Correctly Calculating Net Investment in Capital Assets

Weaver ■ September 2022

Agenda

- Background and Purpose of Net Investment in Capital Assets
- Reporting Units
- Capital Assets
- Capital Liabilities (“Capital Debt”)
- Capital Deferred Resource Flows
- Frequent Missteps in Calculation of Net Investment In Capital Assets
- Example Calculation

WHY HAVE A CAPITAL ASSET CLASSIFICATION OF NET POSITION?

Background and Purpose

- Concept introduced by GASB 34
  - First time reporting general governmental capital assets and long-term debt on an economic resources measurement focus (MF) and accrual basis of accounting (BA)
  - Components of residual value should be classified by *degree of constraint* rather than by source
  - Capital assets are most constrained
    - Not in spendable form
    - Cannot be spent for any other purpose

Background and Purpose (cont.)

- Updated by GASB 63
  - *Net position* replaced *net assets*
  - *Net investment in capital assets* replaced *invested in capital assets, net of related debt*
  - Introduction of *deferred outflows of resources* and *deferred inflows of resources*
- Net position =

  (Assets + Deferred outflows of resources)

  – (Liabilities + Deferred inflows of resources)

Allocation of Net Position

	Total	Net Investment in Capital Assets*	Non-Capital	
			Restricted	Unrestricted
Assets (net)	$$$$$$	$$$	$$	$
+ Deferred Outflows	$$$$$$	$$$	$$	$
- Liabilities	$$$$$$	$$$	$$	$
- Deferred Inflows	$$$$$$	$$$	$$	$
= Net Position	$$$$$$	$$$	$$	$

* When governments have no outstanding capital debt, the capital-asset classification of net position may be referred to as "investment in capital assets" rather than as "*net* investment in capital assets."

Big Picture

- Net position =

  (Assets + Deferred outflows of resources)

  – (Liabilities + Deferred inflows of resources)

- Net investment in capital assets classification of net position =

  (*Capital* Assets + *Capital* Deferred outflows of resources)

  – (*Capital* Liabilities + *Capital* Deferred inflows of resources)

Net Investment in Capital Assets For a Reporting Unit

All reported capital assets *of the reporting unit*

Liabilities and deferred inflows of resource from constructing, developing, acquiring and improving *those capital assets*

Deferred inflows of resources and deferred outflows of resources from refinancing *those capital liabilities*

Detailed Calculation

Capital assets (both tangible and intangible)

Less: Accumulated depreciation/amortization

Less: Outstanding principal of capital-related borrowings related to the government's own capital assets (limited to proceeds expended for capital purposes and *excluding* unspent proceeds) ("outstanding capital-related debt")

Less: Debt used to refund capital-related borrowings, including lease liabilities and subscription liabilities[19]

Less: Any other (non-debt) capital-related liabilities as of fiscal year end, including accounts payable and retainage payable

Less: Original issue premiums on outstanding capital-related debt

Less: Capital-related deferred inflows of resources (such as a gain on refunding of outstanding capital-related debt or those resulting from the acquisition of a capital asset, such as through a service concession arrangement)

Plus: Original issue discounts on outstanding capital-related debt

Plus: Capital-related deferred outflows of resources (such as a loss on refunding of outstanding capital-related debt)

Equals: Net investment in capital assets

Polling Question 1

The three classifications of net position are based on:

A. The degree to which net position is constrained
B. The purpose for which net position is constrained
C. Relative sizes of each classification
D. A and B

WHAT ARE REPORTING UNITS?

Reporting Unit

- A reporting unit may be:
  - A governmental entity (that is, an entity that has separate legal standing),
  - Part of a governmental entity (e.g., governmental activities or business-type activities, a major fund, a non-major fund, an aggregation of funds, or a segment),* or …

* When the reporting unit is only part of a governmental unit, the assets, liabilities, residual balances, and changes in those amounts that are included in the reporting unit's financial statements have been assigned by the government to that reporting unit for control, management, or financial reporting purposes.

Reporting Unit (cont.)

