition for its intended purpose. Any proceeds obtained in the process of getting the land ready for its intended use, such as salvage of the old building or receipts from the sale of timber that has been cleared, are reductions in the cost of the land.

Self-Constructed Assets and Historical Cost

Assets that are constructed should be priced at the total cost to build the asset. This includes both direct and indirect costs.

Group Purchase of Assets

When two or more assets are purchased at the same time and the individual cost for each is known, the value of the assets will be the purchase cost plus any costs associated with putting those assets into use. However, if these additional costs are not directly assigned to a particular asset, these costs will be apportioned to the cost of all of the assets in a proportional manner. This will yield a cost for each unit, which will include the assets' direct costs, plus any ancillary costs incurred when putting the asset into service.

When two or more assets are obtained at one time and their individual costs are not readily known (i.e., land and building purchased as one), the individual costs are allocated to the assets based on their relative fair market values at the time of acquisition. These costs are simply a ratio of the initial acquisition cost vs. the relative fair market values.

Considerations for the Acquisition of Durable Commodities

When deciding to acquire durable commodities, procuring departments and procurement management teams (PMTs) should assess their requirements and weigh and compare their available options.

Departments must use one of the four acquisition methods identified below unless another method is legislatively authorized and/or approved by the Operational Services Division (OSD) or CTR:

1. **Rental** – Temporary short-term use without ownership (less than 12 months; never a fixed asset).
2. **License** – Temporary use without ownership of intellectual property or software.
3. **Lease** – Temporary use without ownership for 12 or more months (these leases must be reviewed for capitalization under GASB 87 (Leases) or GASB 96 (Software)).
4. **Outright Purchase** – Immediate ownership (when the value of the commodity is $50,000 or greater, this is considered a Commonwealth capital asset).

Capital Asset Determination: When To Record Commodities As Capital Assets in the Commonwealth's Enterprise Financial Accounting and Reporting System

Regardless of the acquisition method, departments are responsible for recording capital assets with a value of **$50,000 or greater** for equipment.

The Fixed Asset Tables are a component of the Commonwealth's enterprise financial accounting and reporting system whose purpose is to provide a uniform and fully automated vehicle to account for and report on GAAP (Governmental Generally Accepted Accounting Principles) capital assets owned by the Commonwealth's departments. Departments must record GAAP capital assets in the Commonwealth's enterprise financial accounting and reporting system. The recording of these assets allows CTR to incorporate this information into the Commonwealth's Annual Comprehensive Financial Report (ACFR).

Reporting

Capital assets shall be reported in accordance with requirements as they relate to each group of capital assets, namely GAAP capital assets or non-GAAP capital assets. Each of these groups of assets has its own reporting requirements. These capital assets shall be reported to the appropriate management bodies within and outside the Commonwealth by whatever appropriate and practical means.

Assets Held in Trust

Assets held in trust are those assets that are owned by another individual or organization but are in the custodial care of the Commonwealth. Departments must properly account for and report custodial obligations, as well as assets of the Commonwealth. These assets should not be listed or recorded by departments as capital assets in the Commonwealth's enterprise financial accounting and reporting system, as the Commonwealth does not own the assets. Departments must report assets to CTR as required by the GAAP reporting package. CTR's Statewide Financial Reporting Team will record the asset held in trust on a consolidated basis, to the relevant custodial fund.

Chief Fiscal Officer

The Chief Fiscal Officer of each department is responsible for the management of capital assets. Management includes an annual physical capital asset inventory, the reconciliation of the results of that inventory, and reporting the results of that inventory to the proper authorities. Department staff shall be properly trained on the workings of the Fixed Asset tables in the Commonwealth's enterprise financial accounting and reporting system.

Annual Inventory

There shall be an annual inventory taken of capital assets owned by every department. This inventory shall include, at a minimum, a verification of the existence and location of capital assets owned by a department. This inventory shall be done on or about June 30 of each year for GAAP and non-GAAP assets. All changes needed to assets shall be entered in the Commonwealth's enterprise financial accounting and reporting system no later than seven (7) business days after June 30 of each year.

