ARCHDIOCESE OF SEATTLE

SECTION E

CAPITAL ASSETS AND EXPENDITURES

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TABLE OF CONTENTS

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CAPITAL ASSETS

A capital asset is an asset that will benefit the organization over a relatively long period of time. A purchase is a capital asset if the item cost $10,000 or more and is expected to be useful to the organization for more than one year. If a purchase does not meet these criteria, the cost of the purchase should be recorded as an expense for the current year.

For example, a parish purchases a telephone system that costs $10,500, and it is expected to last for 5 years. The following entry records the transaction.

ACCT #	DESCRIPTION	DEBIT	CREDIT
1530	Capital Purchase / Equipment	10,500	
1115	Cash in Checking – Parish		10,500
To record capital purchase			

Recording the purchase or construction of an asset is referred to as *capitalizing* the cost. These cost figures will remain on the parish books until the item is replaced or sold. Any new purchases will simply add to this total.

Note: For insurance and control purposes, we recommend keeping a list of parish assets that includes description of the asset, purchase date, purchase price, location, and estimated useful life. This list should be updated at least annually. Refer to Section A.V – Inventory List.

Renovation vs. Ordinary Repairs

The cost of major renovations to parish-owned facilities should also be recorded as a capital asset if the renovation costs more than $10,000 and is expected to be useful for more than one year. Conversely, ordinary repairs should be recorded as an expense in the current year.

For example, if a parish replaces the roof on the church building at a cost of $15,000, the cost of replacing the roof should be capitalized and the roof would then be classified as a capital asset. The following transaction records the activity:

ACCT #	DESCRIPTION	DEBIT	CREDIT
1552	Renovations – Church	15,000	
1115	Cash in Checking – Parish		15,000
To record the cost of replacing the church roof.			

However, if a parish replaces a window which costs $800, the cost of the replacement is recorded as an expense. The entry is:

ACCT #	DESCRIPTION	DEBIT	CREDIT
5801	Repairs	800	
1115	Cash in Checking – Parish		800
To record the replacement of a broken window.			

When to Capitalize

There are some gray areas in determining what should be capitalized. For example, if the parish pays $10,000 every three years to paint the parish buildings, is this a capital expenditure, or should it be classified as Repairs and Maintenance Expense? In this case, we recommend expensing the cost, but it is a matter of preference. Make decisions based on your experience and judgment.

To sort out these questions, remember the primary reason for capitalizing assets:

FINANCIAL RECORDS MUST ACCURATELY REFLECT THE FINANCIAL EVENTS OF EACH YEAR.

Large capital expenditures in any one year tend to destroy the ***comparability*** of one year with another. ***Comparability*** (the ability to compare one year with another) is essential to effective financial decision-making. Capitalization improves the comparability of your financial information.

Recording Unrecorded Capital Assets

In some cases, parishes have assets that have not been recorded on the financial records. It is important that these items be recorded to provide an accurate picture of parish finances. The following entry records this correction:

ACCT #	DESCRIPTION	DEBIT	CREDIT
1530	Capital Purchase	30,000	
3103	Change in Fund Balance		30,000
To record the value of a previously unrecorded asset.			

The recording of previously unrecorded Statement of Financial Position items is one of the events that justifies the use of the Change in Fund Balance account (#3103).

Generally, capital assets are recorded at cost. However, if cost data is not available, replacement cost can be used.

Recording Donated Capital Assets

Donated capital assets should be recorded using fair market value or an estimate at the time they are donated to the parish. There are several sources for determining the fair market value including classified ads, local stores, and appraisers.

For example, suppose a 2-year-old car is donated to the parish. The car's value is estimated at $12,200. The following journal entry records the transaction:

ACCT #	DESCRIPTION	DEBIT	CREDIT
1530	Capital Purchase / Equipment	12,200	
4450.10	Donated Assets		12,200
To record the donation of a car.			

The accounting reflects the *economic reality* of the event. The transaction is a donation (revenue) and the acquisition of an asset. Even though the donation of assets (other than cash) does not include cash, the parish has received an economic benefit. Economic benefit defines the term "revenue".

