GUARDIANS OF THE FINANCE GALAXY

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Capital Assets: Bridging the GAAP Between Finance and Engineering

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Cucamonga Valley Water District

About Cucamonga Valley Water District and Chad

Am I That Old?

- District Stats
  - Enterprise Fund
    - 128 staff, $100 million Budget
    - $460 million net assets
    - $178 million LT Debt
    - 50,000 accounts, 200,000 pop.
  - Recent completion of AMR system
- Chad
  - 15 years, CPA
    - Budgets, CAFR's
    - 5 COP's, 4 RB's, 3 Leases
    - Rate Studies

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Capitalization

- Amount capitalized should be the cost of the asset AND ancillary charges necessary to place the asset into its intended location and condition for use

Acquisition Costs

- Common examples – legal fees, closing costs, land preparation costs, demolition costs
- Example – A district has acquired a parcel of land to construct a pump station. The parcel is on an extreme slope and requires substantial grading preparation prior to installation of the pump station. Should these costs be included in the costs of the asset to be capitalized?

Acquisition Costs

- Example – A city relies heavily on water provided from an external district and wishes to reduce its reliance on imported water. To do so, it decides to conduct a study to determine if there is adequate groundwater to construct new wells. Should the cost of the study be capitalized?

Improvements

- To qualify for capitalization, improvements must either
  - Increase an asset's useful life or;
  - Increase the capacity of an asset, i.e. increase the ability to deliver a larger capacity of water or add lanes to an existing roadway

GASB Q & A

- 7.17.6. Q—What constitutes a change in capacity or efficiency?
  - A—A change in capacity increases the level of service provided by an asset. For example, additional lanes could be added to a road or the weight capacity could be increased. A change in efficiency also increases the level of service, but without increasing the size of the asset. For example, the speed limit of a road may be increased after entrance and exit ramps are added to a state highway to convert it to an interstate highway.

Improvements

- A City has roads in need to improvements and decides to undergo a slurry seal project throughout the city. Should these costs be capitalized?

Improvements

- IT DEPENDS!
- A slurry seal project that allows the road to reach its estimated useful life is considered maintenance
- Slurry seal costs that allow a road to continue to be functional after it has reached its useful life are considered preservation costs

GASB Q & A

- 7.17 Costs expensed versus costs capitalized
  - 7.17.1. Q—Under the modified approach, costs for both maintenance and preservation of eligible infrastructure assets (for example, a network) should be expensed in the period incurred. Is this treatment different from traditional depreciation?
    - A—Yes. Maintenance costs allow these assets to continue to be used during their originally established useful life. Maintenance costs are expensed in the period incurred, regardless of the method of accounting for the assets. For assets accounted for using depreciation, **preservation costs extend the useful life of the assets beyond their previously established useful life**. For assets accounted for using the modified approach, preservation costs are what is intended to keep the assets at (or above) the condition level established by the government. Preservation costs are capitalized and depreciated if the assets are accounted for using traditional depreciation, but are expensed in the period incurred if the assets are accounted for using the modified approach.

GASB Q & A

- 7.17.2. Q—What are preservation costs?
  - A—Although the term is not defined in Statement 34, as amended, preservation costs generally are considered to be those outlays that (a) **extend the useful life of assets accounted for using traditional depreciation beyond what was established as the original estimated useful life** or (b) are intended to keep assets that are accounted for using the modified approach at (or above) the condition level established by the government but do not increase the capacity or efficiency of the assets. (See Question 7.17.1 for discussion of accounting for preservation costs.)

Joint Projects

- Government agencies sometimes take on joint projects
  - Example include construction of a bridge
  - Who should record the capital asset?
    - Whomever has title to asset?
    - Whomever manages or maintains the asset?
    - Split the asset down the middle?