Reconciliation of Capital Assets Inventory

There shall be a reconciliation of the capital asset inventory in the Commonwealth's enterprise financial accounting and reporting system against records maintained by the department. This reconciliation is

to be done, at a minimum, on an annual basis. This reconciliation shall be available for audit. A department will maintain supporting documentation of capital asset transactions available for examination by appropriate audit organizations.

Leases – GASB 87, 94, and 96

CTR has implemented GASB 87, 94, and 96 - leases requirement for GAAP reporting.

Departments may find it more feasible to lease equipment rather than making out-right purchases. This is typically the case for rapidly changing technology, such as computers, servers, copiers, etc., where the equipment may become outdated by the time the lease term expires. In order to keep up with the pace of technology and associated increasing costs, leasing may be the best option for departments.

CTR sends out an email quarterly asking departments to provide the following information about their departmental leases:

GASB 87 – Leases

Leases of Buildings, Land, and Equipment (Commonwealth as Lessor)

Departments are asked to provide the following information for buildings and land with an obligation of $250,000 or over, for 12 months or more and equipment leases for 12 months or more and subject to either a Master Procurement Agreement or an obligation of $250,000 or more.

- **Equipment –** Please send copies of contracts for any new or renewed/extended leases for equipment, including the physical address of the equipment. If this is a replacement of an existing piece of equipment, please provide information on the equipment being removed/replaced. Please indicate any pieces of equipment for which the lease has expired that will not be subject to renewal.
- **Land –** Please send copies of contracts or other relevant documents for any new or renewed/extended leases for land. Also, please indicate if existing land leases have been terminated or expired without being subject to renewal.
- **Building –** Please provide the encumbrance ID number in the Commonwealth's enterprise financial accounting and reporting system for any new, renewed, or expired building leases. We will collect the relevant lease agreements and Form 3 documents from DCAMM.

GASB 94 – P3 arrangements, Service Concessions, or Commonwealth as Landlord

Departments with leases receivable should record the payments received as lease (or rent) revenue using the appropriate code set up for the department. If the lease term is greater than 12 months and of $250,000 or more, departments must send copies of the executed lease and any amendments to CTR Statewide Financial Reporting. CTR will make all necessary adjusting entries to convert lease entries to GAAP format for publication in the ACFR.

GASB 96 – Subscription Based IT Arrangements (SBITAs)

Departments are asked to provide the following information for software leases with an obligation of $500,000 or over, for 12 months or more (this does not include maintenance fees or cancellable leases):

- Provide a copy of the executed contract.
- Provide a copy of the procurement document.

Intangible Assets

Except for SBITAs, covered above, intangible assets are required to be capitalized and accounted for in the Commonwealth's enterprise financial accounting and reporting system, if they meet the capitalization thresholds established herein. GASB Statement No. 51, *Accounting for Intangible Assets*, defines intangible assets as, "Assets that possess all of the following characteristics:

- *Lack of physical substance*: An asset may be contained in or on an item with physical substance, for example, a compact disc in the case of computer software. An asset also may be closely associated with another item that has physical substance, for example, the underlying land in the case of a right-of-way easement. These modes of containment and associated items should not be considered when determining whether or not an asset lacks physical substance.

- *Non-financial nature:* An asset with a nonfinancial nature is one that is not in monetary form, similar to cash and investment securities, and it represents neither a claim or right to assets in a monetary form similar to receivables, nor a prepayment for goods or services.

- *Initial useful life extending beyond a single reporting period*: Examples include patents, copyrights, trademarks, easements and local use rights, computer software (whether it is purchased, or internally generated).

Intangible assets with an indefinite useful life, such as permanent easements, should not be depreciated.

Intangible assets are included in the annual fiscal year GAAP Memo. There is a questionnaire in CTR's Wdesk spreadsheet reported under a cloud-based software managed by Workiva that each department must complete.

Capitalization for Internally Generated Intangible Assets

GASB Statement No. 51, Paragraph 7, says that, "Intangible capital assets are considered internally generated if they are created or produced by the government or an entity contracted by the government, or if they are acquired from a third party but require more than minimal incremental effort on the part of the government to begin to achieve their expected level of service capacity."

