PacificCPE

COURSE
21157A

Capital Assets, Investments, and Derivative Instruments in Government Accounting

Accounting for capital assets and investments in government involves unique valuation, depreciation, and disclosure considerations. This course covers GASB standards for capital asset reporting, marketable securities, and investment management, including how avoiding financial statement volatility can lead to suboptimal decisions. It also tackles derivative instruments, with a focus on interest-rate swaps. If you work with governmental entities and want a deeper understanding of asset and investment accounting under GASB guidance, this course delivers.

CREDIT HOURS 2 | FIELD OF STUDY ACCOUNTING | EXAM QUESTIONS 10

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LEARNING ASSIGNMENTS AND OBJECTIVES

Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Identify what costs are properly capitalized and how they should be reported.
- Identify various marketable securities and how they should be reported.

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Chapter 1: CAPITAL ASSETS AND INVESTMENTS IN MARKETABLE SECURITIES

Chapter Objective

After completing this chapter, you should be able to:

- Identify what costs are properly capitalized and how they should be reported.
- Identify various marketable securities and how they should be reported.

The accounting for both capital assets (sometimes referred to as "fixed" or "long-lived" assets) and investments, albeit for different reasons, should be of vital concern to financial statement users, auditors, and preparers. Capital assets are a key component of many of the services provided by governments and not-for-profits. They include its police cars, administrative buildings, and utility lines and roads. If they are inadequate to meet the demands for services to be delivered in the future, then the organization will either have to reduce its services or come up with the financial resources to enhance the assets. At the same time, existing stocks of capital assets have to be either maintained or replaced, thereby necessitating an ongoing commitment of financial resources. In addition, the constituents of governments and not-for-profits generally want and are entitled to assurance that the organization is using its assets efficiently and effectively. Whereas the previous chapter was concerned with the resources that are used to acquire "general" capital assets, this chapter is directed to the assets themselves.

Per the current standards—as set forth in GASB Codification Section 1400—Reporting Capital *Assets*, paragraph 119—governments do not record capital assets, and hence do not charge depreciation, in their modified accrual-basis governmental funds financial statements. They must, however, do so in their government-wide and other full accrual-basis statements (albeit with certain exceptions). Key constituents of the GASB strongly opposed the capital asset provisions when they were first proposed in 1997 and subsequently issued in 1999 as Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, objecting in particular to the requirement that **infrastructure assets** be reported on the government-wide statement of net position and depreciated. With the passage of time, the critics of the requirements (particularly financial statement preparers) seem to have adapted to them and have muted their criticisms. Many, in fact, now resist any efforts to alter the infrastructure and other key provisions of Statement 34. Nevertheless, among some the Statement remains controversial.

The second part of the chapter addresses marketable securities held as investments. Investments generally are near the opposite end of the liquidity spectrum from capital assets and present

contrasting issues of both disclosure and control. They are of critical concern to both governments and other not-for-profits. Unlike capital assets, they are subject to significant risks of declines in fair values, as well as of fraud and mismanagement on the part of both the financial institutions with which they deal and their own employees. The entity needs to inform financial statement users of these risks and to establish policies and procedures to manage and control them.

WHAT ACCOUNTING PRACTICES DO GOVERNMENTS FOLLOW FOR GENERAL CAPITAL ASSETS?

In its Concepts Statement No. 1, *Objectives of Financial Reporting*, the GASB set forth the purpose of capital asset reporting and laid the foundation for the current provisions: [1]

> *Financial reporting should provide information about a governmental entity's physical* and other nonfinancial resources having useful lives that extend beyond the current year, *including information that can be used to assess the service potential of these resources.*
>
> *This information should be presented to help users assess long- and short-term capital needs.*

Maintaining Accounting Control over Capital Assets

General capital assets—capital assets that, by definition, are associated with the government as a whole, rather than with any specific fund— are distinguished from the assets of proprietary funds (enterprise funds and internal service funds) and of fiduciary funds (pension and other trust funds in which land, buildings, and other capital assets are, for the most part, held as investments).

Nonfinancial and noncurrent in character, general capital assets are excluded from governmental funds because the measurement *focus* of governmental funds is on *current financial resources*. Therefore, in governmental funds, the costs of capital assets are reported as expenditures when the assets are acquired rather than capitalized as assets and subsequently written off as the assets' useful lives run down.

To prepare their government-wide statements and schedules of capital asset activity, governments must maintain records of their capital assets (and the related accumulated depreciation) that are not recorded on the balance sheets of their governmental funds. They can be listed in a ledger; they need not be in double-entry format.

