Chapter 5
Accounting for General Capital Assets and Capital Projects

Dr. Chula King
The University of West Florida

Student Learning Outcomes

- Describe the nature and characteristics of general capital assets
- Account for the acquisition of general capital assets, including infrastructure assets
- Account for the maintenance and disposition of general capital assets
- Account for depreciation of general capital assets, including the modified approach for infrastructure assets.

Student Learning Outcomes

- Explain the purpose and characteristics of a capital projects fund
- Explain the typical sources of financing for capital projects
- Prepare journal entries for a typical capital project, both within the capital projects fund and within the governmental activities category at the government-wide level.
Student Learning Outcomes

- Explain and prepare journal entries for special cases such as:
  - Alternative treatments of project surpluses or deficits at completion
  - Original issue premiums or discounts and accrued interest on bonds issued
- Explain the concepts and accounting procedures for special assessment capital projects
- Prepare financial statements for capital projects funds.

General Capital Assets

- Long-lived assets used by activities accounted for by governmental fund types
- Distinguished from capital assets that are specifically associated with activities reported in proprietary and fiduciary funds.

Typical Classifications

- Land
- Buildings
- Improvements other than Buildings
- Machinery and Equipment
- Construction Work in Progress
- Infrastructure (e.g., roads, streets, bridges)
Typical Financing Sources

- Tax-supported bonds
- Grants from other governmental units (e.g., Federal or state grants)
- Transfers from other funds
- Gifts from individuals or organizations
- Special assessment bonds or taxes
- Capital leases

Accounting for General Capital Assets

- Capitalized in the governmental activities accounts at the government-wide level
- Depreciated at the government-wide level
- Debited to Expenditures in the appropriate governmental fund.

Acquiring Capital Assets

- From expenditures of
  - General fund
  - Special revenue funds
  - Capital project funds

Note: If money received from governmental units, individuals, or organizations is restricted for the purchase or construction of specified capital assets – it is recommended that a Capital Projects Fund be used.
Assigning Costs

- Follow Cost Principle (subject to materiality threshold)
  - Invoice cost or historical cost
  - All other necessary and reasonable costs to prepare asset for use (not forgone cash discounts and financing charges)
  - Capitalize interest on constructed assets
- Record donated assets at fair value on date of gift (unless received from another fund, in which case use lower of book value or fair value).

Accounting for Acquisition

Example: Purchased office equipment for the Mayor’s office and paid $30,000 cash from the General Fund.

<table>
<thead>
<tr>
<th>Governmental Activities</th>
<th>Dr.</th>
<th>Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equipment</td>
<td>50,000</td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td></td>
<td>50,000</td>
</tr>
<tr>
<td>General Fund:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Expenditures</td>
<td>50,000</td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td></td>
<td>50,000</td>
</tr>
</tbody>
</table>

Depreciation

- Depreciation on general capital assets, including infrastructure, is required at the government-wide level under GASBS 34.
- Depreciation is not recorded on inexhaustible assets, such as land and noncapitalized collections of art.
- The government can elect not to depreciate certain eligible infrastructure assets, under the modified approach (see next slide).
Election to Use Modified Approach

The government can elect not to depreciate certain “eligible” infrastructure assets if

• An asset management system is in place that includes
  • an up-to-date inventory of eligible assets,
  • condition assessments of the assets and summary of results using a measurement scale
  • estimates each year of the annual amount needed to maintain and preserve the assets at the established condition level
• The government documents that these assets are being preserved at or above the condition level established and disclosed.

Capital Leases

Follow SFAS No. 13 criteria to determine if the lease is a capital lease, rather than an operating lease

• Record capital assets in the government-wide statements in the amount of the present value of minimum lease payments or fair value, if lower
• Record an expenditure in the governmental fund that is using the asset and making the payments.

Example: Capital lease with present value of minimum lease payments of $50,000

<table>
<thead>
<tr>
<th>Governmental Activities</th>
<th>Dr.</th>
<th>Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equipment</td>
<td>50,000</td>
<td></td>
</tr>
<tr>
<td>Capital Lease Obligations Payable</td>
<td></td>
<td>50,000</td>
</tr>
</tbody>
</table>

| Special Revenue Fund                        |       |        |
| Expenditures                                | 50,000|        |
| Other Financing Source                       |       |        |
| Capital Lease Agreements                    |       | 50,000 |
Required Disclosure – Capital Assets

