

Department of Finance and Administration – Policy 33

Accounting for Capital Assets

Authority and Applicability

This policy statement, effective upon signing, is issued by the Department of Finance and Administration in accordance with the authorities granted to it by TCA 4-3-1007, and is applicable to all state departments, agencies, boards and commissions (herein referred to as agency or agencies), with the exception of colleges and universities.

Objective

The State of Tennessee (the state) has a significant investment in capital assets such as land, buildings, land improvements, machinery and equipment (including furniture and fixtures, vehicles, works of arts and historical treasures), intangibles (e.g. computer software), infrastructure, and construction in progress. This policy statement, covering the accounting and financial reporting of capital assets, is to help ensure accounting for the state's capital assets in accordance with Generally Accepted Accounting Principles (GAAP) as promulgated by the Governmental Accounting Standards Board (GASB), and improve accountability, and operational efficiencies in managing the state's assets.

This policy statement is not intended to address all matters that require consideration when establishing internal controls or assessing risk for capital assets, particularly in the area of property control (i.e. the efficiency, effectiveness and safeguarding of capital assets). Each agency is responsible for reviewing their business practices and processes to determine where risks exist and where and how controls can be established to mitigate risks in achieving the entity's objectives.

Definition and Scope

When cited in governmental accounting and financial reporting standards, the term, *capital assets*, includes land, improvements to land, easements, buildings, building improvements, vehicles, machinery, equipment, software, works of art and historical treasures, infrastructure, and all other tangible and intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period.

As a practical application of the materiality principle, not all capital assets with useful lives extending beyond a single reporting period are required to be reported in a government's statement of financial position. Items with extremely short useful lives or of small monetary value are properly reported as an expense or expenditure in the period in which they are acquired. When outlays for capital assets are reported on the statement of financial position, they are considered *capitalized*. The monetary criterion used to determine whether a capital asset should be capitalized is known as the *capitalization threshold*.

This policy statement is limited to the state's capitalized assets, or those meeting the state's capitalization thresholds, and having an estimated useful life of three years or more. Department of Finance and Administration, Policy 32, *Maintaining Control Over Items That Are Not Capitalized*, helps ensure that adequate property controls are in place over capital assets that do not meet the state's thresholds for financial reporting purposes.

General Policy

1) Resources

The state provides detailed information on the reporting, valuation and depreciation of capital assets in the State of Tennessee Capital Asset Guide, issued by the Department of Finance and Administration. Designed to assist agencies in completely and accurately recording and properly reporting capital assets in their respective funds, agencies are required to account for their capital assets in accordance with this guide.

2) Fundamental Principles

a) Accounting and reporting

Purchases of capital assets are recorded as expenditures against appropriations, and reclassified from expenditures to assets through fiscal year-end adjustments for financial reporting in the state's Comprehensive Annual Financial Report.

Capital assets used in fiduciary or proprietary (enterprise and internal service) funds are reported in each of the respective funds. All other capital assets are reported as expenditures in the governmental fund financial statements, but are reclassified to capital assets in the government-wide financial statements.

b) Valuation

Capital assets should be reported at historical cost. Historical cost is the cash or cash equivalent price paid at the time of purchase or acquisition. The cost of a capital asset should include ancillary charges necessary to place the asset into its intended location and condition for use such as freight and transportation charges, site-preparation costs, and professional fees. Donated capital assets should be reported at acquisition value, or the price that would be paid to acquire an asset with equal service potential.

For a capital asset that does not fall under the classifications of land, infrastructure or internally generated intangible assets, the state has set a standard capitalization threshold of \$5,000. The state capitalizes all costs classified as land and infrastructure, and has set a financial reporting capitalization threshold of \$1,000,000 for internally generated intangible assets. The State of Tennessee Capital Asset Guide provides details and examples of expenditures (costs) to capitalize and not to capitalize.