In order for a government to show its commitment to funding and completing a project, all four of the following criteria must be met:

1. The specific objective of the project has been determined,
2. The nature of the service capacity to be provided has been determined,
3. The feasibility of successfully completing the project has been demonstrated; and
4. The government has demonstrated that it: 1) intends, 2) is able to, and 3) is making an effort to develop and complete the project.

Any costs expended prior to all four of these criteria being met are to be expensed. The most common example is a feasibility study. Departments may expend funds to have a software company perform a study detailing the feasibility of creating new accounting software. Based on the results of the study, the department determines that it is not feasible to move forward with the new software. Since the study was performed prior to meeting these criteria, according to GASB Statement No. 51, the cost of any feasibility study must be expensed.

The chart below, although not inclusive of all activities in each stage, provides guidance on when to capitalize and when to expense costs incurred during the development of internally generated intangible capital assets:

Preliminary project stage	**Application development stage**	**Post-implementation/ operation stage**
• Conceptual formulation and evaluation of alternatives; • Determination of the existence of needed technology; and • Final selection of alternatives for development	• Design of the chosen path, including software configuration and software interfaces; • Coding; • Installation to hardware; • Minimum data conversion necessary to make the software operational; and • Testing, including the parallel processing phase	• Application training • Data conversion beyond what is strictly necessary to make the software operational; and • Software maintenance
EXPENDITURE (GAX/PRC)	**CAPITALIZE – FIXED ASSET (FA)**	**EXPENDITURE (GAX/PRC)**

Any costs incurred to train employees on the use of a new system are not costs necessary to put the computer software into condition for use. Therefore, costs related to training should not be capitalized as part of the system and instead should be expensed.

Commercially purchased software that requires more than minimal effort to make the software operational as the department intends is considered, under the provisions of GASB Statement No. 51, to be internally generated.

Impairment of Capital or Other Assets and Insurance Recoveries

In accordance with Government Accounting Standards Board (GASB) Statement No. 42, Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries, the Commonwealth is required to evaluate prominent events or changes in circumstances affecting fixed or other assets, such as cash, to determine whether impairment has occurred.

What is Impairment?

"Impairment" may include physical damage to an asset, enactment or approval of laws or regulations or other changes in environmental factors, technical changes or evidence of obsolescence, changes in the manner or duration of use of an asset, and construction stoppage.

A fixed asset is impaired if both:

a) The decline in the ability to use an asset is large in magnitude, and
b) The event is outside the normal life cycle of a capital asset.

All impaired assets, if significant ($100,000 or greater in value), must be reported to CTR's Statewide General Accounting Team within 7 days of event occurrence. For all unaccounted for variances, losses, shortages, or thefts of funds or property, the rules established under Chapter 647 of the Acts of 1989 apply. CTR's Statewide General Accounting Team will work with you to determine if impairment exists and if there is an event that needs to occur in the Commonwealth's enterprise financial accounting and reporting system.

In the case of a theft, fire, flood, obsolescence, or other event regarding the usefulness of an asset, be it fixed or non-fixed such as cash, departments need to evaluate the usefulness or availability of that asset in the future. This may require outside assistance from an appraiser and/or CTR to determine significance and applicability. Impairment must be conspicuous – e.g., known to the Commonwealth that a material event has occurred. These events may be known by management or the media.

Assets that are impaired that will no longer be of use to the Commonwealth will need to be evaluated for either the lower of their fair market value or their "book" value after depreciation, and their value adjusted accordingly in the Commonwealth's enterprise financial accounting and reporting system.

Insurance recoveries associated with impairment should be reported as a separate transaction, especially if received in a different fiscal year.

Role of CTR

CTR's Statewide General Accounting Team will work with the affected department to determine and document if impairment exists and if there is an event that needs to occur in the Commonwealth's enterprise financial accounting and reporting system, using the following decision tree:

1. Is the asset impairment significant ($100,000 or more), resulting in an unexpected decline in the usefulness of the asset, and is it unexpected? For example, a wing of a building is no longer useful because of newly discovered asbestos. Or is physical damage present from fire or flood when the level of damage is such that efforts are needed to restore the asset to useful service?
2. Is there a decline in service utility? For example, if an information system can only run at 80% instead of 100% due to obsolescence, enactment or approval of laws or regulations, or changes in environmental factors. Another example is new water quality standards that have rendered a treatment system obsolete.
3. Is there technological obsolescence, such as a major piece of equipment that no longer is in use due to better equipment becoming available?
4. Is there a change in the duration of use? For example, a building closing prior to its 40-year life cycle being completed?
5. Is there a construction stoppage on a new asset due to lack of funding?
6. Is the impairment temporary or permanent?

