Fixed Assets Management: For Churches & Nonprofits

Contents

ASSET MANAGEMENT IS IMPORTANT

The largest capital investments that nonprofits and churches have are the investments in their property, furniture, vehicles and other equipment. These are fixed assets, and when it comes to managing, tracking and depreciating them, you want to be sure you are doing it correctly.

This eBook provides a holistic understanding of what a fixed asset is and how to track, manage, and depreciate the asset throughout the course of its useful life. We will also go over:

•Calculating and comparing different methods of depreciation
•Allocating fixed asset costs according to GAAP
•Maintaining a record of depreciation for each fixed asset

The information provided is for educational purposes only and is not intended to serve as professional tax advice for your organization. Be sure to consult a licensed tax advisor if you have any questions on the material provided here.

Defining a Fixed Asset

When a nonprofit or church buys a piece of furniture, computer, or vehicle, these items have lasting value and usefulness. Rather than recording the entire purchase price as an expense in your accounting software, the item is tagged as a fixed asset. A fixed asset is a resource that is available for use now and into the future.

Determining whether an item is a fixed asset or not is made possible through a **capitalization policy**. Typically, this policy will state that fixed assets must meet two criteria:

1. A useful life of more than one year, and
2. Cost more than a certain amount — ex: anything over $500

Fixed assets are long-term items like:

- Land
- Equipment
- Vehicles
- Furniture
- Buildings
- Building Improvements

For most fixed assets, their value will diminish over time. After a couple of years, those laptops you bought for your organization will be slower compared to today's, or that furniture will start showing signs of wear and tear from all the meetings you've held. As the value of your assets decrease over time, you can *depreciate* them.

Fixed Asset Depreciation Basics

In an accrual system of accounting, fixed assets are not expensed when they are purchased; instead, they are allocated over a period of time known as the useful life of an item (the amount of time the asset is expected to last before it gets old and outdated). This process is known as depreciation.

Before we get into how an item gets depreciated, we need to first establish of few things.

First, we need to establish the fixed asset's **placed-in-service** date. This is the date on which depreciation may begin to be claimed and isn't limited to the day the asset was purchased or acquired.

An asset is considered to be "placed in service" when it is fully operational and ready to use. The date of purchase usually marks when an asset is placed in service, but not always. If a building needs to be remodeled before it can be put into service, it cannot be depreciated until the remodeling is finished.

Second, we've mentioned a few times already about the importance of knowing what a fixed asset's **useful life** is — now we'll go into some detail here about what that really means.

> Useful life is the estimated lifespan of a depreciable fixed asset. It's the total time during which it can be used in your organization.

Every church and nonprofit must select a lifespan for that fixed asset that best represents an asset's true economic usefulness. Industry guidelines, and a nonprofit or church's maintenance and replacement policies, can also help with this determination.

Fixed Asset Depreciation Basics Cont.

Below is a chart that shows some of the most common fixed assets found in churches and nonprofits, followed by a column that shows their typical useful life. While these are quite common, be sure to check these against GAAP and the IRS' recommendations as these guidelines sometimes vary in certain situations.

Asset Type	Estimated Useful Life
Buildings	40 years
Improvements	Life of original asset (min 20 years)
Leasehold Improvements	Life of lease (max 15 years)
Furniture and Equipment	5-10 years
Vehicles	3-5 years
Computers	5 years

Third, once the useful life is determined, before each item can be depreciated, you'll need to know it's **salvage value** (or scrap value). The salvage value is an estimated value of a fixed asset at the time it will be sold or disposed of – sometimes this can be a zero, but best practice is to have some salvage value.

What Cannot Be Depreciated?

Not all property used in your church or nonprofit can be depreciated. Land retains its usefulness forever, and therefore can't be depreciated. There's also inventory and property that you lease that isn't depreciable either. However, the cost of permanent improvements to property you lease can sometimes be depreciated. Your accountant can help you understand the rules about those improvements.

Fixed Asset Depreciation Methods

Now that we know what a fixed asset is and how to determine its useful life, we can begin talking about how to specifically depreciate it.