The state's capitalization thresholds apply to GAAP financial reporting requirements only. The U.S. Office of Management and Budget establishes guidance for an asset acquired in whole or in part with federal funds, to determine when a particular purchase may be expensed against federal programs, and when it must be amortized or depreciated over the life of the asset.

c) Depreciation/amortization

Depreciation/amortization is the systematic and rational allocation of the cost of a capital asset over its estimated useful life. Capital assets are depreciated/amortized unless they have an indefinite useful life (e.g. land, certain intangibles) or are infrastructure assets as described in the Special Considerations section of this policy.

Depreciation/amortization is calculated using a straight line methodology, and estimated useful life guidance has been established for the major classifications of depreciable capital assets. This guidance is detailed in the State of Tennessee Capital Asset Guide, and is required to be used unless a shorter or longer estimated useful life is justified based on factual circumstances, environmental conditions, replacement policy, or industry practice.

3) Special Considerations

a) Leases

Accounting and financial reporting for the assets involved with leases (or the right to use nonfinancial assets such as buildings, land, vehicles and equipment) will be completed in accordance with the standards established by the Governmental Accounting Standards Board (as more fully explained in the State of Tennessee Capital Asset Guide).

b) Disposals of capital assets

When an asset is fully disposed of before it is fully depreciated a gain or loss on the disposition must be recognized. The gain or loss should be the difference between the net book value (historical cost minus accumulated depreciation) and the proceeds from the disposition, taking into account any expenses of the disposition as well.

Lost and stolen assets are treated as de facto disposals. When a capital asset is traded in, the trade-in value of the old asset is added to the amount expended to reflect the full acquisition cost of the new capital asset.

c) Impairment

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 manner or duration of use of a capital asset and construction stoppage.

If a reportable capital asset is impaired, there are two options for reporting the impairment. If the asset will be permanently removed from service, the asset should be written down to the lower of the carrying value or fair value. If the asset will continue to be used, that asset should be written down by the estimated impairment loss.

d) Additions and Improvements

An addition or improvement, unlike a repair, either enhances a capital asset's functionality (effectiveness or efficiency) or it materially extends a capital asset's expected useful life.

Additions represent a new asset (e.g., a new wing to a building) and must equal or exceed the standard threshold related to the major capital asset class to be capitalized. Improvements represent a substitution of a better asset (e.g., a concrete floor for a wooden floor) and must equal or exceed the standard threshold related to the major capital asset class to be capitalized.

Repairs and maintenance costs maintain the capital asset in its original operating condition and should be expensed when incurred.

e) Infrastructure

Infrastructure assets are 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. Examples of infrastructure assets include roads, bridges and right-of-way acres. Infrastructure assets are capitalized regardless of cost or useful life, and are reported and accounted for using a modified approach, or an alternative to depreciation. Under the modified approach, depreciation expense is not recorded for these assets. Instead, costs for both maintenance and preservation of these assets are expensed in the period incurred.

f) Exchanges with Other State Agencies

When a state agency transfers capital assets to another state agency, regardless of whether consideration was or was not exchanged between the two agencies, the capital asset is moved to the buying/receiving agency (from the selling/donating agency) using the net book value at the time of the transfer.

Exceptions

Exceptions to this policy may be approved by the Department of Finance and Administration, Division of Accounts Deputy Chief of Accounts.

Approval of the Commissioner of Finance and Administration

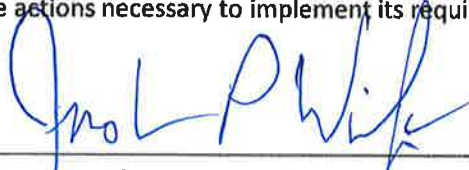
I, Larry B. Martin, hereby approve Policy 33 of the Department of Finance and Administration, and authorize actions necessary to implement its requirements.

Signed 
Larry B. Martin, Commissioner
Department of Finance and Administration

Date 10/18/16

Approval of the Comptroller of the Treasury

I, Justin P. Wilson, hereby approve Policy 33 of the Department of Finance and Administration, and authorize actions necessary to implement its requirements.

Signed 
Justin P. Wilson, Comptroller
Office of the Comptroller of the Treasury

Date 10/26/16