



WHEN TO CAPITALIZE VS. EXPENSE

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THE DECISION TO CAPITALIZE A PURCHASE RATHER THAN EXPENSE IT IS SEEMINGLY STRAIGHTFORWARD.

Does the acquisition cost more than your capitalization threshold? Will it provide benefits for more than one accounting period (useful life of more than one year)? The concept behind capitalization is to spread out the expense of the benefit throughout the duration the benefit is received. The useful life represents the anticipated duration of the benefit the acquisition will provide. The General Accounting Standards Board (GASB) Statement 34 published in 1999 provides the framework for State and Local government capital asset accounting. In paragraph 18, GASB 34 states the capital assets should be reported at historical costs, including ancillary charges to place the asset in service. This would include shipping and handling, set-up, and site-preparation. Training costs should not be capitalized. Donated assets should be capitalized at fair value including ancillary charges.

The following paragraph (GASB 34 paragraph 19) provides the definition of a Capital Asset as follows:

“The term capital assets includes land, improvements to land, easements, buildings, building improvements, vehicles, machinery, equipment, works of art and historical treasures, infrastructure, and all other tangible or intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period.”

OUTFITTING AN ILLINOIS STATE POLICE FLEET VEHICLE
Equipment typically installed after purchase; as shown on a 2013 Chevrolet Caprice PPV

Communications:		Electronics:	
Radio equipment: \$5,324	Repeater for extending radio coverage: \$10,536	Wireless laptop computer with Internet: \$4,500	Thermal printer: \$330
			Digital video camera: \$4,782

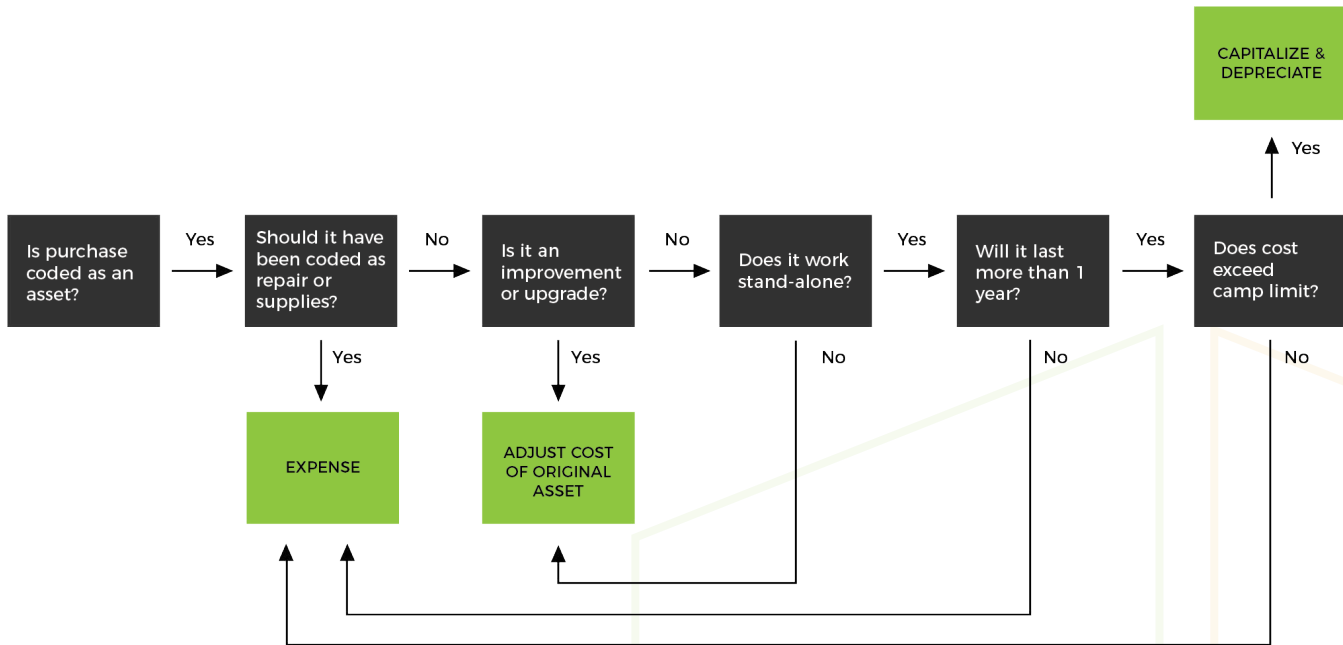
2013 Chevrolet Caprice PPV State paid about \$27,000 for each base vehicle

- 160-mph certified speedometer
- Six-speed automatic transmission
- Optional 6.0L V8 (V6 is standard)
- Heavy duty power four-wheel disc anti-lock brake system
- Transmission and power steering coolers
- Heavy-duty, 18-inch steel wheels with bolt-on center caps
- All-season tires

SOURCES: Illinois State Police; GM; Tribune reporting TRIBUNE

SO, WHAT DO YOU DO WHEN THE ACQUISITION IS NOT SO BLACK AND WHITE? WHAT RESOURCES DO YOU USE TO DETERMINE TO CAPITALIZE OR NOT AND HOW MUCH TO CAPITALIZE?

