



ACCOUNTING FOR FIXED ASSETS

HUD's Real Estate Assessment Center (REAC) is requiring all Public Housing Authorities (PHAs) to electronically file financial information that has been prepared in conformity with Generally Accepted Accounting Principles (GAAP). This is the second in a series of REAC documents called "GAAP Flyers" which are designed to assist PHAs in implementing these new requirements. This Flyer provides guidance on accounting for fixed assets and corresponding depreciation of those assets under GAAP. It has been prepared for REAC by the accounting firm of PricewaterhouseCoopers LLP.

FORMER HUD ACCOUNTING

Cost is the basis for fixed assets. Formerly, HUD had preferred that not only costs associated with the actual purchase of capital assets and any major additions in the form of additional construction and improvements, known as "hard costs," be capitalized (recorded as assets). Administrative and other costs that did not add value to the buildings, known as "soft costs", associated with modernization and development, were accumulated into fixed asset accounts and capitalized. After these costs were captured, they remained in this account and were not depreciated. This method of accounting for fixed assets is not in accordance with GAAP.

Under the former rules, the above costs were accumulated in property ledgers and the totals were then posted to the Development account, the Modernization account, or the Fixed Asset account in the general ledger. This means that the detail of the fixed assets is not in the general ledger accounts, but are summarized in the cost

ledgers. It also means that as new assets were added and, in many cases, the old ones were not removed, therefore the PHA effectively accounted for the same asset twice.

GAAP METHODOLOGY

HUD now requires that all accounting records, including those for fixed assets, be kept using GAAP accounting. The GAAP basis for the treatment of fixed assets for governmental and enterprise funds comes from NCGA Statement No. 1, *Governmental Accounting and Financial Reporting Principles*. This Statement says, in

part, that fixed assets are recorded at cost in the fund accounts of an enterprise fund or in the General Fixed Asset Account Group (GFAAG), a memorandum group of accounts that is not a fund but that is used to account for fixed assets acquired by governmental funds. REAC's conclusion, as per GAAP Flyer Number 1, is that the enterprise fund method of accounting should be utilized. Under either method, the basis for the fixed assets is cost or, if cost is not practically determined, at estimated

cost. Donated fixed assets should be recorded at their estimated fair value at the time received.

Determination of Costs to Capitalize

The first difference between GAAP and the former HUD accounting rules is in the determination of those costs that should be capitalized. Under GAAP, only those costs actually relating to the purchase of new assets or the construction or improvement of a project should be capitalized. These are basically the costs that formerly were referred to as "hard costs" which added value to the building. All other costs associated



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with these assets or projects should be expensed. This would also include all routine maintenance and repair.

This means that some costs previously capitalized now will be expensed. These are basically the costs formerly referred to above as "soft costs." Some examples of soft costs are costs incurred for:

- Security officers
- Relocation costs
- Relocation specialists salaries
- Management improvements
- Mental health liaison
- Rent collection costs
- Emergency maintenance, to the extent that it is in fact repairs

When land is purchased for a construction of a building, its cost includes the amount paid for the land plus real estate commissions, escrow and legal fees, fees for examining and insuring the title, and any accrued property taxes paid by the purchaser. The cost of land improvements that produce permanent benefits, such as landscaping, sewer installation, and special assessments by a government body for paying for paving and street lights, may all be included in the land account. Because land and land improvements provide benefits indefinitely and an outside agency replaces and maintains such improvements, depreciation is inappropriate. Conversely, the cost of improvements that provide benefits over limited periods, such as fences and parking lots, and those items listed above that are not maintained by an outside agency, should be recorded separately in an improvements account and depreciated.

The cost of buildings should include not only the cost of the structure itself but also the costs of all permanent equipment and fixtures necessary for the intended use of the structure, such as boilers, furnaces, air conditioners, elevators, permanent floor covering, wiring, and lighting fixtures. All of the costs necessary to obtain the building and to get it into condition for its intended use should be included in the cost of the building. Additional costs incidental to the purchase, such as attorneys' fees and building permits, should be capitalized along with the purchase cost. For enterprise funds, one of these additional costs is interest expense incurred during the construction of the asset.



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Capitalization of Interest During Construction

The basic rules for interest capitalization are set forth in Statement of Financial Accounting Standards (SFAS) No. 34, *Capitalization of Interest Cost*. Under this statement, interest incurred throughout the construction period of a project should be included as part of the cost of the asset under construction rather than reported as an expense of the period. The construction period extends from the initial preconstruction activities (e.g., obtaining necessary permits) until an asset is ready to be placed into service.

The amount of interest to be capitalized is calculated by multiplying the interest rate on the related borrowings (debt incurred for construction purposes) by the weighted average of the expenditures for the period. For example, assume that the entity borrowed \$10,000,000 at 5 percent and began construction at the beginning of the period. Also, assume that the weighted average of the entity's spending for construction throughout the year was

\$7,000,000. In this example, the capitalized interest would be \$350,000 (\$7,000,000 X 5%).