- A reporting unit may be (cont.):
  - An aggregation or consolidation of two or more governmental units (e.g., a primary government and its discretely presented component units, all discretely presented component units of a primary government)

Reporting Units with Net Investment in Capital Assets

- Government-wide financial statements
  - Governmental activities
  - Business-type activities
  - Total primary government
  - Discretely presented component units (each column)
  - Total reporting entity, if presented

Reporting Units with Net Investment in Capital Assets (cont.)

- ~~Governmental fund financial statements~~
- Proprietary fund financial statements
  - Each major enterprise fund
  - Aggregate nonmajor enterprise funds
  - Total enterprise funds
  - Aggregate internal service funds
  - In combining and individual fund statements:
    - Each individual fund
- ~~Fiduciary fund financial statements~~

CAPITAL ASSETS

Capital Assets

- Capital assets
  - Includes land, improvements to land, easements, buildings, building improvements, vehicles, machinery, equipment, works of art and historical treasures, infrastructure, and all other tangible or intangible assets that
  - Are used in operations
  - Have initial useful lives extending beyond a single reporting period

CAPITAL LIABILITIES (a.k.a, "CAPITAL DEBT")

Capital Purposes

- Capital purposes
  - Proceeds were used to
    - Construct, develop, acquire, or improve* capital assets of the reporting unit, or
    - To refinance liabilities of which the original proceeds were used for those purposes

* Collectively, “acquire”

Capital Liabilities (Capital “Debt”)

- Capital liabilities include
  - Currently-outstanding *principal* amounts of debt used for capital purposes
  - Unamortized original-issue discounts and premiums on debt used for capital purposes (including refunding debt)
  - Unamortized deferred inflows of resources (“gains”) and deferred outflows of resources (“losses”) on refunding of debt used to acquire capital assets

Capital Liabilities (cont.)

- Capital liabilities include (cont.)
  - Lease, public-private and public-public partnership, and subscription liabilities
  - Non-debt liabilities used for capital purposes (inter-governmental – not *intra*-governmental – capital loans, capital accounts payable, capital retainage payable)

Noncapital Liabilities

- **Non**capital liabilities – *Do Not Include in Calculation*
  - Interfund liabilities, regardless of use of proceeds*
  - Debt corresponding to unspent bond proceeds, regardless of restrictions for capital purposes

* *Special case:* When a blended component unit (BCU) borrows from an external source and then lends or grants proceeds to its primary government (PG) or to another BCUs of the same PG, the external liability is a capital liability of the PG

Noncapital Liabilities (cont.)

- **Non**capital liabilities (cont.) – *Do Not Include in Calculation*
  - Debt and other liabilities incurred to acquire capital assets of *an outside party or another reporting unit*, or to refinance such liabilities
  - Accrued interest payable on liabilities, regardless of use of proceeds – including accreted interest on deep discount debt (“zero-coupon” bonds)
  - Long-term liabilities unrelated to capital assets

Inter- and Intra-Governmental Borrowing

- Intra-government borrowing
  - Internal to a single legal entity
    - Example: between two funds of a primary government (*other than* funds representing blended component units)
  - An amount due to another fund or activity of the same government is a <u>noncapital</u> liability regardless of how the proceeds were used by the borrowing fund/activity

Inter- and Intra-Governmental Borrowing (cont.)

- Intra-entity borrowing
  - Borrowing between legally separate entities within the same financial reporting entity
    - **With a blended Component Unit** – a loan between a primary government (PG) one of its blended component units (BCUs) or between two BCUs of the same PG
      - *Special case:* When a BCU borrows money from an *external source* and then loans the proceeds to the PG or another BCU of the PG – The external liability of the BCU becomes a capital liability of the PG to the extent that the proceeds of the intra-entity loan were used for capital purposes.
      - *All other cases:* Loans are noncapital liabilities regardless of how proceeds were used by the borrower.

Inter- and Intra-Governmental Borrowing (cont.)

