

3.

ACCOUNTING

3.3 Capital Assets

3.3.6 Depreciation

3.3.6.10 Capital assets including infrastructure should be depreciated. There are some exceptions for depreciating art and historical treasures, if they are inexhaustible. See [Capital Assets System Accounting](#) for more details on art and historical treasures.

The following should be considered when recording depreciation:

1. Except for land, all capital assets must be depreciated. For quarries, timberlands, and mineral rights, depletion expenses must be recorded.
2. Scrap value can be ignored in establishing the amount to depreciate.
3. Depreciation must be based on a reasonable estimate of expected useful life; that is, the number of years, miles, service hours, etc., that the government expects to use that asset in operations. An asset that is surplus or that is held for possible future use is an investment and should not be depreciated. See [Infrastructure Reporting](#) for recommended useful lives for infrastructure.
4. Whether group-life or individual asset depreciation is used, the amount of depreciation charged must be constant for each time period (called straight-line depreciation) or for each unit of service (such as quantity of output, hours or miles of operation, etc.)
 - a. Depreciation must be based on the entire cost of the asset, including any amounts contributed or donated. Depreciation rates may be set for groups of related assets (see the paragraph on group-life depreciation) or for individual assets.
 - b. When depreciation charges are based on time periods, charges should be made for each month that an asset is in service. Exceptions such as the half-year convention or excluding depreciation in the first year of service are acceptable, unless capital asset additions to a fund in one year exceed 50 percent of net capital assets before the addition. When such large additions are made in one year, depreciation must be charged for no less than each whole month the additions are in service, because it is likely that material distortions in operating income would result from applying more approximate methods.
5. When assets are depreciated individually, each asset may contain components, which will have an estimated useful life considerably shorter than the asset taken as a whole. (The most common example is a building, where the roof and flooring will need replacement long before the entire structure.) While not required, the use of component depreciation for such assets is much more accurate and simpler to maintain.
6. As a government uses its capital assets, it needs to revise the expected useful lives of some of them. Any such changes should be applied prospectively; that is, the rate should be recalculated based on the remaining useful life at the time of the revision, and the new rate should be applied in the present and future accounting periods. No changes should be made to financial records of previous years for revised estimates.

Placed in Service Date

- 3.3.6.15 Construction in progress reflects the status of construction activities of buildings, other structures, infrastructure, etc. Construction in progress is a non-depreciable capital asset. Constructed assets should be re-classified from construction in progress and begin to be depreciated when they are substantially completed/placed in service.

There is no specific definition of *substantially completed* and the local governments should use professional judgement to determine the timing of the transition from construction in progress to depreciable capital asset. The constructed asset would be considered substantially completed when it can at least partially perform its intended function (e.g., an empty or partially occupied building for which the government obtained the occupancy permit; the structure is completed except for the landscape; a multilane road with cars using some of the lanes; the asset is being used even if not all “punch list” items are completed or the dispute with a contractor is resolved; equipment [e.g., a fire truck, etc.] is delivered and being used despite some unfinished modifications; etc.).

Group-Life Depreciation

- 3.3.6.20 There are two entirely different applications of group-life depreciation. The first type is applied to a set of very similar assets, such as a fleet of police cars or a suite of office furniture. For this type of group-life depreciation, the group of assets should be treated as a single asset; any gain or loss on disposal is delayed until the entire group has been retired. When some items within the group are retired ahead of schedule, the original cost of the items is removed from both the asset and the accumulated depreciation account. Depreciation continues to be charged only for the remaining assets at the original rate. This defers any gain or loss until the entire group has been retired. When some items in the group require major repair, the book value of the group should be adjusted and the periodic depreciation recalculated for the remaining life of the group.
- 3.3.6.30 The second type of group-life depreciation is used primarily in utilities, and it is applied to dissimilar assets, which are related by the mode of operation in which they are used. The rate of depreciation is a weighted average of the rates applicable to the individual assets, which comprise the group. The use of this method is intended to eliminate gains and losses on asset retirements, except when an entire operating system or facility is retired from service.

Depreciation on Donated Assets

- 3.3.6.40 Depreciation of assets acquired from contributions is calculated in the same manner as for other assets and is reported in the same way on the operating statement. In electric and gas utilities, the FERC system requires that donated assets be recorded at zero cost and no depreciation expense taken. This requirement is a departure from the GAAP.

Fully Depreciated Assets

- 3.3.6.50 Because depreciation is intended to allocate the cost of a capital asset over its entire useful life, it normally is not appropriate to report assets still in service as fully depreciated. Instead, the annual amount of depreciation expense should be reduced prospectively as soon as it becomes clear that an asset's useful life will be longer than originally estimated. In practice, however, the use of average estimated useful lives for entire classes of assets means that at least a few fully depreciated capital assets typically will be reported (i.e., those whose actual lives exceed the group estimate). Such reporting of fully depreciated capital assets is acceptable, but only if such balances do not become material, in which case the estimated useful life for the group would need to be changed.

Modified Approach to Infrastructure

3.3.6.60 Local governments can report infrastructure assets using the modified approach, provided certain requirements are met. They may use the modified approach for all of its infrastructure assets or only a portion of its infrastructure assets either at the network or subsystem level.

There are two requirements for using the modified approach:

- The local government must maintain the eligible infrastructure assets using an asset management system (requirements below).
- There must be documentation that the eligible infrastructure assets are being preserved approximately at (or above) a condition level established and disclosed by the government.

3.3.6.70 Under this approach only expenses for additions and improvements to eligible infrastructure assets should be capitalized on the statement of net position. The maintenance and preservation cost (preservation extends the useful life of an asset beyond the originally estimated, but does not increase its capacity or efficiency) of eligible infrastructure is expensed.

3.3.6.80 Depreciation is not calculated and reported for infrastructure assets using modified approach.

3.3.6.90 An asset management system must possess the following minimum features:

1. Have an up-to-date inventory of eligible infrastructure assets,
2. Perform condition assessments of the eligible infrastructure assets and summarize the results using a measurement scale,
3. Estimate each year the annual amount to maintain and preserve the eligible infrastructure assets at the condition level established and disclosed in the financial statements.