SFAS No. 34 also requires capitalization of interest even when the entity did not have specific borrowings for a particular construction project but had other unpaid outstanding debt and

used its existing funds for construction instead of repaying the existing debt. In this case, the interest rate used in the calculation would be the weighted average interest rate on the entity's outstanding debt.

SFAS No. 62, *Capitalization of Interest Cost in Situations Involving Certain Tax-Exempt Borrowings and Certain Gifts and Grants* modifies the provisions of SFAS No. 34 for tax-exempt debt that is externally restricted for the acquisition of specified assets. Under SFAS No. 62, the amount of interest to be capitalized is the difference between total interest expense on the total amount borrowed (in this example \$10,000,000) and total interest earned on the proceeds of the debt that have been temporarily invested. Using our example above, we would assume that the average investment of borrowed funds was \$3,000,000 earning 6%. Therefore, the interest capitalized (ignoring the tax effects of rebatable arbitrage) is illustrated at ***Exhibit 1***:

Exhibit 1: Capitalization of Interest Cost	
Interest expense ($\$10,000,000 \times 5\% \times 1 \text{ year}$)	\$500,000
Less: interest income ($\$3,000,000 \times 6\% \times 1 \text{ year}$)	<u>(180,000)</u>
Capitalized interest	<u>\$320,000</u>

Under SFAS No. 62, it is possible to generate “negative interest capitalization”. Interest earnings could exceed interest expense for a time. This could result in a net decrease in the capitalized cost of the assets under construction.

SFAS No. 62 also provides that interest should not be capitalized for expenditures financed by capital grants externally restricted for the acquisition of specific assets. The reasoning is that entities incur no interest expense when construction is funded by outside parties.

Subsequent Expenditures – Expense or Capitalize

Many costs are incurred for project assets after the entity begins to use them. Some of these costs represent normal repair and maintenance activity, whereas other costs represent significant alterations to the assets, such as the addition of several floors to an existing building. A determination as to whether these types of costs should be recorded as building improvements (an asset) or as an expense must be made.

The general guideline for accounting for expenditures made after acquisition is that if the expenditures provide additional service potential beyond the current period, they should be capitalized; if they do not provide additional service potential, they should be expensed as incurred. An entity may produce future service potential by making current expenditures that:

1. Extend the useful life of an asset.
2. Increase the quantity of services provided by an asset.
3. Increase the quality of services provided by an asset.

If an expenditure causes one or more of these results, then, according to the historical cost and matching principles (requiring the matching of costs and related revenue) of GAAP the entity should debit the asset account. Through depreciation charges, the entity will then match the cost against the revenues generated over the estimated benefit period.

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Even though the guideline for distinguishing between expenditures that should be currently expensed and those that should be capitalized is conceptually clear-cut, it is not always straightforward in practice. Many entities, as a matter of expediency, expense all costs incurred below a certain amount (e.g., \$1,000) on the basis of materiality. This practice makes it unnecessary to distinguish between capital expenditures and current expenditures for those costs. If this policy is established, it should be put into writing and applied consistently.

Entities incur many costs to keep assets in normal operating condition. Costs are associated, for example, with maintenance of machinery, cleaning of buildings and machinery, replacement of minor parts, and painting. These activities do not add to the benefits provided by the plant asset; they merely enable the asset to provide the benefits expected of it. Therefore, costs of such activities should be expensed as they are incurred.

Cost Basis When Assets Are Replaced or Traded-In

When an entity acquires a new asset and disposes of an old asset of like kind and PHAs are able to identify the cost and accumulated depreciation associated with the old asset, PHAs should eliminate the cost of the old asset from the accounts and record a gain or loss on its disposal. Then PHAs can debit the cost of the new asset to the proper asset account. Assume that the entity had an air conditioner that originally cost \$40,000 and had recorded accumulated depreciation in the amount of \$35,000.

If the entity could not determine the exact cost, the entity should estimate the cost and the depreciation taken to date. Assume the replacement unit had a cost of \$70,000. **Exhibit 2** illustrates the entries required to account for this transaction if the PHA uses Enterprise Fund accounting:

Exhibit 2: Asset Disposal and Replacement - Enterprise Fund Accounting		
	DR	CR
Accumulated depreciation	35,000	
Gain from disposition	5,000	
Building		40,000
<i>To remove the old asset</i>		
Building	70,000	
Cash-unrestricted		70,000
<i>To record the new asset</i>		

Exhibit 3 illustrates the entries required to account for this transaction if the PHA uses Governmental Fund accounting:

Exhibit 3: Asset Disposal and Replacement - Governmental Fund Accounting

(GFAAG)	DR	CR
Accumulated depreciation	35,000	
Investment in general fixed assets	5,000	
Building		40,000
<i>To remove the old asset</i>		
 (GFAAG)		
Building	70,000	
Investment in general fixed assets		70,000
<i>To record the new asset</i>		
 (Capital Projects Fund)		
Expenditure-capital outly	70,000	
Cash-unrestricted		70,000
<i>To record paying for the asset</i>		

