

## Establishing a Capital Asset Accounting System

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Dear Reader:

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We hope this information will be useful to you; reference to it will assist you with many of the questions that will arise in your tenure with municipal government. However, the *Tennessee Code Annotated* and other relevant laws or regulations should always be consulted before any action is taken based upon the contents of this document.

Please feel free to contact us if you have questions or comments regarding this information or any other MTAS website material.

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## Establishing a Capital Asset Accounting System

Reference Number:  
MTAS-629

In most small and medium-size cities, establishing a CAAS is not a major undertaking. However, planning, direction and cooperation are needed to achieve satisfactory results.

The following steps are suggested to establish the initial capital asset record:

- Assign one responsible individual the task and authority for establishing capital asset records.
- Take an initial physical inventory to collect all essential information. Description, assigned department, location, model number, serial number, manufacturer, size, and capacity are a few of the suggested identifying characteristics of each asset.
- Establish a value for all capital assets. Use historical cost records if available, or estimate value. Documentation is important.
- Complete and file an individual property record card or computer file on each capital asset.
- Label or tag capital assets. Adhesive metal tags or labels are convenient for marking each asset.

## Designating a Responsible Official

Reference Number:  
MTAS-630

We recommend that the office of the chief fiscal officer be responsible for the CAAS because this office keeps general ledger control accounts and many of the source documents used to process and file property information. The chief fiscal officer, or deputy, acting as property accounting officer, should control the identification of equipment, detailed records, physical inventory planning, entries in the books of account and report preparation. Centralizing this responsibility results in a more efficient and accurate system than maintaining it in individual departments. The official assigned to establish the CAAS will need the cooperation and assistance of all department heads during system establishment, annual inventories, and on other occasions.

## Initial Inventory

Reference Number:  
MTAS-632

The next step in establishing the CAAS is taking a physical inventory and preparing the initial database. Make every effort to obtain a complete record of all capital assets owned by the city. The chief administrative officer should inform all department heads and agencies that capital asset controls have been established and announce the person who is responsible for them. Each department should designate a person to assist in taking inventory for that department. The city's size should determine if a formal meeting of department heads is required.

## Valuing Capital Assets

Reference Number:  
MTAS-633

After conducting and reducing to paper a complete physical inventory, the next step is to assign a dollar value to each capital asset identified. Where possible, capital assets should be recorded at historical cost. While this step can be time consuming, actual costs usually can be found through searching prior years' financial records and source documents. The objective is to determine the initial investment, not the present market or replacement value. If you cannot determine cost, the following alternatives can be used, in this order, to determine the value of capital assets:

1. Estimated market value at the time of purchase or construction; or
2. Fair market value (or appraised value) at the time when establishing the capital asset records.

During GASB Statement 34 implementation, Phase 1 and Phase 2 cities had to go back to 1981 to pick up infrastructure assets. Phase 3 cities — those with less than \$10 million in revenues recorded in their fiscal year 1999 audit — simply picked up new infrastructure from the date of implementation. GASB Statement No. 51 had the identical implementation phase in for intangible assets as used for GASB Statement No. 34. If no historical records exist or fair market value cannot be determined, a city could take current replacement costs and deflate the amount using a pertinent index such as the

Consumer Price Index. If no better records exist, a city could hire an expert to estimate cost. Finance personnel could consult an external auditor during this process to determine if their cost data are acceptable for financial statement presentation.

## Individual Property Records and Filing System

Reference Number:  
MTAS-634

A subsidiary ledger card system should be adequate for small- and medium-size cities. Cities with computer capabilities probably will want to computerize their CAAS records. A separate card should be prepared for each unit of property (any item that can be readily identified and accounted for individually or any group of items, such as chairs, purchased at the same time).

This record of individual properties constitutes the subsidiary ledger. The total of the amounts shown on the subsidiary ledger cards corresponds to the control totals for the capital assets.

The following information should be on each individual property card:

- Asset number, including the class code;
- Sequence or payment voucher number;
- Date of acquisition;
- Name and address of vendor;
- Abbreviated description;
- Department, division and unit charged with custody;
- Location;
- Cost;
- Fund and department from which purchased;
- Method of acquisition;
- Estimated life;
- Date, method, and authorization for disposition; and
- Depreciation method and annual depreciation expense.

Once information has been entered on the asset ledger card, the next step is to develop a filing system to provide controls. Group the cards first by department. In the case of equipment, this usually amounts to grouping by location. Within each department or location, arrange the cards according to the classification of capital asset (i.e., land, building, infrastructure). Further subdivisions may be advisable if justified by the number of cards. For example, equipment could be divided into automotive, construction, office, etc.