- Capitalization policy
- Policy for estimating useful lives of assets
- Beginning and end of the year balances, including accumulated depreciation
- Acquisitions during the year
- Sales or other dispositions during the year
- Depreciation expense for the current period
- Why collections (e.g., works of art or historical treasurers) are not capitalized

Post Acquisition Costs

- Additions/betterments vs. replacements/maintenance
  - Capitalize costs of additions and betterments; don’t capitalize replacements and maintenance expenditures
  - Some replacements might be partly additions or betterments; if so, capitalize as appropriate but remove cost of old asset
  - Requires judgment to determine whether an asset has been enhanced

Disposition of General Capital Assets

- Remove original cost of assets being disposed of. If only part of structure is demolished, remove a pro-rata share of the cost.
- Record in both the governmental fund and the governmental activities general journals.
Disposition of General Capital Assets

Example 1: Assume a machine is sold for $500. The asset had originally been purchased for $8,000 using GF revenues. It was fully depreciated.

<table>
<thead>
<tr>
<th>General Fund:</th>
<th>Dr.</th>
<th>Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>500</td>
<td></td>
</tr>
<tr>
<td>Revenues—Misc.(or OFS)</td>
<td>500</td>
<td></td>
</tr>
</tbody>
</table>

**Governmental Activities:**

| Cash         | 500 |
| Accumulated Depreciation | 8,000 |
| Machine      | 8,000 |
| Gain on Sale of Machine  | 500  |

Disposition of General Capital Assets

Example 2: Assume a fully depreciated building with an original cost of $100,000 (from tax-supported bonds) is demolished; cost of demolition was $5,000.

<table>
<thead>
<tr>
<th>General Fund:</th>
<th>Dr.</th>
<th>Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expenditures</td>
<td>5,000</td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td></td>
<td>5,000</td>
</tr>
</tbody>
</table>

**Governmental Activities:**

| Loss on Disposal of Building | 5,000 |
| Accumulated Depreciation    | 100,000 |
| Buildings                   | 100,000 |
| Cash                        | 5,000  |

Capital Projects Funds

Two types of capital projects:
- General (public benefit)
  - Examples: public buildings; roads, highways and bridges; park improvements; etc.
- Special assessment (private benefit)
  - Examples: street improvements, curbs, sidewalks, street lighting, sewage, etc. deemed to benefit citizens in a specified benefit district.
Characteristics of capital projects:
- Involves long-lived assets (e.g., buildings, roads and bridges, etc.)
- Usually involves a construction project
- Usually requires long-range planning and extensive financing
- Have a project-life focus, rather than a year-to-year

Project authorization/preconstruction phase
- Usually planned for in a multiyear capital improvement plan
- Usually requires long-term financing
  - Voter approval required for general obligation (tax-supported) bonds or special taxes for capital projects (memo entry only for bond/tax authorization)
  - Apply for and obtain grants
  - Obtain other forms of financing discussed on preceding slide

Illustrative Transactions
Assume approval is obtained for a $100,000 federal grant as partial funding for a city’s office building project. Upon approval the following journal entry would be made:

<table>
<thead>
<tr>
<th>Account</th>
<th>Dr.</th>
<th>Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Projects Fund:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Due from other Governmental Units</td>
<td>100,000</td>
<td></td>
</tr>
<tr>
<td>Revenues</td>
<td></td>
<td>100,000</td>
</tr>
<tr>
<td>Governmental Activities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Due from Other Governmental Units</td>
<td>100,000</td>
<td></td>
</tr>
<tr>
<td>Program Revenues-Capital Grants and Contributions-General Government</td>
<td></td>
<td>100,000</td>
</tr>
</tbody>
</table>
Illustrative Transactions

It may also be necessary to obtain interim financing, particularly to complete architectural and engineering design. Assume for the office building project, $50,000 was borrowed from the General Fund, to be repaid later from bond proceeds.

**Capital Projects Fund:**

<table>
<thead>
<tr>
<th>Dr.</th>
<th>Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>50,000</td>
</tr>
<tr>
<td>Due to General Fund</td>
<td>50,000</td>
</tr>
</tbody>
</table>

**Governmental Activities:**

No entry needed.

Illustrative Transactions

A contract was let in the amount of $50,000 with an architectural firm to complete the architectural design for the new city office building. The following entry would be required in the capital projects fund.

**Capital Projects Fund:**

<table>
<thead>
<tr>
<th>Dr.</th>
<th>Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Encumbrances</td>
<td>50,000</td>
</tr>
<tr>
<td>Reserve for Encumbrances</td>
<td>50,000</td>
</tr>
</tbody>
</table>

**Governmental Activities:**

No entry needed.