The entry to record this transaction in a governmental fund is illustrated at **Exhibit 5**:

Exhibit 5: Old Asset Traded-in On A New Asset - Governmental Fund Accounting

(GFAAG)	DR	CR
Accumulated deprreciation	12,000	
Furniture, equipment and machinery	21,000	
Furniture, equipment and machinery		15,000
Investment in general fixed assets		18,000
<i>To record trade-in of asset</i>		
 (Capital Projects Fund)		
Expenditure-capital outlay	18,000	
Cash-unrestricted		18,000
<i>To record paying for the asset</i>		

As a practical matter, since most assets are fully depreciated when sold or traded-in, there would be no gain or loss to record.

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The above entries for the enterprise fund would generate a new vehicle with a depreciable basis of \$21,000 (Cash in the amount of \$18,000 plus the undepreciated basis of the old vehicle of \$3,000 (\$15,000 -\$12,000)).

In some instances, an old asset is traded-in on a new asset and the resulting charge to the entity is the difference in value between the new and the old assets (book or recorded value). This is commonly the situation when PHAs purchase a new vehicle to replace an old one. Assume that the entity had a vehicle originally costing \$15,000 and had recorded accumulated depreciation of \$12,000. The new vehicle can be purchased by trading-in the old vehicle and cash in the amount of \$18,000. The entry to record this transaction in the enterprise fund is illustrated at **Exhibit 4**:

Exhibit 4: Old Asset Traded-in On A New Asset - Enterprise Fund Accounting

	DR	CR
Accumulated depreciation	12,000	
Furniture, equipment and machinery	21,000	
Furniture, equipment and machinery		15,000
Cash-unrestricted		18,000
<i>To record trade-in of asset</i>		

Account Numbers

The Financial Data Schedule Line Definitions and Crosswalk Guide issued by HUD on December 4, 1998 recommends that the costs for all fixed assets, as discussed above, be recorded into the following accounts and account numbers to facilitate the associated reporting on the Financial Data Schedule:

Exhibit 6: HUD Recommended Fixed Asset Accounts

1400.6	Land
1400.7	Buildings
1400.8	Furniture, equipment and machinery – dwellings
1400.9	Furniture, equipment and machinery – administration
1400.10	Leasehold improvements
1400.5	Accumulated depreciation structures and equipment

ASSET CONVERSION

The PHA should currently have detailed records of all of its fixed assets recorded in its fixed asset accounts as formerly required by HUD. The existence of property ledger records is not a new requirement resulting from the conversion to GAAP, but rather a management of assets compliance issue because under ALL HUD agreements the PHAs are supposed to maintain property records in accordance with the requirements of Public and Indian Housing Low-Rent Technical Accounting Guide, 7510, dated January 1996. **The absence of property records** should have generated a compliance finding in the OMB Circular A-133 compliance report. If these records do not exist, we will discuss guidance in obtaining this information later.

Examination of Current Fixed Asset Records

The first step in the conversion process should be to determine what fixed assets the PHA currently has in its property records. These assets should be sorted into the following classifications:

- ◆ Land
- ◆ Buildings
- ◆ Building improvements
- ◆ Furniture and fixtures - Dwelling
- ◆ Furniture and fixtures – Administration
- ◆ Equipment – Dwelling
- ◆ Equipment - Administration

This process may be accomplished by obtaining the original development cost certificates and the modernization cost certificates and any other grant-related closeout documents. These documents can then be used to segregate the costs that should be capitalized from those that now should be expensed, i.e. “soft costs.” A simple procedure to use would be to accumulate all costs on a spreadsheet with columns categorized for cost to be capitalized, per the guidance above, and costs that should be expensed, also per above, for each asset. This allocation should equal the “hard” and “soft” costs for each asset as originally accumulated. This would assist in accumulating sufficient cost information to generate subsequent conversion entries. The totals of these columns, both hard and soft costs, should agree with the total costs for fixed assets as shown on the PHAs existing accounting records under the former HUD accounting.

Allocation of Costs

This allocation of costs between those to be capitalized and those to be expensed should only be required for the costs

relating to buildings and building improvements. The former concept of “hard costs” and “soft costs” did not normally apply to assets other than buildings and building improvements.

As the information is accumulated for the cost of the assets, the dates that each asset was put into service must also be determined. This date will be required to compute the amount of accumulated depreciation to be recorded for the depreciation that should have been recorded in prior periods in accordance with GAAP. Therefore, the easiest way to capture this information may be to break this information down on the spreadsheet by year that the assets were placed into service.