- Intra-entity borrowing (cont.)
  - Borrowing between legally separate entities within the same financial reporting entity (cont.)
    - **With a discretely presented component unit** (DPCU) – loan between a PG one of its DPCUs, or between two DPCUs of the same PG
      - Capital liability to the extent the proceeds of the intra-entity loan were used for capital purposes by the borrower

Inter- and Intra-Governmental Borrowing (cont.)

- Inter-governmental borrowing
  - Between two governments that are not in the same reporting entity
    - Example: a state lends money to a county
  - Liability of borrowing government is a capital liability to the extent that the proceeds of the inter-governmental loan were used for capital purposes

Polling Question 2

Which of the following should *not* be included in the calculation of net investment in capital assets

A. Donated capital assets
B. Intangible capital assets
C. Buildings taken in rem (lien for unpaid property taxes)
D. Refunding bonds used to retire capital debt
E. A and C only

DEFERRED RESOURCE FLOWS

Capital Deferred Resource Flows

- Arising from capital debt refunding
- Arising from acquisition of capital assets through certain arrangements

Capital Deferred Resource Flows (cont.)

- Arising from capital debt refunding
  - Unamortized deferred inflows of resources (“gains”)
  - Unamortized outflows of resources (“losses”)

	DR	CR
Cash with fiscal agent	$3,300	
Cost of issuance	65	
Refunding debt		$3,365
(To record issuance of refunding debt)		
Refunded debt	$3,000	
Deferred outflow of resources – debt refunding	300	
Cash with fiscal agent		$3,300
(To record placement of refunding debt proceeds into escrow)		

Capital Deferred Resource Flows (cont.)

- Unamortized deferred inflows of resources arising from the acquisition of capital assets of the reporting unit
  - Unamortized deferred inflow of resources of the issuer from a conduit-debt associated arrangement when both:
    - The issuer will retain title to an underlying asset in an associated arrangement when the term of the arrangement ends, and
    - The third-party obligor will have exclusive use of only *part(s)* of underlying asset during the term of the associated arrangement

Capital Deferred Resource Flows (cont.)

- Unamortized deferred inflows of resources arising from the acquisition of capital assets of the reporting unit (cont.)
  - Unamortized deferred inflow of resources of the transferor in a PPP, when an underlying capital asset in a service concession arrangement (SCA) PPP is:
    - Constructed, acquired or improved by the operator, and
    - Placed into service (the underlying asset immediately becomes the property of the transferor)

FREQUENT MISSTEPS IN THE CALCULATION OF NET INVESTMENT IN CAPITAL ASSETS

Unspent Bond Proceeds

- Unspent proceeds
  - Noncapital assets (cash & investments)
  - Generally, restricted
  - The *debt follows the assets* in the classification of net position:

	Total	Net Investment	Restricted	Unrestricted
Assets (net)	$$$$$$	$$$	$$	$
+ Deferred Outflows	$$$$$$	$$$	$$	$
- Liabilities	$$$$$$	$$$	$$	$
- Deferred Inflows	$$$$$$	$$$	$$	$
= Net Position	$$$$$$	$$$	$$	$

  - No (net) impact on any classification of net position

Excluding Capital Liabilities

- Causes overstatement, except as noted
- Frequently omitted capital liabilities:
  - Unamortized original issue discounts on capital debt (contra-liability; *omission would cause understatement*)
  - Unamortized original issue premiums on capital debt
  - Refunding capital debt (proceeds used to refinance previous capital debt)
  - Non-bonded capital debt (notes, bank loans)

Excluding Capital Liabilities (cont.)

- Frequently omitted capital liabilities (cont.):
  - Non-debt capital liabilities
    - Inter-governmental (not *intra*-governmental)
    - Accounts payable
    - Retainage payable
    - Other capital *fund* liabilities (e.g., callable bonds payable, debt service due early in following year and accrued in a debt service fund at FYE)
  - External debt of BCU if, and to the extent that, the debt proceeds were:
    - Used for capital purposes of the BCU, or
    - Loaned or granted to the PG or another BCU of the PG and used for capital purposes

Including Noncapital Liabilities

- Causes understatement
- Frequently included noncapital liabilities:
  - Debt in the amount of unspent proceeds
  - Debt used to fund capital assets *belonging to others*, including:
    - Belonging to external parties
    - Properly reported by another reporting unit within the reporting entity
  - Debt used for noncapital purposes
    - Issued for noncapital purposes
    - Issued for capital projects and spent on the following, *if significant*:
      - Costs of issuance
      - Items not capitalized (e.g., based on a capitalization threshold)

Including Noncapital Liabilities (cont.)