Joint Projects

- Who owns title to the asset
  - When title is clear, the agency which holds title should record the capital asset
    - Although management may be the responsibility of another agency, ownership of the asset is clear and therefore be recorded as such
  - When title is unclear, the agency responsible for **management or maintenance** of the asset should record the capital assets

Project with Differing Components

- Scenario: A water district constructs a facility that consists of varying phases that are expected to be replaced as new technology arises and includes different components. It's estimated useful life is 50 years.

Accounting Treatment

- An entity has a few options which have been adopted over the years with varying success

- Option A: Record that asset as Water Treatment Facility at its historical cost and an estimated useful life of 50 years and call it a day

Option A

- Option A may result in headaches in the future
- It may be difficult to estimate deletions as they occur
- Accounting system may not be user friendly to modify partial deletions to an assets
- Organization may overcapitalize assets if it continues to add new assets that do not qualify as maintenance and continue to depreciate the original asset at its historical cost.

Option B

- Capitalize the asset in phases or in categories that can be tracked by their differing useful lives
- Advantages include easy recognition of deletions and replacements as needed or new technology replaces a significant process
- Reduces the risk of overcapitalizing assets
- Readily identifies maintenance vs capitalization expenses

Accounting Needs

When are the Auditors Coming?

- Documentation for Year End
  - Fixed Assets
    - Cost support
    - Details
    - Work In Process
  - Disposals
    - Old records
    - Gain on sale?

Documentation for Debt Funded Projects

Can They Stay out of Trouble?

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- Projects Receiving Other Funding Sources
  - Debt Funded
    - IRS Rules for Tax Exempt Issuances
    - Capital Leases
  - CDIAC Required Disclosure
    - Document Retention
    - Annual Reporting
  - Federal Grant Funds
    - Single Audit Compliance

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Work Flow

Can Engineers do Internal Control?

- Professional Skepticism
  - Internal Controls
  - Materiality
  - Purchasing Policy
  - Skeptical Review
  - Writing SOP

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Project Reporting

What is THIS?

- Reporting that Engineers Understand
  - Budget Remaining
  - Wages and Burden
  - Encumbrances
  - Accounting Entries

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Budgeting for CIP

Will the Project Ever get Done?

- Planning and Budgeting
  - Project List / Wish List
  - Delayed Completion
  - Abandoned Projects
  - Never Ending Story

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Construction in Process

- Should account for costs that are DIRECTLY identifiable with a specific asset
- Should include costs only if the construction of the asset is PROBABLE
  - Feasibility studies should not be capitalized as the results will determine if the project is probable or “feasible”

Construction in Process

- Best practice – review CIP listing throughout the year with others outside of finance
  - Project managers, engineers
  - Old projects with no activity are a red flag
  - Move projects out of CIP when asset is in use

Questions for Engineers

- Conversation between accountant and engineers
  - Accountant: Is the project completed yet?
  - Engineer: No, not until next year, I'll let you know when we're done
  - Translation: The project has been in use half of the fiscal year, we need to continue testing, complete our punch list and then call a landscaping company to beautify the front. Once the beautification is complete we will evaluate the status of the project.

Questions for Engineers

- What does in service mean for this asset?
- Instead of asking engineers if the project is completed ask pointed questions
  - Are customers being charged for water provided to them by this pipeline?
  - Are cars driving over the bridge yet?

Questions for Engineers

- Review of CIP
  - Are any of these projects replacing an old asset? (would indicate a deletion should occur)
- Prior to removing a project from CIP and recording one lump sum, revisit anticipated work to be performed on the asset with engineers
  - Does a component have a differing useful life than the rest of the asset that will need replacing?
  - Will a portion of the asset be replaced by new technology?

In Conclusion…

- Ask pointed question to engineers
- Consider recording projects as different components or phases
- Regularly review CIP with individuals directly involved with projects
- Take advantage of external resources
  - GFOA Accounting for Capital Assets
  - GFOA publications - https://www.gfoa.org/sites/default/files/GFR_APR_09_28.pdf
  - GASB Q & A

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Questions?

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