Estimation of Costs When Historical Costs Are Unknown

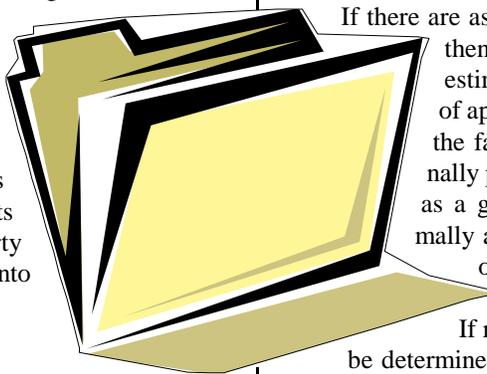
If there are assets for which costs cannot be determined, then estimated costs should be used. These estimated costs are best determined by the use of appraisals and having the appraiser determine the fair value at the dates the assets were originally put into service. Insured values can be used as a guide for estimation purposes but are normally at replacement cost (today’s value) and not original cost.

If replacement cost is the only cost, which can be determined, then the effect of general inflation since the asset was acquired should be removed. This can be accomplished by obtaining the current year and acquisition year Consumer Price Index (CPI) which can be requested from the U. S. Department of Labor. These indexes are easily accessible on the internet in a number of locations by searching for the Consumer Price Index. An example of

this would be to assume an asset with a current replacement cost of \$100,000 and an acquisition date of 1981. Based on the general CPI for 1981 and 1996, 1981 costs are 57.9 percent of 1996 costs. Therefore the estimated historical cost of the asset is \$57,900 (\$100,000 X 57.9%).

More Complex Situations

Certain seemingly complicated situations can arise related to the allocation of costs. Some of these would be scattered site housing and large developments that are completed in phases over several accounting periods. By utilizing the cost principles detailed above related to capitalizing costs, and applying simple, systematic and consistent methods, these projects can be reduced to basic calculations. PHAs should look to OMB Circular A-87 for guidance on allocating costs. In addition, while not applicable to governmental entities, Part 31.200 of the Federal Acquisition Regulation, provides excellent detail instructions on allocating costs. The overriding theme throughout FAR Part 31.200, is utilizing a systemic and consistent allocation method.



“The PHA should currently have detailed records of all of its fixed assets recorded in its fixed asset accounts as formerly required by HUD.”

Examples of the above would be to allocate capitalized costs to scattered site housing based on square footage or on the basis of bedroom size, etc. For large projects, which were completed over several accounting periods, allocate costs based on any reasonable basis: possibly on the number of floors, number of units, etc. The date that a project was placed into service should be discernible from the fixed asset records. If no exact date can be determined, then a best estimate should be developed from all other known information available. In all cases, consult with your auditors.

Take a Physical Inventory

Once the detailed accounting records have been summarized, a physical inventory should be taken to establish the existence of the assets recorded in the accounting records and also to determine if any assets exist that should be added to the accounting records. Assets, which no longer exist, as well as those costs determined not to be capitalizable should be expensed.

It is recommended that the assets, determined to be those that should continue to be recorded fixed assets, be entered into a computerized fixed asset system which has the ability to record depreciation, compute accumulated depreciation and to maintain these records. Most computerized accounting packages on the market have a fixed asset module. If the PHA's current one does not, there are a number of stand-alone fixed asset software programs on the market and are relatively inexpensive. These stand-alone software packages can be found at computer software stores. The obvious advantages are ease of use, accuracy and storage.

Sample Entries to "Write-Off" Costs Which Should Not Have Been Capitalized

To write off the costs determined above that need to be expensed, the entries are only slightly different depending on whether an enterprise fund or the GFAAG is used. These entries are illustrated in *Exhibits 7 and 8*:

Exhibit 7: Write-Off of a Fixed Asset - Enterprise Funds

	DR	CR
HUD PHA contributions	75,000	
Building		75,000
<i>If HUD capital funds were used</i>		
Retained earnings	75,000	
Building		75,000
<i>If HUD capital funds not used</i>		

Exhibit 8: Write-Off of a Fixed Asset - Governmental Funds

	DR	CR
Investment in general fixed assets	75,000	
Building		75,000

Sample Entries to Add Assets Previously Expensed

For any assets, which were discovered above that need to be added to the fixed assets, the following entries would be required:

Exhibit 9: Add Assets Previously Expensed

For Enterprise Funds:		
	DR	CR
Buildings	75,000	
HUD PHA contribution		75,000
<i>If HUD capital funds were used</i>		
Buildings	75,000	
Retained earnings		75,000
<i>If HUD capital funds not used</i>		
For Governmental Funds:		
Buildings	75,000	
Investment in general fixed assets		75,000

Normal Ongoing Entries to Record Costs of Fixed Assets

For the future, the capitalizable costs should be allocated to the appropriate fixed asset category and all other costs should be expensed.. An example is illustrated in *Exhibit 10*.

