

Fixed Asset
Informational
Manual

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I. INTRODUCTION

The purpose of this manual is to introduce fixed asset accounting concepts and to provide you with assistance in understanding our City of North Royalton fixed asset system. The fixed asset system is a subsystem of the City's accounting system, and can be subdivided further into a "fixed asset accounting system" and a "fixed asset management system".

A "fixed asset accounting system" is a system of policies, procedures and methods for recording and reporting monetary amounts associated with fixed asset transactions.

A "fixed asset management system" is a system of methods, policies and procedures, which address the acquisition, use, control, protection, maintenance and disposal of assets.

Throughout this manual, the two subsystems will be discussed together as forming the City's fixed asset system.

II. FIXED ASSET DEFINITION

A fixed asset is defined as a financial resource meeting all of the following criteria:

1. It is tangible in nature.
2. It has an extended useful life.
3. It is not a repair part or supply item.
4. It has a value greater than the capitalization threshold established by the City or is considered to be an asset for which control (accountability) is desired.

The capitalization threshold dollar amount varies from entity to entity. The effect of setting a threshold dollar limit as fixed asset criteria is to create a category of assets that meet the first three criteria but are not classified as fixed assets because their original costs do not exceed the threshold. These are referred to as “controlled” or “critical nature” assets and would include assets that are sensitive, portable or prone to theft. For accountability a black property tag identifies “fixed assets” and “controlled assets” are identified with a yellow property tag.

Items meeting the fixed asset criteria are classified by major categories such as land, buildings, improvements other than buildings, furniture and fixtures, machinery and equipment, vehicles, infrastructure and construction-in-progress.

III. FIXED ASSET PURPOSES

These purposes may include financial statement information, insurable values, control and accountability, maintenance scheduling and cost analysis, excess asset management, accounting for depreciation, debt security, preparation of capital and operating budgets, and debt management.

A. Financial Statement Information

1. The Governmental Accounting Standards Board requires fixed asset reporting in order for a governmental entity to be in conformity with generally accepted accounting principles. A primary objective in the development of any fixed asset system for governmental entities planning to prepare their financial statements according to generally accepted accounting principles is the ability to meet the various requirements for correct and complete presentation of fixed asset financial information.
2. Governmental entities offering securities must meet fixed asset disclosure requirements.

B. Insurable Values

Complete fixed asset identification and valuation may prevent the local government from being over or under insured. In the event of a loss, property valuations, descriptions, and locations are necessary to insure full recovery under the insurance policy.

C. Control and Accountability

The fixed asset system can be used to maintain information regarding the location, responsible party and condition of public property. The system permits loss, theft, or damage to property to be identified by a comparison of the assets on hand and their present condition to the information found in the fixed asset records.

D. Excess Asset Management

If information regarding the use of the fixed asset is maintained, then those assets identified as “not in use” can be scrapped, salvaged, sold, or shifted to other departments. An excess asset list can be compared to the capital budget, purchase orders, or requisitions to save on unnecessary purchases.

E. Accounting For Depreciation

Depreciation of fixed assets must be recorded to determine total expense, net income, and changes in fund equity of proprietary and nonexpendable trust funds. The amount of accumulated depreciation plus the amount of depreciation expense for the current period must be maintained for reporting purposes.

F. Debt Security

Fixed assets in an Enterprise Fund may be used as security for debt issued to construct or improve assets of that enterprise fund.

G. Preparation of Capital and Operating Budgets

Fixed asset information regarding asset condition, useful life and repair costs permits management to prepare long-term capital budgets.

H. Debt Management

Being able to prepare a long-term capital budget allows management to identify both long and short term financing needs and to prepare to meet those needs.

IV. Fixed Asset Policies and Procedures

The purpose or purposes selected by the management determines the information that must be maintained within the fixed asset system. This documentation informs employees and other interested parties of management's expectations. The following are representative areas where fixed asset policies and procedures have been established.

