Accounting for Fixed Assets

Second Edition

Raymond H. Peterson

John Wiley & Sons, Inc.

Accounting for Fixed Assets

Accounting for Fixed Assets

Second Edition

Raymond H. Peterson

John Wiley & Sons, Inc.

This title is also available in print as ISBN 0-471-09210-X. Some content that appears in the print version of this book may not be available in this electronic edition.

For more information about Wiley products, visit our web site at www.Wiley.com

To a number of people who influenced my life and prepared me for the job of creating this book:

First, my mother, who not only taught me to read, but allowed me to experience the enjoyment of reading. She opened up for me the vast knowledge available in libraries.

Dr. Wade Moorehouse, retired Professor of Accounting and former Chairman of the Department of Business and Economics at California State University, Hayward, who many years ago, when I was an undergraduate student in his accounting course, stimulated my excitement about the accounting function. Blessed with classes of fewer than six students in a new university, we spent many class hours discussing the theory of accounting. These discussions had a large impact on my career direction.

Earl Malone, a District Accounting Manager, who early in my career forced me to develop my own thoughts and not just rely on past practice. He also forced me to aquire the skill of dictation, which made the creation of this book a possibility.

Dodie Peterson, world's best secretary, who converted my ramblings into a manuscript.

Contents

About the Author

Raymond (Ray) H. Peterson is currently the senior partner of Ray Peterson & Associates, a consulting firm offering business assistance in establishing and changing accounting systems. He has served as the treasurer of a number of nonprofit organizations. He has over thirty years experience as a management accountant with the Bell System. He retired as Director of Financial Accounting with Pacific Bell.

Mr. Peterson has managed the design of Pacific Telephone and Telegraph Companies detail property records. During the three-year breakup of the Bell System, he was appointed to a Federal Communications Commission task force to create a new uniform system of accounts for telephone companies. The proposed system was adopted by the FCC and was installed in all telephone companies.

Mr. Peterson served for 12 years on the Institute of Management Accountants Financial Accounting Standards Committee and its predecessor Subcommittee on Management Accounting Statement Promulgation. He received a BS from California State University at Hayward and an MBA from Golden Gate University in San Francisco. He also taught accounting and management information systems at Golden Gate University.

Preface

Since the first edition of this book in 1994, not much change has occurred to accounting standards for Property, Plant, and Equipment in business. The GAAP promulgated by the Financial Accounting, FASB, has been to further the concept of identifying the cost of an asset and spreading that cost over the accounting periods that benefit. Accounting for contributions, impairments, and financing of assets have been addressed by the FASB.

In contrast, much has happened in the areas of Not-for-Profit and Government accounting for fixed assets. FASB ordered the capitalization of assets and charging of depreciation by Not-for-Profits. The government Accounting standards Board was created as an equal to the FASB with the authority and responsibility to promulgate GAAP for governments. They replaced the Government Finance Officers Association and its "Blue Book", Governmental Accounting, Auditing, and Financial Reporting as the "official" accounting rules for State and Local government. An early step by the new GASB was to suspend depreciation for "government" not-for-profit accounting.

There was a determination of jurisdiction between FASB and GASB which are outlined in Chapter 10, "Government Accounting" and Chapter 11, "Not-For-Profit Accounting."

Then the GASB issued concept papers that moved government accounting toward the practices long held as appropriate for businesses. These concept papers state that assets should be placed on the books at acquisition cost and that cost spread over the accounting periods they benefit. This is a major change in accounting for these groups. Past practice was for assets to be purchased and expensed in the current period, if purchased with general revenue, or not even recorded if purchased with bonds or other special revenue sources.

There was considerable argument that these changes were not appropriate for governments. Implementation of GASB statement 33 and

34 were delayed, but are now being implemented. The accounting for governments is not the subject of this book and government accountants are referred to GASB and GFOA publications in the bibliography for the details. However, some discussion is included because it will be of interest to the business accountant that is establishing accounting policy for business and not-for-profit organizations.

There has been considerable argument that fixed assets of businesses should be recorded on the books at something different than depreciated original cost, that adjustments should be made to reflect the market value up as well as down, and that book asset accounting should be changed from cost allocation to reflect some measurement of value. The public review and promulgation process of the GASB provide rebuttals to all of those arguments. I urge any accountant that holds those views to research the process that GASB statements 33 and 34 followed, much of which is available on the web site at http://www.gasb.org.

This book is designed for accountants and managers who want to get the most from the physical assets of their organizations.