- Frequently included noncapital liabilities (cont.):
  - Long-term liabilities unrelated to capital assets
    - Compensated absences
    - Claims and judgements
    - Pension/OPEB
    - Pollution remediation/landfill/asset retirement obligations
  - Interfund liabilities
  - Accreted interest on deep-discount debt

Omitting Capital Assets

- Causes understatement
- Frequently omitted capital assets:
  - Assets that are not debt-financed
    - Donated
    - Grant-funded
    - Funded with existing resources
  - Intangible

Including Noncapital Assets

- Causes overstatement
- Frequently included noncapital assets:
  - Cash and investments restricted to use for capital purposes (unspent bond proceeds)
  - Cash and investments restricted to use for maintenance/replacement of capital assets
  - “Investments” in joint ventures
  - Pension and other postemployment benefit assets

Excluding Deferred Resource Flows From Refinancing

- Causes
  - Understatement if excluding deferred outflows of resources or
  - Overstatement if excluding deferred inflows of resources
- Frequently omitted deferred resource flows from refinancing of capital debt (refunding bonds, defeasances) :
  - Deferred inflows of resources (“gains”) and
  - Deferred outflows of resources (“losses”)

Excluding Deferred Inflows of Resources Arising From Capital Asset Acquisition

- Causes overstatement
- Not frequently encountered … *yet!*

Including Deferred Inflows of Resources Not Arising From Capital Asset Acquisition

- Causes understatement
- Not frequently encountered… yet
- Deferred inflows of resources arising from certain arrangements but not from acquisitions of capital assets of the reporting unit:
  - Transferor’s unamortized deferred inflow of resources from up-front payments in PPPs, including SCAs, even if up-front payments were used for capital purposes
  - Transferor’s unamortized deferred inflows of resources arising from the transferor’s receivable for the underlying PPP assets not yet transferred to the transferor, in non-SCA PPPs
  - Sales of future revenues

Net Investment in Capital Assets For a Reporting Unit

All reported capital assets *of the reporting unit*

Liabilities and deferred inflows of resource from constructing, developing, acquiring and improving *those capital assets*

Deferred inflows of resources and deferred outflows of resources from refinancing *those liabilities*

EXAMPLE CALCULATION OF NET INVESTMENT IN CAPITAL ASSETS

Example

- Calculate net investment in capital assets for the governmental activities of Sample Village, using the following excerpts from the village's FYE April 30, 2027

Statement of Net Position - Assets

	Primary Government		
	Governmental Activities	Business-Type Activities	Total
ASSETS			
Cash and Investments	$ 11,349,919	$ 5,680,573	$ 17,030,492
Receivables (Net Where Applicable of Allowance for Uncollectibles)			
Property Taxes	3,961,988	-	3,961,988
Intergovernmental	448,601	-	448,601
Accounts	54,410	241,255	295,665
Interest	17,034	4,444	21,478
Other	222,185	-	222,185
Prepaid Expenses	73,075	9,838	82,913
Deposits	7,876	969	8,845
Internal Balances	(25,000)	25,000	-
Net Pension Asset	53,090	-	53,090
Capital Assets not Being Depreciated	5,700,281	159,222	5,859,503
Capital Assets Being Depreciated (Net of Accumulated Depreciation)	11,331,201	8,701,912	20,033,113
Total Assets	33,194,660	14,823,213	48,017,873

$17,031,482

Statement of Net Position – Deferred Outflows of Resources

DEFERRED OUTFLOWS OF RESOURCES			
Unamortized Charge on Refunding	61,814	-	61,814
Total Deferred Outflows of Resources	61,814	-	61,814
Total Assets and Deferred Outflows of Resources	33,256,474	14,823,213	48,079,687