Exhibit 10: Entries to Record Cost of Fixed Assets

For Enterprise Funds		
	DR	CR
Cash-unrestricted	100,000	
Revenue-HUD PHA Grants		
<i>(costs to be expensed)</i>		25,000
HUD PHA Contribution		
<i>(costs to be capitalized)</i>		75,000
<i>To record receipt of HUD Grant funds</i>		

Exhibit 10: Entries to Record Cost of Fixed Assets - Continued

For Enterprise Funds

	DR	CR
Land	25,000	
Buildings	30,000	
Furniture, equipment and machinery – dwellings	10,000	
Furniture, equipment and machinery – administration	10,000	
Cash-unrestricted		75,000
<i>To record purchase of fixed assets</i>		
Other administrative expense*	25,000	
Cash-unrestricted		25,000
<i>To expense costs not capitalized</i>		

For Governmental Funds:

(General and/or Capital Projects Funds)

Cash-unrestricted	100,000	
Revenue – HUD PHA grant		100,000
<i>To record HUD grant</i>		

(GFAAG)

Land	25,000	
Buildings	30,000	
Furniture, equipment and machinery – dwellings	10,000	
Furniture, equipment and machinery – administration	10,000	
Cash-unrestricted		75,000
<i>To record purchase of fixed assets</i>		

(Capital Projects Fund)

Expenditures-capital outlay	100,000	
Cash-unrestricted		100,000
<i>To expense costs reimbursed from grant Funds</i>		

(General Fund)

Other administrative expense*	25,000	
Cash		25,000
<i>To expense costs not capitalized</i>		

** This item could be any expense category in which Expended modernization costs are classified.*

PHAs focus should be on maintaining proper GAAP fixed assets records prospectively.

DEPRECIATION

The second difference between GAAP and the former HUD accounting is that GAAP requires depreciation in enterprise funds and allows, but does not require, depreciation in the GFAAG. REAC’s conclusion, as per GAAP Flyer Number 1, is that the enterprise fund method should be utilized, which requires depreciation. However, if the GFAAF method is used, then REAC would prefer depreciation be recorded.

Depreciation is the measure of the wearing out, consumption or other reduction in the useful economic life of a fixed asset whether arising from use, affluxion of time or obsolescence through technological or market changes.

Depreciation is a system of accounting that aims to distribute the cost or other basic value of tangible capital assets, less salvage (if any), over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner. It is a process of allocation, not valuation.

Depreciation Methods

The most commonly used methods of depreciation are the straight-line and accelerated methods. Use of the straight-line method is quite simple. After reducing the cost basis by estimated salvage value at the end of the asset’s life, if any, the remaining balance is divided by the number of years of estimated life. This amount is then recorded as depreciation each year in amounts that are dependent on the method of depreciation selected. The straight-line method is almost always used for buildings and building improvements, however it is more than acceptable for use with all depreciable assets. This method is normally exclusively used in situations where the determination of net income is not of paramount importance.

Straight-Line Depreciation Method

HUD recommends the use of the straight-line method of depreciation for simplicity purposes. This method of allocating depreciation is a function of the passage of time and recognizes equal periodic charges over the service life of the asset. The depreciation expense allocated to each year is determined by dividing the depreciable base by the estimated useful life of the asset in years:

$$\frac{\text{Acquisition cost} - \text{Estimated salvage value}}{\text{Estimated useful life}} = \text{Depreciation expense}$$

Assume that on the first day of the year, the entity acquires an asset for \$70,000 cash. The estimated useful life is five years, and the estimated salvage value is \$10,000. Depreciation expense under the straight-line method would be \$12,000 per

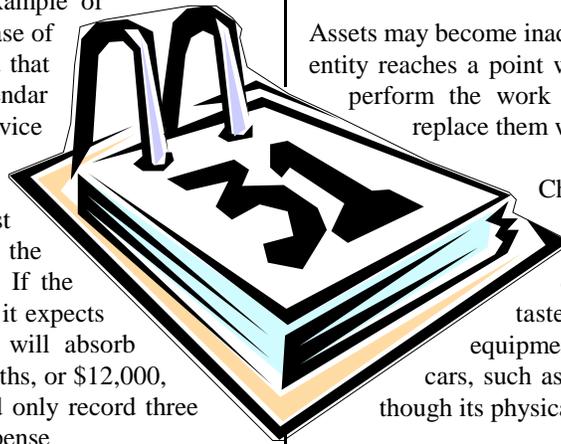
Using the concepts enumerated above, REAC requests that the PHA, in conjunction with its CPA, put forth a “Best Efforts” attempt to accumulate its fixed asset records. This should not become a MAJOR undertaking. REAC would like the best prior year records that can be documented or estimated, but the

year, calculated as follows:

$$\frac{\$70,000 - \$10,000}{5 \text{ years}} = \$12,000$$

Note that we also may express the annual depreciation expense as a rate, in this case, $1/5 = 20$ percent. Also, generally, salvage value will be minimal and in most cases can be disregarded.