Impairment exists if these factors are significant ($100,000 or more) and the occurrence is unexpected.

Impairment Measurement and Reporting

To measure the amount of impairment, CTR will need to work with the department to determine if the above factors exist. If so, the portion of the asset to be adjusted would depend on the usefulness after repair (if applicable.) Usefulness assessments will need to be known as soon as possible. Other items that will need to be known include:

1. What is the estimated cost to restore the asset to full utility?
2. What would be the current cost to replace the asset?
3. What is the salvage value, if any?

Assets No Longer in Use or Construction Stoppages

Assets no longer in use or that are part of a permanent construction stoppage will have their value adjusted to fair market value or "book" value, whichever is lower, in the Commonwealth's enterprise financial accounting and reporting system. For such assets, an appraisal in writing must be provided by the department to CTR as soon as possible.

Reporting

Asset Impairment changes will require the use of Increase or Decrease of a Fixed Asset (FI) transactions (for assets still in use) or Fixed Asset Disposition (FD) for permanent losses. If the loss is permanent, the Commonwealth will report these losses as part of its GAAP financial statements. If losses are deemed temporary by the department, in conjunction with and with the concurrence of CTR after evidence is reviewed, the value of the asset will be adjusted.

Idle Capital Assets

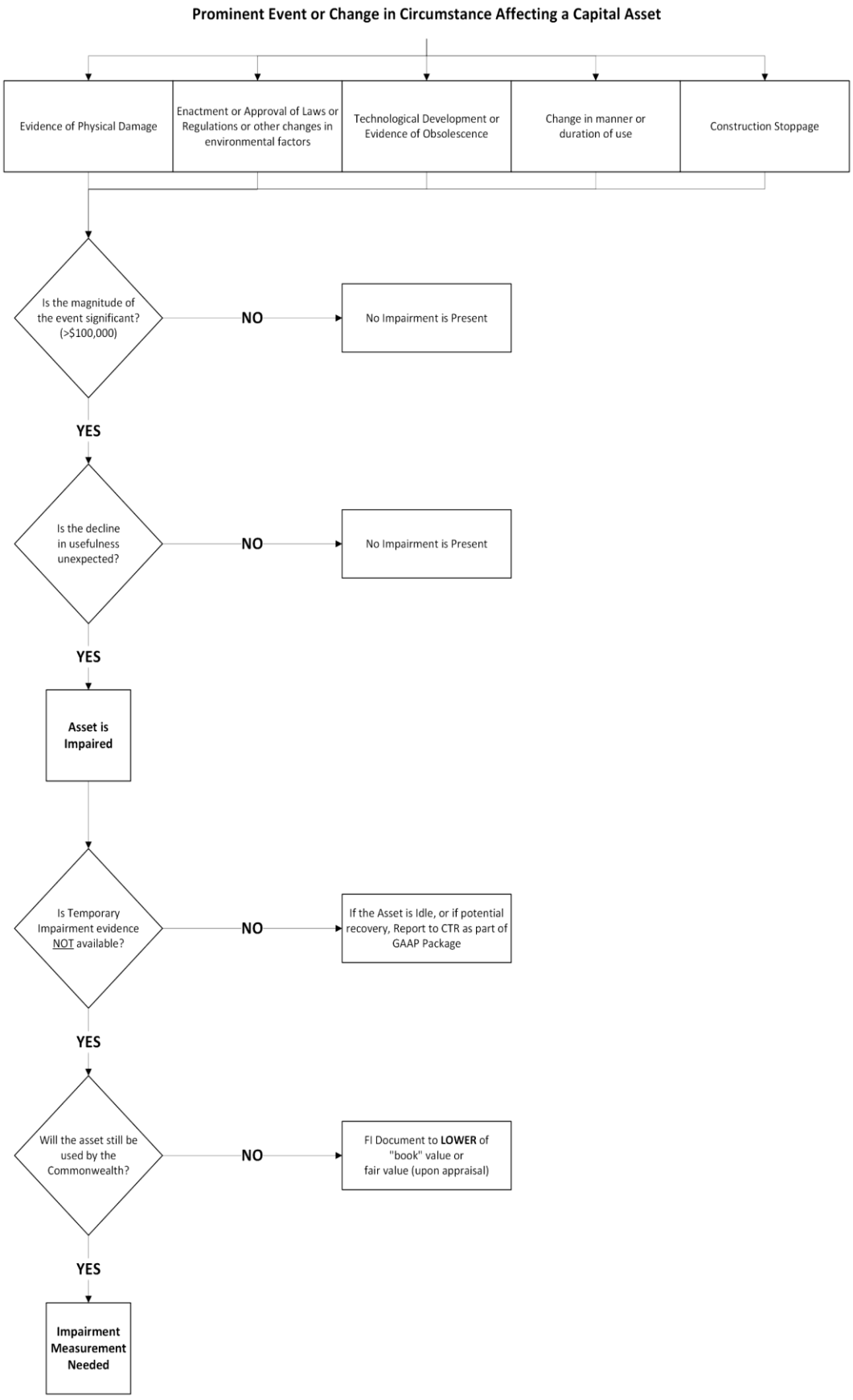
Capital assets that are unused or idle, and valued at $100,000 or more, must be disclosed to CTR as part of the department's GAAP reporting package.