Capitalization Criteria – criteria that must be met before an asset will be accounted for as a fixed asset.

Fixed Assets under Construction – the costs to be included on the cost of constructing the asset.

Additions – what constitutes an addition to an asset as opposed to routine maintenance.

Transfer of Assets – the transfer of assets between departments.

Retirements – disposal of fixed assets under certain conditions.

Capital Leases – reporting of a leased asset with a corresponding liability for the lease payments.

Asset Number – the asset numbers assigned and recorded to insure that specific assets can be identified.

Department – each asset will be assigned to a specific organizational unit, which will be responsible for the asset's location, condition and safekeeping.

Accumulated Depreciation – depreciation is calculated, computed and reported.

Asset Type – classes of fixed assets (see Class Codes)

Location

Description

Acquisition Date

Purchase Order Number

Vendor

Model & Serial Number

Estimated Life

Asset Account Number

V. ACCOUNTING FOR FIXED ASSETS

The appropriate accounting treatment for the acquisition of a fixed asset is governed by the fund type from which the fixed asset was purchased and the ultimate use of the asset.

A. Fund Categories

There are three categories of funds employed in governmental accounting, which are further classified into eight fund types.

1. Governmental Funds

Governmental funds are those funds through which most governmental functions typically are financed. A government's expendable financial resources and related liabilities, except those accounted for in proprietary funds are accounted for through governmental funds. The four governmental fund types are: general, special revenue, capital projects, and debt service.

2. Proprietary Funds

Proprietary funds are used to account for a government's ongoing organizations and activities that are similar to those found in the private sector. All assets, liabilities, equities, revenues, expenses and transfers relating to the government's business activities are accounted for through proprietary funds. There two types of proprietary funds: enterprise and internal service funds.

a) Enterprise Funds account for operations that are financed and operated in a manner similar to private business enterprises; where the intent is that the costs of providing goods or services to the general public on a continuing basis be financed through user charges. (Wastewater Department)

b) Internal Service Funds account for the financing of goods or services provided by one department or agency to other departments or agencies of the governmental unit, or to other governmental units on a cost reimbursement basis.

3. Fiduciary Funds

Fiduciary Funds are of two types, trust funds and agency funds. They are used to account for assets held by a governmental unit in a trustee capacity and/or as an agent for individuals, private organizations, other governmental units or other funds.

B. Fixed Asset Categories

Fixed assets may be classified in three categories: general fixed assets, fund fixed assets and infrastructure, depending on whether the asset is associated with a governmental or proprietary fund type operation.

1. General Fixed Assets

Fixed assets associated with governmental functions are known as general fixed assets. General fixed assets are not included in the balance sheets of governmental funds, but rather are reported at historical cost in a separate, self-balancing account group called “General Fixed Assets Account Group”. The cost of general fixed assets is summarized in the General Fixed Assets Account Group by categories such as Land, Buildings, Improvements Other Than Buildings, Furniture and Fixtures, Machinery and Equipment, and Construction in Progress. Sources of the money used to acquire general fixed assets may include individual funds, federal or state grants, taxes or debt proceeds. Source disclosure for general fixed assets is only required if a comprehensive annual financial report is prepared. If the government entity is unable to identify sources from prior years, source disclosure in the CAFR may begin with the year for which the statements are prepared.

2. Fund Fixed Assets

Fixed assets utilized in proprietary (Enterprise and Internal Service) fund activities or in Trust Funds are accounted for in the appropriate fund, and are referred to as fund fixed assets.

Enterprise fund fixed assets are capitalized (recorded) in the fund because the fixed assets are used in the production of goods or services provided and sold. In order to determine profit or loss, the expense of using these assets (depreciation) must be included as an operating cost.

Internal Service Fund fixed assets are recorded in the fund’s accounts for similar reasons. These assets are also directly related to fund operations, as in the case with enterprise fund fixed assets. Depreciation must be recorded to determine fund expenses, charges to departments, and changes in fund equity.

