BDO PHA FINANCE

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NEWS AND UPDATES FROM BDO PHA FINANCE

FLASH ALERT

THE CONUNDRUM WITH FIXED ASSET ACCOUNTING

Every year PHAs struggle with accounting and reconciling fixed assets. Fixed asset challenges can include proper recording of cost and classifications of fixed assets, determining depreciation expense, accounting and reporting for disposition and/or transfer of fixed assets, and distinguishing between items that should be recorded as fixed assets and depreciated vs. those items that are expendable equipment or repairs and maintenance costs.

When HUD converted to Generally Accepted Accounting Principles (GAAP) accounting in 1999, it changed the requirements for accounting and reporting fixed assets. The criteria to capitalize an item as a fixed asset are that it must both meet a dollar threshold and provide a useful life greater than one accounting period (one fiscal year). For example, if a PHA purchased a maintenance equipment item for $20,000, (assuming this item has a useful life greater than one year) and the PHA-policy-driven minimum threshold for capitalizing an item is $5,000, then the item would be capitalized as a fixed asset. If the item cost less than $5,000, then it would be recorded as a maintenance expense. PHAs have flexibility to set the minimum amount for an item to be capitalized. According to the Uniform Guidance, 2 CFR 200, the highest amount a threshold can be is $5,000. Below are some thoughts to consider when a PHA creates its capitalization threshold for fixed assets.

- Thresholds typically range from $250 to $5,000, depending on the size of the PHA.
- Thresholds can contain exceptions. For example, the threshold to capitalize assets could be $250, but not include ranges and refrigerators.
- The cost of the item when determining whether or not to capitalize will include the purchase price, transportation costs and the cost of installing the item. Basically, the cost of the fixed asset will represent all expenses to get the item in use.
- The cost is measured on an individual basis. For example, if the PHA bought 10 chairs at $250 per chair or $2,500 in total costs, and the capitalization threshold is $1,000, all the chairs would be expensed since the individual cost was $250 per chair.

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- Different thresholds have no different effects on cash. Regardless, cash still went "out the door" to purchase the item.
- The Months Expendable Net Asset Ratio (MENAR) could be impacted by the threshold. The higher the threshold, the more expenses the AMP will incur which could possibly result in a lower MENAR score. Based on our experience, the MENAR score is rarely, if ever, materially affected in a negative way.
- The PHA could be exposed to audit findings with too low a threshold amount. We have seen numerous audit findings for incorrect depreciation amounts and fixed assets that are not being tracked.

Once a PHA has determined to capitalize on an asset, the PHA needs to determine the fixed asset classification. Per HUD's recommendation, there are five categories of fixed assets: land, building, dwelling equipment, non-dwelling equipment, and leasehold improvements.

The general guideline for accounting for expenditures made after acquisition is that if the expenditures provide additional service potential beyond the initial estimated useful life, they should be capitalized; if they do not provide additional service potential, they should be expensed as incurred. A PHA may produce future service potential by making current expenditures that meet one of the following requirements:

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

Since the asset that is capitalized is providing a benefit in the accounting period, it must have an offsetting expense. That expense is called depreciation. There are numerous types of deprecation methods, but the method that HUD recommends is the Straight Line Method. The Straight Line Method is simple and there is less inherent risk of error when compared to the other accelerated depreciation methods. Also, depreciation expense does not affect the Financial Assessment Sub-system (FASS) ratios, cash, or subsidy. The formula is as follows:

$$\frac{\text{Acquisition Cost} - \text{Estimated Salvage Value}}{\text{Estimated Useful Life}} = \text{Depreciation Expense}$$

HUD recommends the following useful life for each category:

CATEGORY	USEFUL LIFE (IN YEARS)
Building	20 to 40
Building Improvements	10 to 40
Furniture & Fixtures	5 to 10
Equipment	3 to 10
Telephones	5
Tools	5
Appliances	7
Furniture	10
Computers	3
Roofs	10
Leasehold Improvements	15 or life of lease

When the PHA implements a useful life, we recommend that a PHA examines the HUD-suggested range and selects the smaller number; the sooner a PHA can depreciate an item, the less work the PHA will have in the future, with no negative impact on the financial statements. Furthermore, we recommend the PHA choose to implement a full or mid-year depreciation convention. With a full or mid-year convention, regardless of when the PHA purchases the asset over the course of the year, in the first year either a full amount of depreciation or half-years'-worth of deprecation will be recorded. This will help prevent audit findings and make the reconciliation of fixed assets easier.

The PHA is required is complete an asset count at lease every two years, per the Uniform Guidance. We recommend a fixed asset count be completed at every year end. The asset count will include all the assets of the PHA. The PHA will then compare to the prior year asset count and reconcile any assets that were disposed of, transferred, or purchased. Finally, the PHA can compare the final asset reconciliation to the depreciation schedule to ensure the fixed assets are reported correctly.

Once the PHA has determined their thresholds for depreciation, how assets will be classified, useful life specifics, and whether to implement a full year or mid-year convention, the PHA should create a fixed asset and depreciation policy, which should be included with the overall accounting policies.

HUD's recommendations are located in GAAP Flyer Volume 1, Issue 2, June 1999.