Often, plant assets are acquired and disposed of at times other than the beginning or end of an accounting period. Therefore, entities must adopt some logical and consistent means of allocating depreciation to the period of acquisition and to the period of disposition. Using the example of depreciation above, assume the purchase of the \$70,000 asset was on April 1 and that the entity's accounting year is the calendar year. Since the asset provided service potential for only nine months in the year of acquisition, the entity would only charge three-fourths of the first year's depreciation, or \$9,000, on the asset to the first accounting period. If the entity uses the asset for five years, as it expects to do, each of the next four years will absorb depreciation charges for a full 12 months, or \$12,000, and in the fifth year, the entity would only record three months, or \$3,000, of depreciation expense



Determination of Depreciable Lives

The fixed assets are to be depreciated over their estimated useful lives. The useful life of an asset is the period of time during which the entity expects to use the asset for its intended purpose. It should be clear that the useful life of an asset to an entity couldn't exceed the asset's physical life. Several different entities may use an asset during its physical life.

The cost of maintaining an asset in efficient operating condition is usually very high during the latter years of its physical life. This is the one reason that an asset's useful life is often shorter than its physical life because the asset would have to be abandoned or replaced because of the high cost to maintain. Thus, we must consider both physical and economic factors in estimating the useful life of an asset. Also, an entity's experience with previous assets provides some basis for estimating the useful life of a similar asset that is newly acquired.

Physical factors affecting useful life are the normal wear and tear that result from use and the passage of time. With the exception of land, the service potential of an asset expires as an entity uses the asset. Because repair and maintenance policies vary among entities, so do the estimated useful and physical

lives of identical assets.

More often than not, economic factors are the limiting factors in the determination of useful life. Economic factors include obsolescence, inadequacy, and changing economic conditions.

Obsolescence refers to the process by which an existing asset becomes outmoded as improved, more efficient substitutes become available. For example, consider the continuing development of new generations of computers, making the previous generation obsolete. In many cases, to remain competitive, an entity must continually replace its assets with the most up-to-date resources available, even though the replaced asset may not be near the end of their physical lives.

Assets may become inadequate as a result of growth. A growth entity reaches a point where its existing assets simply cannot perform the work required. Therefore, the firm must replace them with more efficient assets.

Changing economic conditions can cause an asset to lose its potential; such economic changes include inflation, energy crises, and changes in consumer tastes. For example, much of the equipment used in the manufacture of large cars, such as body molds, is no longer useful even though its physical life still may be substantial.

Suggested Range of Depreciable Lives

Useful lives in practice for broad general categories are normally as follows. Please note these are

suggested, not mandatory, useful lives:

- ◆ **Buildings** 20 to 40 years
- ◆ **Building improvements** 10 to 40 years
- ◆ **Furniture and fixtures** 5 to 10 years
- ◆ **Equipment** 3 to 10 years

For some more specific items, the following may be suggested lives:

- ◆ **Telephones** 5 years
- ◆ **Tools** 5 years
- ◆ **Appliances** 7 years
- ◆ **Furniture** 10 years
- ◆ **Computers** 3 years
- ◆ **Roofs** 10 years
- ◆ **Leasehold improvements - 15 years or the life of the lease**
- ◆ **Land, and permanent improvements to land, are not depreciated.**

The determination of the estimated life requires consideration of all of the factors listed above. Building improvements

would normally not be depreciated longer than the remaining life of the original building unless it substantially extended the original building's life. A new roof on a building will obviously not last 40 years. Therefore a more realistic period, as example, 10 years would be used. These periods would be adjusted based upon the experience of the PHA. The actual estimated life of any particular asset should be determined using common sense and a realistic assessment of the expected life using the criterion above. The ranges shown above are included as references. If the PHA purchased a used building, the estimated useful would probably be closer to the lower range shown above. If fact, if the building would need to be or was planned to be replaced in 10 years, then 10 years would be the proper useful life to use in the depreciation computation.

Exhibit 12: Entries to Update Depreciation Records - Governmental Funds

	DR	CR
(GFAAG)		
Investment in general fixed assets	20,000	
Accumulated depreciation		20,000
<i>To record prior year depreciation</i>		

Examples of Annual Depreciation Entries

Examples of Depreciation Entries to Update Depreciation Records

Now that the proper GAAP basis has been established and the depreciation method and appropriate lives have been determined, the entity must bring the accumulated depreciation up to date for all assets. The total depreciation that should have been expensed in prior periods should be determined. It's a rather simple task if you are utilizing a computerized fixed asset program. How this entry will be made depends on whether the PHA follows the enterprise or governmental fund accounting as illustrated in *Exhibits 11 and 12*:

“Building improvements would normally not be depreciated longer than the remaining life of the original building unless it substantially extended the

At closing for enterprise funds, the amount of depreciation relating to the assets reimbursed by HUD would be removed from retained earnings account and charged to HUD PHA Contributions, as shown in *Exhibit 13*.

This HUD amount would be shown as depreciation added-back on the income statement after net income. This is in keeping with HUD's preference for the add-back provision related to assets contributed by governments outside the financial entity, which is consistent with the provisions of GAAP (NCGA Statement 2).