The identification of the source of fixed assets associated with an enterprise or internal service fund is required in order for the entity to be able to properly prepare financial statements in accordance with generally accepted accounting principles. Sources may include federal grants, special assessments, property taxes, contributions from other funds or developers and purchase or construction by the enterprise or internal service fund itself.

Fixed assets associated with trust funds are also accounted for in those funds. This requirement assists in assuring compliance with the terms of the trust instrument, provides a deterrent to mismanagement of trust fund assets, and facilitates accounting for depreciation where trust principal must be maintained intact.

3. Infrastructure

Infrastructure fixed assets – roads, bridges, curbs and gutters, streets and sidewalks, drainage systems, lighting systems and similar assets are reported within the fund from which funds are budgeted to construct and maintain such infrastructure. Those fixed assets belonging to an enterprise, internal service or trust fund must be recorded and reported within the fund.

C. Leased Assets

A review of each lease is necessary to determine whether the lease should be classified as an operating lease or capital lease. There are four criteria used to make this classification, the underlying issue being whether the benefits and risks of ownership are transferred from lessor to the lessee.

The purpose of the criteria is to establish the substance of the transaction and determine whether the lease is merely an extended rental agreement or actually an installment purchase in the form of a capital lease. If a lease is classified as a capital lease, the asset and a corresponding liability for the lease payments will be reported on the financial statements of the City.

VI. VALUING FIXED ASSETS

Fixed assets should be reported at cost or, if the cost is not practicable determined, at estimated cost. Donated fixed assets should be recorder at their estimated fair value at the time received.

Cost is defined as the cash price, or its equivalent, plus all other costs necessary to place the asset in its intended location and condition for use.

A. Sources of Cost Data

Sources of acquisition cost include: vendor invoices, vouchers, construction contracts, purchase contracts, real estate closing documents, insurance values, price lists, certificate of title and for land and buildings, the county auditor.

B. Existing Cost

Initial costs of fixed assets are usually ascertainable from contracts, purchase vouchers and other transaction documents at the time of acquisition or construction. However, governmental units are sometimes faced with the task of establishing fixed asset records after many years of operation without such records. It may be necessary to estimate the original cost of assets on the basis of documentary evidence available, and to record these estimated costs in the appropriate fixed asset funds.

One method of estimating original cost is to relate current replacement cost to the relevant price level at the acquisition date using the consumer price indexes.

C. Cost of Land

Items that are included as part of the acquisition cost for land are; purchase price, legal and title fees, appraisal fees, site preparation, including demolition of existing buildings, and damage payments. Improvement with limited lives, such as driveways, walks, fences, and parking lots are recorded separately as land improvements so they can be depreciated over their estimated lives.

D. Cost of Buildings

The cost of buildings includes all expenditures related directly to their acquisition or construction. These costs include; (1) purchase price, (2) direct materials, direct labor and overhead (indirect) costs incurred during construction, (3) fees, such as attorneys, architects and building permits, and (4) interest charges incurred during construction. All costs incurred, from excavation to completion of the buildings are considered part of the building costs.

E. Cost of Machinery and Equipment

The cost of machinery and equipment includes the purchase price, freight and handling charges, cost of special foundations, if required, assembling and installation costs, and costs of trial

runs. Costs thus include all expenditures incurred in acquiring the machinery or equipment and preparing it for use, plus the market value of any trade-ins or exchanges.

(a) Trade-ins – the cost of the asset when payment includes both cash and a trade-in is the sum of the cash paid plus the fair market value of the asset traded-in. If the fair market value of the asset being traded-in is not readily determinable, cost may be recorded as the cash paid plus the book value (cost minus depreciation) of the asset traded-in.

VII. COSTS SUBSEQUENT TO ACQUISITION

After fixed assets are acquired and made ready for use, additional costs are incurred that range from ordinary repair costs to significant additions. Costs incurred to achieve greater benefit should be capitalized, whereas expenditures that simply maintain a given level of services should be expensed.