HCA Asset Management specializes in capital asset management, accountability, and valuation. Our staff assists public clients daily with asset capitalization and we frequently encounter scenarios that are not as simple as the rules state. We have created a Capitalization Decision chart to help bring the decision down to the most basic steps.



OFTEN OVERLOOKED, THE FIRST FEW QUESTIONS THAT SHOULD BE ASKED WHEN DETERMINING WHETHER OR NOT TO CAPITALIZE ACQUISITIONS:

1. SHOULD THE PURCHASE HAVE BEEN RECORDED AS A REPAIR OR SUPPLIES?

Just because the acquisition cost far exceeds the capitalization threshold it does not make it a capital asset. Bulk purchases, supplies, and repairs to equipment should not be capitalized.

2. IS THE ACQUISITION AN UPGRADE TO AN EXISTING ASSET?

If the purchase is an improvement or upgrade to an existing asset the original cost of the existing asset should be adjusted to properly depreciate the additional costs.

3. IS THIS A STAND-ALONE ASSET?

One item that can operate independently of others should be segregated and tracked as a unique asset. One item with add-ons that allow it to function should be capitalized together as one asset.

4. WILL THE ASSET PROVIDE BENEFIT FOR LONGER THAN ONE YEAR OR ONE ACCOUNTING PERIOD?

If yes, then it should be capitalized as a unique asset. Assets with indefinite useful life (Land, works of art) are to be capitalized with 0 useful life and not depreciated.

THE ASSET CLASSES IN WHICH WE MOST COMMONLY ENCOUNTER ISSUES ARE BUILDINGS, BUILDING IMPROVEMENTS, AND INFRASTRUCTURE.

BUILDINGS:

The construction costs of a new building are typically clear and should be capitalized, but be sure to capture the engineering, design, and architectural costs as part of the building's cost. Also be sure to review the invoices for the construction. Many times, moveable equipment will be purchased with the construction funds, but should be reclassified in your asset system. You do not want to carry the costs of equipment for 50 years when it could have been segregated and depreciated for 10 years or less. We also recommend some form of componentization when capitalizing a building.

Componentization is the practice of segregating construction costs by components of the building. A new building's roof will not last 50 years, therefore it is appropriate to segregate that portion of the construction cost to a shorter useful life. Componentization not only allocates the costs to appropriate useful lives, but it also allows for clearer accounting practices when replacements and retirements are needed. If your building's roof needs a complete replacement in 20 years, the accountants can simply retire the original roof component and add the roof replacement as a new capital entry.

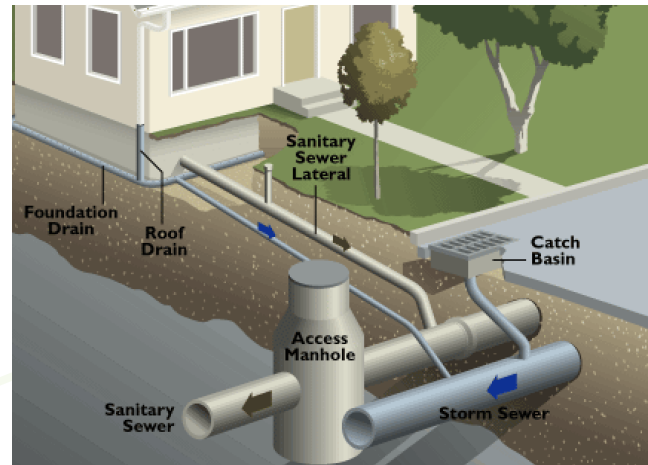


BUILDING IMPROVEMENTS:

Any time a project will occur for an existing capital asset, you should ask if it will improve the asset or if it is a repair or maintenance. An improvement provides additional value—it either extends the useful life or increases the service capacity. Painting the interior of a facility is maintenance. Redoing the tuckpointing of the exterior increases the useful life. A complete interior renovation will also increase the useful life. As with new building construction you will want to capture the design and planning costs as well as the construction. You will also want to review construction invoices for furnishing and fixtures as well as capital moveable equipment.

INFRASTRUCTURE:

This category includes roads, bridges, sidewalks, sewer lines, water lines, electrical utilities and more. The difficulty with infrastructure accounting is that the upgrades and replacements are seldom a clear one for one replacement. Many entities are great about capturing additions in these categories, but they rarely retire any portions. It is important to always ask if this is an addition to our total category or a replacement of existing infrastructure. For example, when a section of sewer line is replaced, the accountant needs to know how old the replaced section was. They can then enter a proportional retirement amount for the original pipe entry.



AT HCA, WE'RE HERE TO GUIDE YOU THROUGH THE ENTIRE CAPITALIZATION PROCESS.

When it comes to your Capital Asset Management, we offer the services you want with expertise you need. From external audit requirements to financial reporting and the control of fixed assets, we are proven performers that know how to get the job done right. Don't hesitate to reach out to us with any questions on when and how to capitalize your assets.