The donated item should only be recorded as a capital asset if it fits the definition of a capital asset, otherwise, it should be recorded as an expense (e.g., small equipment purchases and donation revenue).

Note: This discussion is intended to address the accounting treatment of these donations. It does not deal with tax laws. The IRS has specific requirements to document tax deductibility of donations. (See Appendix A-2 for our recommendations.)

DEPRECIATION

Depreciation is the means of recognizing the loss in value of capital assets over time. It is also the method used to spread the cost of an asset over its "useful life". Depreciation is an essential element in accurate financial reporting. Parishes are not required to depreciate Capital Assets but may do so (see Parish Accounting Policy VI.3).

WHY DEPRECIATE?

Depreciation normally constitutes a major part of the expenses of the parish. For example, buildings and equipment are needed for the parish to conduct masses and carry out its various ministries. Through its activities, the parish can generate revenues (either through donations, fundraising or other sources) to support its operations and enable it to continue carrying out its mission for a long time. If there is no depreciation cost to match these revenues, income will be overstated, the fixed assets in the Statement of Financial Position (or Balance Sheet) will also be overstated, and the true state of the parish's finances will not be fairly presented by the financial statements.

Capital assets are subject to normal wear and tear and therefore it is prudent for the parish to set aside funds for future major repairs or even replacement of the asset. Assuming there is no depreciation expense, and assuming all the profits were withdrawn during the life of the asset, the parish would need to raise additional capital when it is

time to replace the fixed assets. Since depreciation is a non-cash expense, by charging depreciation against profits, the net profit available for withdrawal is lowered by the amount of the depreciation and these funds are retained in the business for future replacement.

In reality though, parishes that depreciate their assets fund major projects through capital campaigns or PRF loans and not through the amount set aside, if any, due to recording depreciation expense. It therefore raises the question of why even bother depreciating the assets. It is for this reason why depreciating assets, while it is the generally accepted accounting practice, is now optional. However, if the parish chooses not to depreciate, there should be a capitalization policy that says capital assets are to be funded by capital campaigns.

Parishes that have been recording depreciation but decide to discontinue should just stop recording depreciation at the beginning of the fiscal year immediately following the current period.

ACCOUNTING FOR DEPRECIATION

Assets are typically assigned an estimated *useful life*, or amount of time that the asset will continue to be useful and productive. For example, a car might be deemed to have a useful life of 7 years. Depreciation allocates or spreads the original cost of the car over 7 years.

As an example, a parish buys a car for $14,000, and it is expected to have a useful life of 7 years. The following entries show the purchase and the first journal entry recording the depreciation expense.

ACCT #	DESCRIPTION	DEBIT	CREDIT
1530	Capital Purchase / Equipment	14,000	
1115	Cash in Checking		14,000
To record the purchase of a new car.			

There are several ways of calculating depreciation. We recommend taking the total cost of the asset and dividing it by the estimated useful life:

Total Asset Cost / Estimated Useful Life (in years)	**=**	**Yearly Expense Depreciation**
$14,000 car / 7 years useful life	=	$2,000 per year depreciation

ACCT #	DESCRIPTION	DEBIT	CREDIT
6201.10	Depreciation of Equipment	2,000	
1580	Accumulated Depreciation		2,000
To record the first year's depreciation expense on the car. (Note: if the asset was put in service several months after the beginning of the fiscal year in which it was acquired, prorate the depreciation expense to the actual months in the fiscal year that the asset was in service).			

The above entry is a non-cash transaction involving an expense account and a "***contra asset***" account. By crediting the Accumulated Depreciation account (#1580), we are recognizing that the asset is losing some of its value over time. The Accumulated Depreciation account is a ***contra asset***. This account should be viewed in conjunction with the related asset account, in this case Capital Purchases / Equipment (#1530):

1530	Capital Purchase / Equipment	14,000 (debit)
1580	Accumulated Depreciation	2,000 (credit)
	Net Book Value	12,000 (debit)

By viewing the asset account and contra asset account together, we recognize that the car has lost value since we purchased it. The asset's cost minus its related accumulated depreciation equals its ***Net Book Value***.