Before completing the property card, assign and attach an individual asset number to each asset. This number should appear on the property card. Assigning each item a permanent number provides the necessary link between asset and property record card.

There are a number of adequate numbering systems for recording capital assets. A simple, flexible system might be a numerical sequence code system, with an alpha prefix. The alpha prefix classifies the asset according to the seven classes recommended for accounting and statement presentation purposes (L: land, B: building, I: infrastructure, O: improvements other than building, E: equipment, N: intangibles and C: construction in progress). This code numbering system might also identify the department and asset number.

## Proper Marking of Capital Assets

Reference Number:  
MTAS-635

Regardless of the code system you adopt, you should assign individual asset numbers and permanently affix them to each asset. You can attach the identification number to the asset through labels, tags, decals, epoxy paint or other appropriate method. Attach the number in a conspicuous place where it will not be worn or knocked off. Try to standardize the location.

It may not be practical to place a number on some items. In these cases, assign numbers, and indicate on the cards that the number is not present.

## Maintaining a Capital Asset Accounting System

Reference Number:  
MTAS-637

Once you establish a CAAS, proper maintenance is imperative. All accounting systems require current and accurate information to be meaningful. The best capital asset records can quickly become outdated if they are not maintained. Conversely, the most elementary records will become more accurate if properly maintained.

In small cities it may be sufficient to update the capital asset records at the close of each fiscal year. Large cities may require monthly updates.

We suggest that the person paying or approving invoices prepare a preliminary list of all items to be accounted for in the CAAS. Establish definite accounting procedures to ensure proper recording of asset purchases, sales, transfers and retirements.

## Sources of Cost Information

Reference Number:  
MTAS-638

The obvious source of information about capital assets are vendors' invoices or contracts. Another source of information are minutes from past governing body meetings. If historical records are unavailable, use a replacement value and deflate that amount to the original purchase date. In some cases, using an expert or appraiser may be acceptable to arrive at an estimated cost.

Close cooperation with the property accounting officer is required in cities where a purchasing agent handles surplus property sales, interdepartmental transfers of equipment, or retirements.

Where department heads control the purchase, movement, and disposal of assets, you should design procedures and reports to give the property accounting officer prompt notice of any changes affecting capital assets.

## Disposing of Capital Assets

Reference Number:  
MTAS-640

Capital assets may be sold, lost, junked or traded for new assets. Regardless of the manner of disposition or the amount of proceeds, remove the asset from the CAAS at its recorded value.

The capital asset card should show clearly the method of disposal and, if sold, the amount of money received.

In order to furnish necessary information on fixed asset changes, those responsible should fill out a form such as the one found later in this section, and transmit it immediately to the property officer.

## Cost Subsequent to Acquisition

Reference Number:  
MTAS-646

**Maintenance** is an expenditure that neither materially adds to the value of property nor appreciably prolongs its life. Maintenance keeps the property in ordinary efficient operating condition. Maintenance costs do not add value and should not be recorded in the CAAS. Paving or resurfacing roads is an expense while construction of new roads would be recorded as infrastructure.

**Betterment** is the replacement of a unit of an existing asset by an improved or superior unit, usually resulting in a more productive, efficient or longer-lived asset. Significant betterments are capital assets and should be added to the value of the property improved on the CAAS.

Before recording the cost of additions to capital assets, determine that the expenditure has bettered the asset. Analyze expenditures and add the part that bettered the asset to the value of the asset. Treat the part that only restored the asset to its former operation as a current expense.

## Physical Inventory

Reference Number:  
MTAS-639

To ensure that the system is functioning as intended, the city should initially take a complete inventory of capital assets every three or four months. The inventory should agree with the records maintained in the CAAS.

After determining that the system is operating properly, an annual physical inventory (coinciding with the end of the city's fiscal year) should be sufficient. In the interest of internal control, the property accounting officer should check inventories randomly and unannounced.

We recommend that you require strict accountability for the use and care of capital assets. Make an investigation of any shortages or overages in cooperation with the department involved.

Frequently such conditions are due to the lag in recording acquisitions, transfers, and dispositions. Report any unexplained shortage to the head administrative or chief fiscal officer. Make adequate written explanation of all items accounted for and be available for any administrative or legislative inquiry regarding discrepancies.

It will simplify taking inventories if the property accounting officer provides a current listing, in numerical order, of the equipment charged to each department. This list should provide space for checking each item present, noting exceptions and certification.

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