On an annual basis, the entries for depreciation would be as shown in *Exhibit 13*.

Exhibit 11: Entries to Update Depreciation Records - Enterprise Fund

	DR	CR
HUD PHA contributions	10,000	
Accumulated depreciation		10,000
<i>To record depreciation computed related to Assets purchased in prior years with HUD Capital Funds</i>		
Retained earnings	20,000	
Accumulated depreciation		20,000
<i>To record depreciation computed related to Assets purchased in prior years with other than HUD Capital Funds</i>		

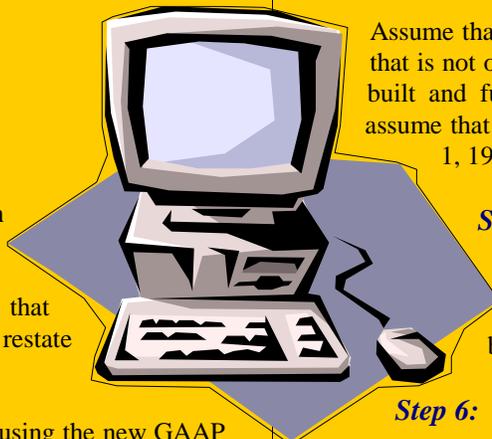
Exhibit 13: Entries to Update Depreciation Records

	DR	CR
For Enterprise Funds:		
Depreciation expense	7,500	
Accumulated depreciation		7,500
<i>To record depreciation expense for the year</i>		
HUD PHA contributions	7,500	
Retained earnings		7,500
<i>To record the add-back of depreciation relating to assets purchased with HUD funds</i>		
For Governmental Funds:		
(GFAAG)		
Investment in general fixed assets	7,500	
Accumulated depreciation		7,500
<i>To record depreciation expense for the year</i>		

RECAP AND ILLUSTRATION

To recap the discussion above, the following are the basic steps the PHA would normally follow to enable it to convert its fixed assets records to GAAP:

1. Gather the fixed asset records, which would include the Cost Certificates, which support the general ledger balances, and any other records necessary.
2. Using a spreadsheet, breakout the costs from the Cost Certificates into the categories of assets.
3. Still using the spreadsheet, spread the costs into the two categories, hard costs and soft costs.
4. Take an inventory of fixed assets.
5. Add any assets determined to be in existence but not on the general ledger to the spreadsheet.
6. Establish for all hard costs:
 - Cost basis
 - Date placed in service
 - Useful lives
7. Calculate accumulated depreciation and current depreciation expense.
8. Prepare journal entries for items that affect current operations and to restate fund balance.
9. Prepare balance sheet and income using the new GAAP records.



To illustrate the above steps, we will make certain assumptions as we proceed through the above steps.

Step 1:

Assume that the fixed asset general ledger shows a building in the amount of \$1,460,000 and we have a detailed property ledger with the same total (\$1,460,000). We will call this building A. Also we will assume that this building was built and furnished with HUD Capital Funds (DEV, CIAP, CGP).

Steps 2 and 3:

Assume that the spreadsheet looks like the one shown at *Exhibit 14*.

Exhibit 14 - Building a Property Ledger

	<i>Hard Costs</i>	<i>Soft Costs</i>	<i>Total</i>
<i>Cost of constructing Building</i>	1,000,000		1,000,000
<i>Land</i>	200,000		200,000
<i>Fixtures</i>	100,000		100,000
<i>Emergency maintenance (replace roof-\$100,000 and fix toilets-\$40,000)</i>	100,00	40,000	140,000
<i>Relocation of tenants</i>		20,000	20,000
Total	1,400,000	60,000	1,460,000

Step 4:

Assume that the PHA has another building, Building B that is not on the fixed asset general ledger and was not built and furnished with HUD Capital Funds. Also, assume that Building B was put into service on January 1, 1980.

Step 5:

Since there are no soft costs involved, the costs as determined in the next step would be added to the spreadsheet as hard costs.

Step 6:

Assume that Building A was put into service on January 1, 1993 and that the PHA's fiscal year end is December 31, 1998. The costs to depreciate are shown as hard costs in the above spreadsheet. Additionally, assume that we determine that the useful life of Building A to be 25 years and the useful life of the fixtures to be 10 years.

Assume that Building B has received an appraisal of \$1,000,000 for the building, \$100,000 for the land and \$20,000 for the fixtures. Assume that we determine the useful lives to be the same as for Building A, 25 years, and the its fixtures, 10 years. Additionally assume that the CPI for 1980 is 40% of 1998. Therefore the cost basis for GAAP purposes would be \$400,000 for the building (\$1,000,000 X 40%), \$40,000 for land (\$100,000 X 40%), and \$8,000 for fixtures (\$20,000 X 40%).