The most common classifications for general capital assets include

- Land
- Buildings
- Improvements to land and buildings
- Equipment
- Works of art

- Historical treasures
- Infrastructure (e.g., roads, bridges, tunnels, drainage systems)
- Intangible assets
- Construction in-progress

Although capital assets are, by definition in the GASB standards, those with useful lives greater than one year, capital asset policies (such as the threshold in terms of dollar amount and useful life) vary among governmental entities. For example, the capital asset policies of the City of Boulder, Colorado, define capital assets as "assets with an initial, individual cost of more than $5,000 ($50,000 for infrastructure) and an estimated useful life in excess of one year[2]." The City of Baltimore, Maryland, in comparison, discloses, "Capitalization thresholds are: $50,000 for buildings, improvements and infrastructure; and $10,000 for equipment, with the exception of vehicles which has a $5,000 threshold. Library books are capitalized as a collection based on total purchases[3]."

GASB Codification Section 1400, paragraph 127, requires that virtually all intangible assets be classified as capital assets. Intangible assets that a government may own include recorded library books, computer software (whether purchased or developed in-house), water rights, and easements. For example, many governments report intangible lease assets that represent their "right to use" assets that they rent, rather than own.

Reporting in Government-Wide (Full Accrual) Statements

Capital assets, including infrastructure, generally should be reported on the government-wide statement of net position at historical cost net of accumulated depreciation or amortization. Most capital assets should be depreciated or amortized over their estimated useful lives in a manner that is "rational and systematic" (i.e., by using commonly accepted methods). However, governments, like businesses, do not have to depreciate inexhaustible assets, such as land and certain works of art or historical treasures. Moreover, as is addressed in a *section* to follow, governments do not have to depreciate infrastructure assets if they can demonstrate that they are preserving the assets at a specified condition.

The level of detail displayed about capital assets on the face of financial statements varies considerably from government to government. As long as the total historical cost net of accumulated depreciation/ amortization is shown, detailed information about types of capital assets can be disclosed in notes.

Governments do not report a separate line item for depreciation and amortization on the government-wide statement of activities. Rather, they should report depreciation and amortization expenses in the appropriate programs and function (e.g., public safety, recreation, health).

The information that governments must include in notes to financial statements include: beginning and ending balances; acquisitions, reclassifications, sales, and retirements; and current-period depreciation and amortization (including the amount charged to each of the programs and functions reported on the statement of activities). The City of Milwaukee's disclosures relating to general capital assets for governmental activities are presented in Table 7-1 (next page).

The sections that follow address issues that apply to proprietary funds and the government-wide statements.

TABLE 7-1. CITY OF MILWAUKEE, WISCONSIN—CAPITAL ASSETS NOTE DISCLOSURE

City of Milwaukee Notes to the Financial Statements for the Year Ended December 31, 2023

Capital asset activity for the year ended December 31, 2023, was as follows:

	Balance 01/01/23	Additions	Deletions	Balance 12/31/23
Governmental activities		*(Thousands of Dollars)*		
Capital assets not being depreciated and amortized:				
Land	$ 166,469	$ 151	$ 246	$ 166,374
Construction in progress	148,073	19,658	24,448	143,283
Intangible right of ways	1,342	—	—	1,342
Total capital assets not being depreciated	315,884	19,809	24,694	310,999
Capital assets being depreciated and amortized:				
Buildings	401,274	3,435	189	404,520
Infrastructure	1,886,815	58,171	19,066	1,925,920
Improvements other than buildings	11,966	—	190	11,776
Machinery and equipment	267,284	15,977	10,087	273,174
Intangible software	14,722	—	—	14,722
Right-to-use lease assets	4,337	1,109	519	4,927
Right-to-use subscription assets	15,221	5,050	1,328	18,943
Total capital assets being depreciated and amortized	2,601,619	83,742	31,379	2,653,982
Less accumulated depreciation and amortization for:				
Buildings	178,133	11,429	183	189,379
Infrastructure	1,177,355	33,509	18,666	1,192,198
Improvements other than buildings	10,992	202	167	11,027
Machinery and equipment	176,413	14,179	9,587	181,005
Intangible software	11,913	1,504	—	13,417
Right-to-use lease assets	300	700	—	1,000
Right-to-use subscription assets	1,500	900	400	2,000
Total accumulated depreciation and amortization	1,556,606	62,423	29,003	1,590,026
Total capital assets being depreciated and amortized, net	1,045,013	21,319	2,376	1,063,956
Government activity capital assets, net	$ 1,360,897	$ 41,128	$ 27,070	$ 1,374,955

Depreciation and amortization expense for governmental activities was charged to the following functions:	Depreciation/ amortization
General government	$ 1,954
Public safety	8,577
Public works	49,845
Health	405
Culture and recreation	1,642
Total	$ 62,423

Note: Minor adjustments were made to this disclosure to conform with GASB Statement No. 104, *Certain Capital Asset Disclosures*, which is effective beginning with fiscal years ending 6-30-26.

