State/Local Governments and Public Institutions of Higher Education | Accounting for Fixed Assets

To manage your entities' fixed assets, you are required to follow the guidance promogulated by the Governmental Accounting Standards Board (GASB), Statement 34 and 35, as well as the Office of Management and Budget, Uniform Guidance (OMB–UG). Both represent the Generally Accepted Accounting Principles (GAAP) for state and local governments, including public institutions of higher education. These standards are subject to review by state, federal and independent auditors.

It is important to note that these pronouncements apply not only to state and local government agencies, but are also applicable to:

- Public utilities
- Public hospitals/healthcare providers
- Public colleges and universities
- Public benefit corporations
- Public school systems
- Community colleges
- Water/sewer districts
- City/county governments
- Government infrastructure (such as roads, tunnels, bridges, and lighting)
- Government-operated long-term care facilities

The overall goal of these statements and standards was to improve financial reporting and to provide more clarity for asset management and financial reporting for the state and local government departments and agencies.

The three guiding GASB principals that govern how the organizations manage their fixed assets include:

- GASB Statement No. 34: Basic Financial Statements and Management Discussion and Analysis for State and Local Governments
- GASB Statement No. 35: Basic Financial Statements and Management Discussion and Analysis for Public Colleges and Universities – An Amendment of GASB Statement No. 34
- GASB Statement No. 42: Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries

It should be noted that the GASB issued GASB 34 and 35 Implementation Guides – Questions and Answers for State and Local Governments – and for Colleges and Universities Using Business Type Activity (BTA) Reporting.

GASB Statements 34 and 35 require for the first time that all government entities use accrual accounting and depreciation for their capital assets. The effective dates for these statements were based upon the entity's annual revenue.

Furthermore, the GASB identified the following fixed asset classifications:

- Land
- Land improvements
- Easements
- Buildings
- Vehicles
- Machinery and equipment
- Works of art and historical treasures
- Infrastructure (such as roads, bridges, tunnels, water/sewer distribution systems, and lighting systems)

Capital Assets are to be reported at their historical cost, including freight and installation. Donated assets are to be recorded at their fair market value at the time of donation. Depreciable assets must be reported net of accumulated depreciation on the entity's statement of net assets. Non-depreciable assets must be reported separately. These assets, other than land, need to be depreciated over their useful lives in any "systematic and rational manner."

Infrastructure Assets are to be depreciated, unless the governmental entity elects to use the "modified approach" that requires a current inventory of the infrastructure assets, a condition assessment every three years, and the amount of funds is budgeted to maintain and preserve the infrastructure assets in a specified condition that is determined on an annual basis.

Works of Art and Historical Treasures are to be capitalized when held in a collection, if:

- They are held for public exhibition, education, or research (that are not for financial gain)
- They are protected and preserved
- The proceeds from their sales must be used to acquire other items in the collection

It should be noted that works of art and historical treasures will wear out (for example, items that are on public display, or that are being used for research) and their useful lives are shortened should they be depreciated. This is true whether they are individual items, or if they are held in/as a collection.

GASB Statement No. 42: Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries

Statement No. 42 contains guidance for measuring impairment losses on capital assets. Governments are required to report the effect of impairments when they occur rather than through depreciation expense or when the asset is disposed.

Prior to the issuance of Statement No. 42, governments were not required to report any decrease to an asset's carrying value except through depreciation. There was no published guidance for assessing and recording impairment losses.

In addition, there was also no guidance for the proper treatment of insurance recoveries. This statement provides guidance on both issues.

Statement No. 42 contains guidance for measuring impairment losses on capital assets. An asset is considered impaired when its usefulness for service decreases significantly and unexpectedly, that is, something occurs that is not within the normal life cycle of the asset.

When deciding if an impairment has occurred, a two-step process is required:

1. Identify any potential impairment
2. Test for impairment

The following are some common indicators that an impairment has occurred for which the asset should be tested:

- Physical damage to the asset
- The enactment of new regulations and standards, or changes in environmental factors, that the asset cannot meet, nor is it capable of being modified to comply with
- Technological advancement that makes an asset obsolete
- A change in manner or duration of the asset's use
- The end of construction (usually due to lack of funding)

When assessing for impairment, land is a separate capital asset and should not be grouped with buildings or depreciable improvements. This is important so that any unrealized gain in the fair value of the land will not offset any impairment found on buildings or other improvements.

The following are methods for measuring an impairment loss for assets that will continue to be used by the government:

- **Restoration cost approach:** The amount of impairment is the estimated cost to restore the utility of the asset. The estimated cost of the restoration is converted to historical cost by:
  - Restating the estimated restoration cost using an appropriate cost index
  - Applying a ratio of estimated restoration cost over the estimated replacement cost to the carrying value of the asset
- **Service units approach:** Determine the amount of the historical cost of the asset's service utility that cannot be used due to the impairment or change in circumstances. This is done by evaluating the service provided by the asset both before and after the impairment.
- **Deflated depreciated replacement cost approach:** Determine the cost of replacing the asset, taking into consideration the asset's current age and utility.

Statement No. 42 recommends one of the above measurement methods based on the type of impairment indicator:

- Use the restoration cost approach if physical damage to the asset has occurred.
- Use the service units approach if there was an enactment of new regulations, changes in environmental factors, or technological advancement has occurred.
- Use the deflated depreciated replacement cost approach or the service units approach if there has been either a change in manner or duration of use of the asset. Impaired assets that will no longer be used by the government or have been affected by a construction stoppage should be reported at the lower of their carrying value or fair market value.

Reporting: Impairment losses, unless considered to be temporary, should be reported in the:

- Statement of Activities
- Statement of Revenues, Expenses, and Changes in Fund Net Assets. If reported as a program expense, an impairment loss should be reported as a direct expense of the program that used the impaired asset.

Whenever there is an indication of an impairment, but impairment testing indicates there is no impairment loss, it is still a good idea to re-evaluate the asset's remaining estimated useful life and salvage value and change them if necessary.

When an impairment loss and an insurance recovery occur in the same year, the impairment loss should be reported net of the insurance recovery.

Our Experience

Kevin J. McHugh is a vice president with Maximus Asset Management and Valuation Services and the Higher Education Consulting Practice. Kevin brings more than 30 years of asset management and valuation consulting experience within the higher education and healthcare/academic medical centers, as well as the state, local and federal government community.

Kevin's experience includes assisting his clients in meeting their asset management, valuation and financial reporting requirements for their land, infrastructure, land improvements, buildings/building improvements, and moveable equipment asset classifications. Kevin's experience includes public/private partnerships, infrastructure valuation studies (such as utilities, airport, roads, bridges, railways, and tunnels), building componentization/cost segregation studies, asset impairment, intangible asset valuations, real and personal property portfolio analysis, and valuation services. Additional professional experience includes fixed asset inventory/tagging costing and valuation studies, real and personal property valuation studies, insurance valuation studies, and fixed asset outsourcing services. Kevin specializes in assisting clients to manage their financial reporting, asset stewardship, and compliance requirements for various reporting standards as promulgated by the Office of Management and Budget, Governmental Accounting Standards Board, Financial Accounting Standards Board (FASB), and Federal Accounting Standards Advisory Board (FASAB).

Kevin currently serves as a Task Force member/technical advisor to the GASB and the FASAB and is a frequent speaker on various valuation/property management topics for numerous professional organizations throughout the United States.

For additional information, you can contact Kevin at 215.514.4553 or email kevinjmchugh@maximus.com.