Illustrative Transactions

The architectural firm for which an encumbrance of $50,000 had been recorded (see preceding slide), tendered its final billing in the amount of $48,000. The city immediately paid the amount due.

**Capital Projects Fund:**

<table>
<thead>
<tr>
<th>Dr.</th>
<th>Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reserve for Encumbrances</td>
<td>50,000</td>
</tr>
<tr>
<td>Encumbrances</td>
<td>50,000</td>
</tr>
<tr>
<td>Construction Expenditures</td>
<td>48,000</td>
</tr>
<tr>
<td>Cash</td>
<td>48,000</td>
</tr>
</tbody>
</table>

**Governmental Activities:**

Construction Work in Progress 48,000
Cash 48,000
Assume that bonds with a face value of $5,000,000 were issued at 101 to finance the project.

**Capital Projects Fund:**
- Dr. $5,050,000
- Cr.
  - Other Financing Sources-Proceeds of Bonds $5,000,000
  - Due to Debt Service Fund $50,000

**Governmental Activities:**
- Dr. $5,050,000
- Cr.
  - Bonds Payable $5,000,000
  - Premium on Bonds Payable $50,000

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Project implementation/construction phase. The amount due from the federal government for the previously recorded capital grant was received in full.

**Capital Projects Fund:**
- Dr. $100,000
- Cr.
  - Due from Other Governmental Units $100,000

**Governmental Activities:**
Same entry.

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The $50,000 due to the General Fund was repaid.

**Capital Projects Fund:**
- Dr. $50,000
- Cr.
  - Due to General Fund $50,000

**Governmental Activities:**
No entry needed.
Illustrative Transactions

A contract was signed with Capital Construction Company in the amount of $5,050,000.

**Capital Projects Fund:**

<table>
<thead>
<tr>
<th>Dr.</th>
<th>Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Encumbrances</td>
<td>5,050,000</td>
</tr>
<tr>
<td>Reserve for Encumbrances</td>
<td>5,050,000</td>
</tr>
</tbody>
</table>

**Governmental Activities:**

No entry needed.

Illustrative Transactions

A partial billing of $3,000,000 was received from Capital Construction Company.

**Capital Projects Fund:**

<table>
<thead>
<tr>
<th>Dr.</th>
<th>Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reserve for encumbrances</td>
<td>3,000,000</td>
</tr>
<tr>
<td>Encumbrances</td>
<td>3,000,000</td>
</tr>
<tr>
<td>Construction Expenditures</td>
<td>3,000,000</td>
</tr>
<tr>
<td>Contracts payable</td>
<td>3,000,000</td>
</tr>
</tbody>
</table>

**Governmental Activities:**

<table>
<thead>
<tr>
<th>Dr.</th>
<th>Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction Work in Progress</td>
<td>3,000,000</td>
</tr>
<tr>
<td>Contracts Payable</td>
<td>3,000,000</td>
</tr>
</tbody>
</table>

Illustrative Transactions

The amount due to Capital Construction Company was paid, except for a 5% retained percentage, which in conformity with the provisions of the contract was withheld pending final inspection.

**Capital Projects Fund:**

<table>
<thead>
<tr>
<th>Dr.</th>
<th>Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contracts Payable</td>
<td>3,000,000</td>
</tr>
<tr>
<td>Contracts Payable—Retained Percentage</td>
<td>150,000</td>
</tr>
<tr>
<td>Cash</td>
<td>2,850,000</td>
</tr>
</tbody>
</table>

**Governmental Activities:**

Same entry.
Capital Construction Company completed the city office building project and tendered its final bill in the amount of $2,000,000.

**Capital Projects Fund:**
- Dr. Construction Expenditures 2,000,000
- Cr. Reserve for Encumbrances 2,050,000

**Governmental Activities:**
- Dr. Construction Work in Progress 2,000,000
- Cr. Encumbrances 2,050,000

The City paid the amount due Capital Construction, except for a 5% retained percentage.

**Capital Projects Fund:**
- Dr. Contracts Payable 2,000,000
  - Cr. Retained Percentage 100,000
  - Cash 1,900,000

**Governmental Activities:**
Same entry.

Upon final inspection, the City incurred $75,000 of additional costs for interior rework. This work was done by employees of the City’s General Fund. The remaining retained percentage was paid to the contractor.

**Capital Projects Fund:**
- Dr. Contracts Payable—Retained Percentage 250,000
  - Cash 250,000

(Cash of $75,000 was paid to General Fund; remainder to contractor)

**Governmental Activities:**
Same entry.
The project being complete the City closed all temporary accounts and transferred the residual equity to the debt service fund.