Insurance and Other Recoveries

Pursuant to M.G.L. c. 29 § 30, "No officer or board shall insure any property of the Commonwealth without special authority of law." Therefore, unless a department has special legislation authorizing it to insure Commonwealth property, the department may not purchase insurance against property damage.

If a department is authorized to purchase insurance, recoveries under such policies will be reported as separate transactions within the General Fund and will not be netted against any current or future expenditure, absent legislation to the contrary. Normal Cash Receipt (CR) Impairment of Fixed and Other Assets and Insurance Recoveries transactions will be used to record such recoveries, using revenue source code 6900 – miscellaneous revenue, and separate documentation forwarded to the CTR Statewide General Accounting Team, which will track these recoveries.

Asset Impairment Decision Process



Measurement of Impairment

Indicator of Impairment	Measurement		
Physical Damage ex. fire	Impairment = Cost to Restore	(Estimated Restore Cost / Estimated Replacement Cost) x Basis	Report Impairment Loss
Legal / Environmental Change ex. lawsuit Tech Change ex. obsolete software Change in Use ex. conversion of school to nursing home	Service Units Approach – what is the % of usefulness lost?	Determine cost of remaining usefulness	Report Impairment Loss
Construction Stoppage	Lower of "Book Value" or "Fair Value" (per appraisal)		Report Impairment Loss

Selection of Methods to Measure Impairment

Indicator of Impairment	Method Generally Used in Measurement
Evidence of physical damage	If asset will continue to be used – what is the cost to restore? If no longer used – FI transaction to lower of "book value" or appraisal
Enactment or approval of laws or regulations or other changes in environmental factors	If asset will continue to be used – what % will continue to be used – adjust asset value to that percentage using an FI transaction. If no longer used – FI transaction to lower of "book value" or appraisal
Technological Development or Obsolecence	If asset will continue to be used – what % will continue to be used – adjust asset value to that percentage using an FI transaction. If no longer used – FI transaction to lower of "book value" or appraisal
Change in Manner or Duration of Use	If asset will continue to be used – what % will continue to be used – adjust asset value to that percentage using an FI transaction. If no longer used – FI transaction to lower of "book value" or appraisal
Construction Stoppage	Use FI transaction to lower of book value or appraisal.

Internal Controls

Internal controls regarding the safeguarding of assets and the assets' financial information shall be developed and maintained in the department's internal control plan. This policy can be carried out through a sound system of internal controls including verification, appointment of a singular, accountable, responsible officer, a periodic inventory of assets, and an independent audit and training.

Department heads are required to annually complete CTR's Internal Control Certification. CTR may also conduct periodic interviews and desk reviews to verify a department's compliance with this policy.

Contacts

- CTR Solution Desk