The adjustment to record the depreciation expense and the related accumulated depreciation should be made at regular intervals (monthly, quarterly, or annually).

If the depreciation adjustment is made at the end of every fiscal year, by the end of the seventh year the credit balance in the accumulated depreciation account will equal $14,000. At that time, the asset will be considered to have a zero Net Book Value; it will be completely "written off".

When the asset is no longer in use, the asset and its related accumulated depreciation will be deleted from the parish books with the following journal entry:

ACCT #	DESCRIPTION	DEBIT	CREDIT
1580	Accumulated Depreciation	14,000	
1530	Capital Purchase / Equipment (car)		14,000
To write off the parish car and related depreciation.			

When to Depreciate

In general, if you capitalize, you should depreciate but this is now optional. We do not recommend depreciating the original parish buildings. Parishes should have recorded building values based on the 1987-88 Insurance Valuation. Even though these buildings (churches, schools, etc.) will become worn and require renovations, over time the buildings and land will increase in value because of inflation. Renovations to these buildings and buildings built later are, however, depreciated.

Depreciation Guidelines
These guidelines are suggested for some common assets:

Type of Asset	Estimated Useful Life
Computers	2 - 3 years
Small Office Equipment	2 - 5 years

Vehicles	3 - 7 years
Large Equipment	7 - 10 years
Building Renovations	10 - 20 years
Buildings	20 - 30 years

Depreciation Methods

There are a wide variety of depreciation methods to choose from. Some are called "accelerated depreciation" in that they take into account that assets may not necessarily lose value at an even rate over time. "Straight-Line" depreciation, illustrated earlier, is the easiest and most effective for parishes. You are free to explore other methods if you wish, however, we recommend the "Straight Line" method.

Depreciation Schedule

Capital assets are put in service at different times. Estimated useful life of these assets and the depreciation method chosen for each asset may also vary. To facilitate the calculation of depreciation expense for the year, a depreciation schedule must be developed. At a minimum, the depreciation schedule must include a description of the asset, cost of the asset, date it was put in service, estimated life, depreciation method, depreciation expense, and book value at the end of the year. A sample depreciation schedule is in Appendix E-1.

Sales of Depreciated Assets

When an asset is sold or otherwise disposed of, it must be removed from the financial records. This includes both the initial (capitalized) value and the appropriate accumulated depreciation. If there is a difference between the amount realized and the "Net Asset Value", the difference is recorded in either Gain on the Sale of an Asset account #4550 or Loss on the Sale of an Asset account #6190.

Assume we are ready to sell our $14,000 car. It has accumulated depreciation of $8,000. Based on its Net Book Value, the car has a "cost" on our books of $6,000 ($14,000-$8,000). Assume we sell it for $7,000.

ACCT #	DESCRIPTION	DEBIT	CREDIT
1115	Cash in Checking	7,000	
1580	Accumulated Depreciation	8,000	
1530	Capital Purchase / Equipment		14,000
4550.10	Gain on Asset Sale		1,000
To record the sale of the parish car, gain on the sale, and to write off the asset and related depreciation.			

Now, if we assume the same facts, except the sales price is $4,000.

ACCT #	DESCRIPTION	DEBIT	CREDIT
1115	Cash in Checking	4,000	
1580	Accumulated Depreciation	8,000	
6190.10	Loss on Asset Disposition	2,000	
1530	Capital Purchase / Equipment		14,000
To record the sale of the parish car, loss on the sale, and to write off the asset and related depreciation.			

It is very important that all elements of these transactions be recorded if the financial records are to accurately reflect the financial condition of the parish.

FINAL NOTE

Capitalization and Depreciation are among the elements of any complete accounting system. Initially these concepts may appear complex, but their value and the logic involved in their implementation will become evident in a very short time.