Generally, the major types of expenditures incurred relative to existing assets are:

- A. Additions – increase or extension of existing assets. Any additions to assets are capitalized because a new asset has been created that increases the ability to provide service.
- B. Improvements and Replacements – substitution of an improved asset for an existing one.
- C. Repairs – expenditures that maintain assets in condition for operation. Ordinary repairs are expenditures made to maintain assets in operating condition; they are charged to an expenditure account in the period in which they are incurred on the basis that it is the only period benefited.

VIII. DEPRECIATION

The usefulness of most assets, other than land and construction in progress, declines over time and some type of write-down or write-off of cost is needed to indicate that the usefulness of an asset has declined. Depreciation is the term most often used to indicate that tangible assets have declined in service potential.

Depreciation is a means of cost allocation. The cost allocations approach (systematic charges of cost to income) is used because values are difficult to measure. The cost of an asset is charged as a depreciation expense over the estimated useful life of an asset. Depreciation is calculated in the following manner; the book value (original cost) of an asset minus accumulated depreciation. This method is called straight-line depreciation. The depreciation expense is the same for each year of the estimated useful life.

IX. DISPOSITION OF FIXED ASSETS

Assets may be retired voluntarily, or disposed of by sale, exchange, involuntary conversion, or abandonment. Regardless of the time of disposal, depreciation expenses for fund fixed assets should be taken up to the date of disposal and all amounts related to the retired asset should be removed from the accounts. Ideally, the book value of the specific asset would be equal to its disposal value. This is generally not the case, however, and a resulting gain or loss occurs.

Gains or losses on the retirement of assets should be shown in the income statements along with the other non-operating revenues/expenses that arise from ordinary business activities.

If an asset is scrapped or abandoned without any cash recovery, a loss should be recognized in the amount of the asset's book value. If scrap value exists, the gain or loss that occurs is the difference between the asset's scrap value and its' book value. If an asset still can be used even though it is fully depreciated, continue to carry the asset on the books at historical cost less its' related depreciation.

X. GLOSSARY

Acquisition - obtaining as asset by purchase, lease, loan, donation or construction

Acquisition date – date asset is acquired and becomes available for use

Average life – the normally expected duration of an asset

Capitalization threshold – a dollar amount established by the entity. Assets with an Original cost in excess of the threshold are capitalized while those assets with an original cost below the threshold are not reported as fixed assets but controlled assets.

Coding – associating a unique number with a particular asset

Controlled asset – property that fails the capitalization threshold criterion but is inventoried and controlled because of its’ sensitive, portable and/or theft prone nature.

Direct costing method – the method of using source documents to obtain the actual original cost

Disposal – a retirement of an asset that has become obsolete, or has exhausted its’ useful life.

Fiduciary type funds – expendable trust funds, non-expendable trust funds and agency funds

Fixed asset – any object tangible in nature, having a useful life longer than one year, not considered a repair part or supply item, and either having a value greater than the capitalization threshold or being considered a controlled asset

Fixed asset accounting – a system of methods, policies, and procedures for recording and reporting monetary amounts associated with fixed asset transactions

Fixed asset control system – a system of methods, policies, and procedures to determine if deviations have occurred between actual fixed asset data and recorded fixed asset data and how to bring those deviations into line with management’s objectives. A system of checks on the fixed asset system.

Fixed asset management system – a system of methods, policies and procedures to acquire, use, dispose, maintain, and safeguard assets

Fund fixed assets – fixed assets associated with Enterprise funds, Internal Service Funds or Trust Funds

General fixed assets – fixed assets not associated with the activity or Enterprise Funds, Internal Service Funds or Trust Funds

Government type funds – General Fund, Special Revenue Funds, Capital Project Funds, Debt Service Funds and Expendable Trust Funds

Infrastructure – also known as “public domain” fixed assets. Assets that are normally immovable and are of value only to the government unit

Normal costing method – an indirect method of estimating the original cost of an asset by using the reproduction cost new at time of appraisal and indexing it back to the estimated acquisition date