Step 7:

Depreciation and accumulated depreciation would be com-

Exhibit 15 - Calculation of Depreciation

Asset	Cost Basis	Useful Life	Annual Depreciation	Years Before 1998	Accumulated Depreciation 1-1-98	Current Year Depreciation
Building A:						
Building	1,000,000	25	40,000	7	280,000	40,000
Roof	100,000	10	10,000	7	70,000	10,000
Fixtures	100,000	10	10,000	7	70,000	10,000
Total Building A	1,200,000		60,000		420,000	60,000
Building B:						
Building	400,000	25	16,000	17	272,000	16,000
Fixtures	8,000	10	800	17	8,000	0
Total Building B	408,000		16,800		280,000	16,000
Total A & B	1,608,000		76,800		700,000	76,000

puted as illustrated in *Exhibit 15*.

Step 8:

The journal entries to record the data in *Exhibit 15* are illustrated in *Exhibit 16*.

Exhibit 16: Entries to Record Depreciation		
	DR	CR
Enterprise Funds:		
HUD PHA Contribution	60,000	
Fixed assets		60,000
<i>To write off soft costs from Building A purchased with HUD Capital Funds (DEV, CIAP, CGP)</i>		
Buildings (Roof is included)	1,100,000	
Land	200,000	
Furniture & fixtures	100,000	
Fixed assets		1,400,000
<i>To reallocate Building A hard costs to proper accounts</i>		
Building	400,000	
Land	40,000	
Furniture & fixtures	8,000	
Retained earnings		448,000
<i>To set up Building B not previously recorded as a fixed asset and financed with other than HUD Capital Funds</i>		

Exhibit 16: Entries to Record Depreciation - Continued

	DR	CR
Enterprise Funds - Continued:		
HUD PHA Contribution	420,000	
Accumulated depreciation		420,000
<i>To record depreciation related to prior years for Building A</i>		
Retained earnings	280,000	
Accumulated depreciation		280,000
<i>To record depreciation related to prior years for Building B</i>		
Depreciation expense	76,000	
Accumulated depreciation		76,000
<i>To record current year depreciation for all fixed assets</i>		
HUD PHA Contribution	60,000	
Retained earnings		60,000
<i>To record the add-back of depreciation relating to assets purchased with HUD Capital Funds</i>		

Exhibit 16: Entries to Record Depreciation - Continued

	DR	CR
Governmental Funds:		
<i>(GFAAG)</i>		
Investment in general fixed assets	60,000	
Fixed assets		60,000
<i>To write off the soft costs from Building A</i>		
Buildings	1,000,000	
Land	200,000	
Furniture & fixtures	200,000	
Fixed assets		1,400,000
<i>To reclassify Building A hard costs to proper accounts</i>		
Building	400,000	
Land	40,000	
Furniture & fixtures	8,000	
Investment in general fixed assets		448,000
<i>To set up costs for Building B</i>		
Investment in general fixed assets	700,000	
Accumulated depreciation		700,000
<i>To record prior depreciation that should have been recorded (PHA elected to record depreciation)</i>		
Investment in general fixed assets	60,000	
Accumulated depreciation		60,000
<i>To record current year depreciation</i>		

Step 9:

A comparison of the balance sheets and the income statements before conversion to GAAP for fixed assets is presented in Exhibit 17.

Exhibit 17 - Comparison of Non-GAAP to GAAP

	Before	After
<i>Balance Sheet</i>		
Enterprise Fund		
All other assets	2,000,000	2,000,000
Fixed assets	1,460,000	
Building		1,400,000
Land		240,000
Furniture & fixtures		208,000
Less accumulated depreciation		(776,000)
Total Assets	3,460,000	3,072,000

Exhibit 17 - Comparison of Non-GAAP to GAAP - Continued

	Before	After
Liabilities	1,000,000	1,000,000
Fund balance:		
HUD PHA contribution	1,460,000	920,000
Retained earnings	1,000,000	1,152,000
Total liabilities and fund balance	3,460,000	3,072,000
Governmental Fund		
<i>(GFAAG)</i>		
Fixed assets	1,460,000	
Building		1,400,000
Land		240,000
Furniture & fixtures		208,000
Less accumulated depreciation		(776,000)
Total assets	1,460,000	1,072,000
Investment in general fixed assets	1,460,000	1,072,000
<i>Income Statement</i>		
Enterprise Fund		
Operating income	3,000,000	3,000,000
Operating expenses	2,500,000	2,500,000
Depreciation		76,000
Net income before depreciation add-back	500,000	424,000
Depreciation add-back (Building A only-Capital funds)		60,000
Net income	500,000	484,000
Governmental Fund		
<i>(GFAAG)</i>		
No income statement required		

THE FUTURE – GASBs NEW REPORTING MODEL

Beginning with year 2002, a new reporting model will be phased in by governmental entities (GASB Statement No. 34). Among other matters, it eliminates the GFAAG. The effort to convert to the new fixed assets requirements of the new model is not expected to be significant for PHAs.