Statement of Net Position – Liabilities and Deferred Inflows of Resources

LIABILITIES			
Accounts Payable * Includes $49,000 in retainage payable for capital projects	513,626	190,079	703,705
Interest Payable	43,892	-	43,892
Accrued Payroll	115,750	8,167	123,917
Unearned Revenue	26,327	26,010	52,337
Refundable Deposits	556,252	-	556,252
Other Liabilities	39,170	21,500	60,670
Long-Term Liabilities			
Due Within One Year	396,503	81,892	478,395
Due in More than One Year	4,181,929	1,187,432	5,369,361
Total Liabilities	5,873,449	1,515,080	7,388,529
DEFERRED INFLOWS OF RESOURCES			
Deferred Revenue - Property Taxes	3,961,988	-	3,961,988
Total Deferred Inflows of Resources	3,961,988	-	3,961,988
Total Liabilities and Deferred Inflows of Resources	9,835,437	1,515,080	11,350,517

Note Disclosures – Long Term Liabilities (cont.)

Capital

The 2021 Series General Obligation Alternate Revenue Source Bonds were issued to fund the costs of Special Service Area #15 road improvements and are funded by the taxes specifically designated in the Special Service Area Funds with the public benefit portion funded by a transfer from the Village's capital projects fund.

Capital

The 2023 Series General Obligation Alternate Revenue Source Bonds were issued to finance certain capital improvements of Special Service Areas #18, 19, 20, 21, 22 and 23 and are funded by the taxes specifically designated in the Special Service Area Funds, motor vehicle license fees, and ad valorem taxes levied against all taxable property within the Village.

Capital

The 2025 Series Debt Certificates were issued to refund the 2012 Series Debt Certificates and to refund a portion of the 2015 Series Debt Certificates, both capital-related. The proceeds of the 2025 Series Debt Certificates were placed in an irrevocable trust to provide for the payment of the old Certificates. Accordingly, the trust account assets and liability for the refunded bonds are not included in the financial statements.

Note Disclosures – Long Term Liabilities (cont.)

Capital

The 2025A Series General Obligation Alternate Revenue Source Bonds were issued to pay the costs of certain road improvements within the Village's Special Service Areas #17 and 24 and to pay the costs of issuance of the bonds. Repayment of the debt is funded by the taxes specifically designated in the Special Service Area funds.

Capital

The 2026 Series General Obligation Alternate Revenue Source Bonds were issued to pay the costs of certain road improvements within the Village's Special Service Areas #25 and to pay the costs of issuance of the bonds. Repayment of the debt is funded by taxes specifically designated in the Special Service Area fund.

Capital

The 2027 Series General Obligation Alternate Revenue Source Bonds were issued to pay the costs of certain road improvements within the Village's Special Service Areas #26 and to pay the costs of issuance of the bonds. Repayment of the debt is funded by taxes specifically designated in the Special Service Area fund.

Note Disclosures – Long Term Liabilities

	Balances May 1, 2026	Additions	Maturities and Retirements	Balances April 30, 2027	Current Portion
Accrued Compensated Absences	$ 298,616	$ 26,273	$ 29,862	$ 295,027	$ 29,503
Net Pension Obligation	181,982	3,195	-	185,177	-
Unamortized Premium on Bonds	36,274	17,843	3,297	50,820	-
Unamortized Discount on Bonds	(16,808)	-	(1,216)	(15,592)	-
2021 Series General Obligation Alternate Revenue Source Bonds	289,000	-	21,000	268,000	22,000
2023 Series General Obligation Alternate Revenue Source Bonds	455,000	-	30,000	425,000	30,000
2025 Series Debt Certificates	2,030,000	-	225,000	1,805,000	230,000
2025A Series General Obligation Alternate Revenue Source Bonds	475,000	-	30,000	445,000	30,000
2026 Series General Obligation Alternate Revenue Source Bonds	440,000	-	20,000	420,000	25,000
2027 Series General Obligation Alternate Revenue Source Bonds	-	700,000	-	700,000	30,000
TOTAL GOVERNMENTAL ACTIVITIES	$ 4,189,064	$ 747,311	$ 357,943	$ 4,578,432	$ 396,503