Most readers are already familiar with the concepts and practical application of total quality management (TQM) zero defects, and the other procedures that describe a continued process of improvement. Having made the process and management changes that brought about easy improvements in quality and cost reduction they are ready to answer the following questions:

How are you applying the principles of continuous improvement to the management of property, plant, and equipment?

Do you have a process in place that allows you to monitor the status of maintenance (or deferred maintenance) on your property, plant, and equipment?

What is the age of the oldest piece of your production equipment?

Do you have a plan in place for replacement of production facilities?

Are there any quality problems in your production or service delivery system caused by property, plant, and equipment failures?

What is the utilization percentage of the property, plant, and equipment?

Can you determine the utilization of your most expensive piece of equipment?

Do you have service or production problems attributable to equipment not being available at the place needed?

Are all of your property, plant, and equipment being utilized to their fullest?

Do you have in place a process that monitors the current condition, evaluates the future need for replacement, and brings to your attention needs to modify that plan?

Do you manage your physical assets or do you put them in place, use them, and replace them when they are worn out?

Do your plans include having the necessary cash to purchase replacement physical assets or will you have to do an extraordinary financing or fund-raising when you are surprised by their failure?

Is there a plan in place for overall management or do you simply hope your assets will continue to allow you to produce your product or provide your service?

The purpose of providing this book on accounting for property, plant, and equipment, is to provide the framework for you to install in your organization accounting processes and procedures that will allow you to manage long-term physical assets.

How can a book on assets help answer these questions? All accounting students learn the basics about assets within various accounting courses, however, there really is not much definitive information available on fixed assets in the accounting literature. The Accounting Principles Board and the Financial Accounting Standards Board are both silent on the subject of accounting standards for fixed assets. Lacking a primary source for accounting standards, it is necessary to look to secondary sources, which also contain very little information on the handling of assets. Most accounting textbooks devote only a single chapter to capitalization of assets, and do not cover the subject in depth. Accounting periodicals have focused on valuation of assets, but offer little on specific concepts of capitalization. The issue of valuing at historical cost versus current market price has received considerable interest over the years. Now the FASB has issued statement 93 requiring not-for-profits to use historical cost less depreciation asset accounting. GASB has issued statements 33 and 34 that require that accounting for all but a few assets. It is even more important to have this single reference to bring all these prospectives together.

A number of organizations including the American Institute of Certified Public Accountants, the Institute of Management Accountants, and the Government Finance Officers Association offer courses on capitalization of assets. Most of these courses, however, cover either the tax implications of assets or the valuation question. Little in these courses describes how to establish asset policies, document them in a manual, and apply them within the company.

During 1989-1990, the National Association of Accountants (now the Institute of Management Accountants) replaced their original Statement on Management Accounting (SMA) on Fixed Assets with two statements relating to accounting for property, plant, and equipment. *SMA 4J*, published in 1989, described the accounting for property, plant, and equipment, and *SMA 4L*, published in 1990, covers control of property, plant, and equipment. A research issues publication called the *Reporting, Control, and Analysis of Property, Plant, and Equipment* was published in 1990. This collection of publications represents the majority of the available information on accounting for fixed assets. As a part of the IMA team coordinating those projects, I became convinced this book was needed.

There is a need to emphasize that assets must be managed, not just purchased, used up, and replaced. The objective is to provide not only accounting for assets, but include that accounting in a process that will allow management to get the most out of the company's investment. It is not always possible to create more debt in order to acquire assets. Therefore, some of our consumption must be sacrificed today in order to provide quality assets for tomorrow.

In today's complex business best quality and maximum utilization are going to give the best return on investment. *Accounting for Fixed Assets* contains more than the routine accounting processes. It also has the management framework that must surround the accounting process.

The United States economy has been built since World War II as "a paper plate society." We rapidly built our economy based on the philosophy of quick production without much concern for quality. We built automobiles that only lasted a few years, and, in fact, are still building houses in the same way that we did in the early 1950s. They require major renovation every fifteen or twenty years. Many of the houses of the early 1950s are currently the subject of redevelopment districts: they either require major repair or must be ripped out and replaced. We have built a tremendous economy and brought the majority of citizens to the highest standard of living of any culture with this "do-it-quick" philosophy. It created many jobs, especially at the unskilled and semiskilled level, and brought the pleasure of accomplishment and the fruits of labor to the largest segment of U.S. citizens quickly. We have done so, however, for the sake of today and at the expense of tomorrow. But tomorrow has arrived, and we cannot continue to use up our assets. Those assets capable of bringing future benefits must be managed in a way that will allow those future benefits to occur.