**Capital Projects Fund:**

<table>
<thead>
<tr>
<th></th>
<th>Dr.</th>
<th>Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proceeds of Bonds</td>
<td>5,000,000</td>
<td></td>
</tr>
<tr>
<td>Revenues</td>
<td>100,000</td>
<td></td>
</tr>
<tr>
<td>Construction Expenditures</td>
<td>5,048,000</td>
<td></td>
</tr>
<tr>
<td>Fund Balance</td>
<td></td>
<td>52,000</td>
</tr>
</tbody>
</table>

**Illustrative Transactions**

To close the accounts at the government-wide level

**Governmental Activities:**

<table>
<thead>
<tr>
<th></th>
<th>Dr.</th>
<th>Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Program Revenues-Capital Grant and Contributions-General Government</td>
<td>100,000</td>
<td></td>
</tr>
<tr>
<td>Net Assets-Invested in Capital Assets, Net of Related Debt</td>
<td></td>
<td>100,000</td>
</tr>
<tr>
<td>Building</td>
<td>5,048,000</td>
<td></td>
</tr>
<tr>
<td>Construction Work in Progress</td>
<td>5,048,000</td>
<td></td>
</tr>
</tbody>
</table>

**NOTE:** The premium on the bond payable should be amortized at the government-wide level, using the effective interest rate method (not shown here).

**Illustrative Transactions**

Transfer of residual equity:

**Capital Projects Fund:**

<table>
<thead>
<tr>
<th></th>
<th>Dr.</th>
<th>Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Other Financing Uses- Interfund Transfers Out</td>
<td>52,000</td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td></td>
<td>52,000</td>
</tr>
</tbody>
</table>

**Governmental Activities:**

No entry needed.
For the illustrative transactions:
- The building is included in the governmental activities Statement of Net Assets as a capital asset, net of accumulated depreciation.
- The long-term liabilities are reported in the governmental activities column of the Statement of Net Assets.
- Depreciation expense is reported at the government-wide level on the Statement of Activities as a direct expense of the General Government function.

For the illustrative transaction the Capital Projects Fund (CPF) is included as a separate column in the governmental funds financial statements, if it meets the criteria for a “major fund”; otherwise in the “Other Funds” column.
- The CPF is reported on the combining balance sheet and combining statement of revenues, expenditures, and changes in fund balances, along with other capital project funds.

At the government-wide level, as in business accounting, cash received from investors for interest accrued from the date of the bonds to the issue date is usually recorded as a credit to Interest Expense or Accrued Interest Payable
- At the fund level, this accrued interest is usually recorded as a revenue of the debt service fund. Though conceptually flawed, this simplifies budgetary control of revenues and expenditures in the debt service fund.
GASBS 34 required that governments prospectively capitalize interest payments made during the period of construction on self-constructed assets.

GASBS 37 reversed the GASBS 34 requirement. Thus, for general capital assets, interest expenditures incurred during construction should **not** be capitalized.

### Capitalization of Interest

### Multiple Years and Projects

Multiple-period projects
- Close Encumbrances at year-end to Fund Balance
- Reestablish Encumbrances balance at the beginning of the next fiscal year (Dr. Encumbrances and Cr. Fund Balance)

Multiple-projects capital projects funds
- Use project name or other designation to identify Encumbrances and Expenditures accounts with the project.

### Special Assessment Projects

Special assessments are compulsory tax levies made against certain property to defray the cost of specific improvements.
- A special assessment district may be called a “local improvement district.”
- The construction phase of the improvement project is accounted for in a CPF.
- If long-term debt is issued to raise funds to make the improvements, then the debt service phase is shown in CH 6 in the DSF.
- The installment receivable for the special tax levy is accounted for in the GF.
- If the government is not obligated in some manner for any special assessment debt issued for the project, the receivable is accounted for in an Agency Fund.
Concluding Comments

- Capital assets used in governmental activities are referred to as “general capital assets.”
- Capital assets are also used in business-type and fiduciary activities (discussed in Chapters 7 and 8, respectively).
- GASBS 34 requires capitalization of general capital assets, including infrastructure, in the government-wide statements as well as depreciation (except if the modified approach is chosen for infrastructure assets).

The Next Step

- Chapter 5 City of Smithville simulation. Due no later than midnight CDT on June 12.
- Chapter 5 CAFR assignment. Due no later than midnight CDT on June 12.
- Problems 5-2, 5-3, 5-4 and 5-7.