ACQUIRING AND DETERMINING AMOUNTS FOR CAPITAL ASSETS

When a government acquires a capital asset by purchase, construction, or lease, it should follow the same general guidelines used by businesses to determine the costs to be capitalized. Thus, capitalized value should include all costs necessary to bring an asset to a serviceable condition. For purchased assets, the capitalized cost should include purchase price (less any discounts, such as those for prompt payment or for favored customers) plus transportation and installation costs, if applicable. For an asset such as land, it would include legal fees, title fees, appraisal costs, closing costs, and perhaps costs of demolishing existing structures that cannot be used (less recoveries from their salvage).

For constructed assets, it would include payments to contractors, direct labor and materials for capital assets built by a government's employees, overhead costs, architect fees, and insurance *premium*s during the construction phase. However, unlike businesses, governments should not capitalize interest incurred during the period of construction because, in the view of the GASB, it does not meet the definition of an asset. Unlike, for example, freight or site preparation costs, interest cost does not enhance the present service capacity of the constructed asset, and therefore should not be added to a project's carrying value. Further, the GASB rejected the possibility of accounting for the interest as a deferred outflow of resources. It maintained that interest is the result of a periodic financing activity and that therefore recognizing it as an expense in the period incurred, rather than a deferral, is consistent with the concept of interperiod equity. In that way, it said, it would be associated with the period to which it relates[4].

Governments also acquire their assets through leases and subscription-based information technology arrangements (SBITAs), which are financing arrangements by which a government acquires the right to use another entity's capital asset. *Leases* and SBITAs are discussed in Chapter 1 of course 21158F.

Governments should report donated assets at their **acquisition value**—the cost to acquire an asset with the same service capacity—at the time the gift is received. Government should then depreciate or amortize (as appropriate) the assets over their remaining useful lives in their government-wide and other full-accrual financial statements.

Accounting for Collections

Like their not-for-profit counterparts, government museums, universities, libraries, and history centers own works of art, rare books, and historical artifacts. These collections often have considerable monetary value and for some entities may be their most significant assets.

Governments and not-for-profits have generally opposed both capitalizing the collectibles they hold and recognizing as revenue the collectibles they receive as contributions. They contend that the value of such objects, like their beauty, is in the eye of the beholder, and only the most philistine

accountants would even consider placing a dollar sign on a "priceless" work of art. Moreover, works of art are not assets that can be associated with future cash receipts or savings. Rather, when retained, they are a drain on resources because they require ongoing protection. They can generate substantial amounts of cash only when sold (if the government or not-for-profit is allowed to sell them). To report them as assets, it can be argued, would result in financial statements that are as surrealistic as some of the art itself.

GASB Standards

The GASB encourages governments to capitalize their art and similar assets but does not require them to do so. Capitalization is not required if works of art meet the following conditions:

- They are held for public exhibition, education, or research in furtherance of public service, rather than for financial gain.
- They are protected, kept unencumbered, cared for, and preserved.
- They are subject to an *organizational* policy that requires the proceeds from sales of collection items to be used to acquire other items for collections.

For example, the City of Atlanta, Georgia, in its ACFR, FY 2024, in the notes to financial statements, stated: [5]

> The City has elected not to capitalize works of art and historical treasures based on its policy that these items are not held for financial gain. They will be preserved and any proceeds from the sale of the items will be used to acquire other collections.

Works of art and other collectibles that do not meet these conditions (e.g., a work of art held purely as an investment or acquired for an administrator's office that is not accessible to the public or for research purposes) must be capitalized. If governments do capitalize art or historical collections, then they should depreciate them *unless* they are inexhaustible; in other words, the "service capacity" of paintings and sculpture housed indoors—to be displayed for public viewing and enjoyment—diminishes so slowly with time that its useful life is extraordinarily long.

Governments should recognize contributions of collectibles as revenue just as if they had received other assets (i.e., per the guidelines discussed in Chapter 1 of course 21154F). However, if the items were to be added to noncapitalized collections, then the governments should offset the revenue with a charge to a program expense.

WHY AND HOW SHOULD GOVERNMENTS REPORT INFRASTRUCTURE?

A government's infrastructure is its capital assets that are generally stationary and can be preserved for a very long period, typically much longer than most other assets. They are of value only insofar