Not Capital

$480,204

$4,578,432 - $480,204 = $4,098,228

Example #1 – ANSWER KEY

Net Investment in Capital Assets of a Reporting Unit [a]

	$
Net carrying value of capital assets (may be entered directly instead of entering above)	17,031,482
Less:	
• Outstanding principal of capital debt and other capital borrowings [b] of the reporting unit (only that pertaining to the reporting unit's own capital assets), limited to the portion of the debt of which proceeds were expended for capital purposes [c] and excluding unspent proceeds ("capital-related debt")	4,098,228
• Outstanding principal balance of any other capital-related liabilities as of fiscal year end, such as accounts payable and retainage payable for for capital purposes	49,000
Plus:	
• Unamortized balance of capital-related deferred outflows of resources, such as from "losses" on refunding of outstanding capital debt	61,814
Equals: Net investment in capital assets of the reporting unit	12,946,068

Effects of a Service Concession Arrangement (SCA)

- In 2023, the village had entered into a service concession arrangement, as transferor, with a minor league sports team.
  - ✓ The team agreed to build a baseball stadium and parking lot (facilities) which immediately became property of the village, on previously unoccupied village-owned land, and to maintain the facilities for 20 years. These facilities were included in the capital assets reported by the village on its FYE 2027 financial statements.
  - ✓ In exchange, the village granted the team the right to the exclusive use of the facilities for the 20 year period, and permits the team to retain revenue from ticket sales, concessions, and from renting the facilities out when not being used by the team.

Effects of an SCA (cont.)

- ✓ The team made a significant one-time up-front payment upon the inception of the arrangement, which the village recognized along with a deferred inflow of resources (“Deferred inflow of resources from up-front payment”)
- ✓ When the facilities were placed into service, the village recognized the building and land improvements as capital assets and another, separate, deferred inflow of resources (“deferred inflow from building and land improvements”)
- ✓ As of FYE 2027, $\boxed{\$50{,}000}$ of the deferred inflow of resources from the up-front payment remained unamortized, as did $\boxed{\$200{,}000}$ of the deferred inflow of resources from buildings and land improvements

Polling Question # 3

Which of the following would properly incorporate the additional facts about the SCA into the calculation of the village's net investment in capital assets (assuming the facilities had already been included as capital assets)?

A. The capital deferred inflows of resources should be increased by $250,000,

B. The capital deferred inflows of resources should be increased by $200,000,

C. The capital deferred inflows of resources should not be changed.

Real Question Received

Hi Michele.

We have a question regarding the net investment in capital assets calculation for one of our Enterprise Funds. In the Asset portion of the calculation, the entity is adding restricted cash based on the following reasons:

- Amounts required to be set aside, under the XXXXX Agreement between XXXXX, XXXXX and XXXXX, for operation and maintenance costs and repair and replacement.
- Amounts required to be set aside per bond funding agreements for debt service payments (bond fund), operation and maintenance costs (pledged revenue), and repairs and replacement.

Does GFOA agree that restricted cash associated with the above categories should be included in the calculation?

Real Answer Sent

Cash is not a capital asset,

regardless of whether, or to what purpose, it is restricted.

GFOA Resources

- Net Investment in Capital Assets Calculation Template https://www.gfoa.org/materials/net-investment-calculation-template
- *Governmental Accounting, Auditing and Financial Reporting* (GAAFR) 2022 eBook edition and GAAFR Plus subscription service https://www.gfoa.org/gaafr-plus
- Certificate of Achievement for Excellence in Financial Reporting Award Criteria Checklists https://www.gfoa.org/coa-award-criteria-checklists
- *Government Finance Review* article "From Confusing to Cringe-Worthy: Errors Made in Calculating Net Investment in Capital Assets"

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