Original cost – cost of property at date constructed or installed

Proprietary type funds – Enterprise Funds, Internal Service Funds, and Non-Expendable Trust Funds

Replacement cost – the cost to replace an asset with one of equal usefulness. Usually used for budgeting the replacement of an asset; in some cases replacement cost and reproduction cost being the same

Reproduction cost – the cost to reproduce an asset of like kind with similar materials and techniques

Standard costing method – an indirect method of estimating the original cost of an asset by averaging the original cost of like, installed assets that were installed and acquired at about the time the asset in questions was installed and acquired

Surplus asset – an asset that is not currently in use but is still retained by the entity

Tagging – placing identifying information physically on an asset

XI. FIXED ASSET POLICY AND PROCEDURES

1) The City of North Royalton shall maintain a fixed asset accounting system. The fixed asset system shall maintain sufficient information to permit the following;

- a. the preparation of year-end financial statements in accordance with generally accepted accounting principles
- b. adequate insurance coverage
- c. control and accountability

2) The Finance Department is responsible for the development and maintenance of the fixed asset accounting system. The Finance Department shall develop and maintain procedures to insure compliance with all fixed asset policies. To insure control over City property, an individual in each Building and/or Department shall be assigned fixed asset responsibilities and be designated to work with the Finance Department.

3) Fixed assets are defined as those tangible assets of the City with a useful life in excess of one year and an initial cost equal to or exceeding \$1,000. Controlled assets are defined as those tangible assets of the City with a useful life in excess of one year and an initial cost equal to or exceeding \$100.

4) Fixed assets shall be classified as following:

- a) Land
- b) Buildings and Improvements
- c) Improvements Other Than Buildings
- d) Machinery and Equipment
- e) Furniture and Fixtures
- f) Motor Vehicles
- g) Construction in Progress
- i) Infrastructure
- j) Capital Lease

5) Fixed assets shall be recorded at historical cost or, if that amount is not determinable, at estimated historical cost. The method (s) to be used to estimate historical cost shall be established by the Finance Department. Donated fixed assets shall be valued at their (estimated) fair market value on the date received.

6) The purchase of fixed assets, the transfer of fixed assets between buildings or departments, and the disposal of fixed assets shall be initiated from within the department of ownership and require the approval of that department head. An asset to be disposed of with a current value in excess of \$100 shall be disposed of at auction. At the discretion of the department of ownership or the Finance Department,

any asset, regardless of value, may be sold at auction. An auction shall be held when sufficient assets have accumulated to warrant the cost.

7) Depreciation shall be recorded for fund fixed assets using the straight-line method. Accumulated depreciation shall be calculated on a straight-line basis and be recorded for all fixed assets.

8) The following information shall be maintained for all fixed and controlled assets;

- a) system number
- b) property identification tag number
- c) description
- d) activity code
- e) fund
- f) G/L asset account
- g) class codes
- h) building
- i) cost center
- j) G/L expense account
- k) department
- l) custodial code
- m) acquisition date
- n) quantity
- o) purchase order number
- p) serial number
- q) vendor or manufacturer
- r) make and model
- s) place in service date
- t) acquisition value
- u) estimated life
- v) accumulated depreciation
- w) net value
- x) disposal, transfer, trade-in, sale, auction information

9) A request for asset disposal, sale or transfer is to be completed by the originating department and submitted to the Finance Department. When an asset is scheduled for auction a copy of the Disposal/Transfer form shall also be submitted to the Mayor's office by the originating department.

10) Annually, the Finance Department shall prepare a master list of all City assets, a report of assets purchased, and a report of assets disposed of or transferred. Each department shall receive that portion of each report which relates to that building or department. It is the responsibility of each department to review and compare the reports to the fixed assets maintained in their area of responsibility. Any discrepancies are to be reported to the Finance Department in writing for resolution.

11) Periodic physical inventories shall be conducted to insure accountability for the assets of the City.