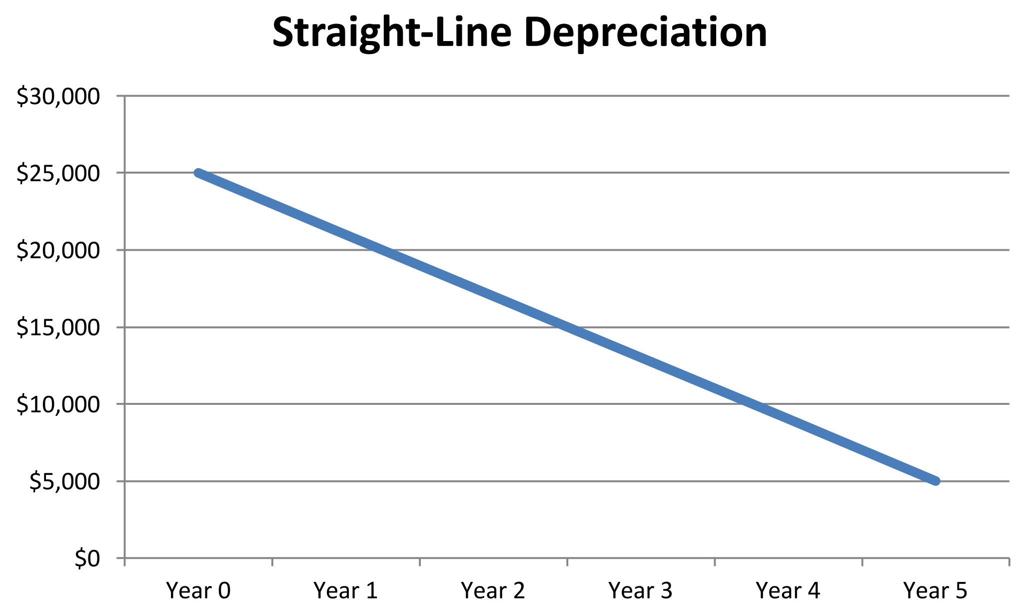
There are several different methods you can use to depreciate a fixed asset. Each of these methods deduct an asset's depreciable basis over its useful life, but do so at different rates. We will cover the two most common methods.

Straight-Line (most common)

This is the most commonly used method of depreciating a fixed asset and it's also the simplest. It basically calculates the same amount of depreciation each year over its estimated useful life.

Formula = (cost – salvage) / years

Let's use a car as an example. If it depreciates over 5 years, and its initial cost is $25,000 with a salvage value of $5000, then this car will depreciate at $4,000 each year. Here's the formula: ($25,000–$5,000) / 5 = $4,000.



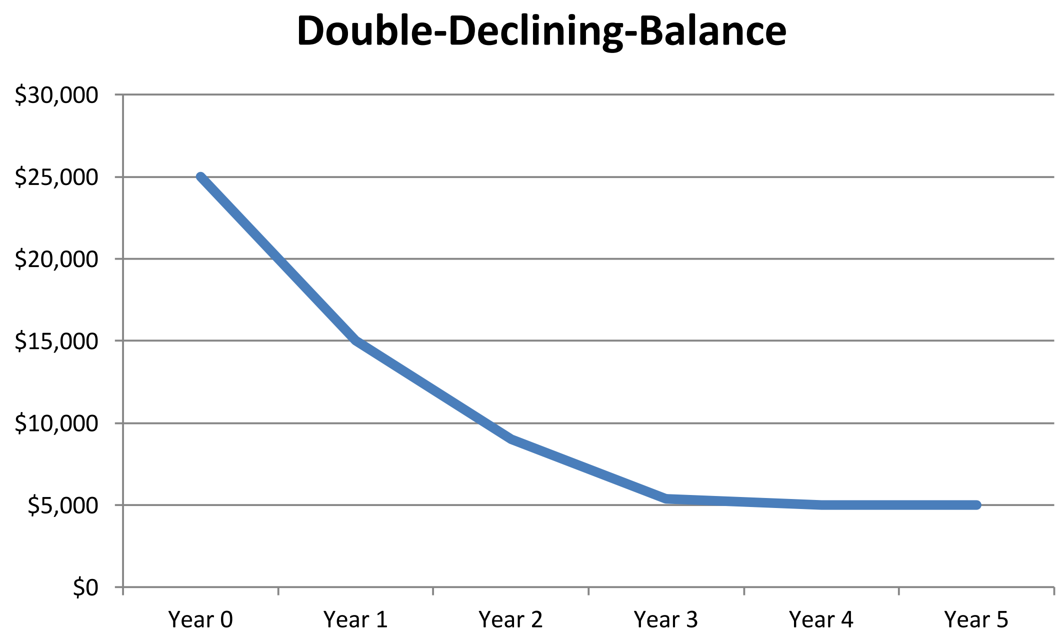
Fixed Asset Depreciation Methods Cont.

Double Declining-Balance Method

The double declining-balance depreciation method calculates more depreciation in the early years of an asset's life and smaller amounts as the asset gets older. The depreciation rate is double the straight-line rate.

Using the double declining-balance method for our same example of the $25,000 car, you would deduct 40% of $25,000 in year one, 40% of $15,000 in year two, 40% of $9,000 for year three and so on. This process continues until it reaches its salvage value. Don't let the asset's book value fall below its salvage value though!

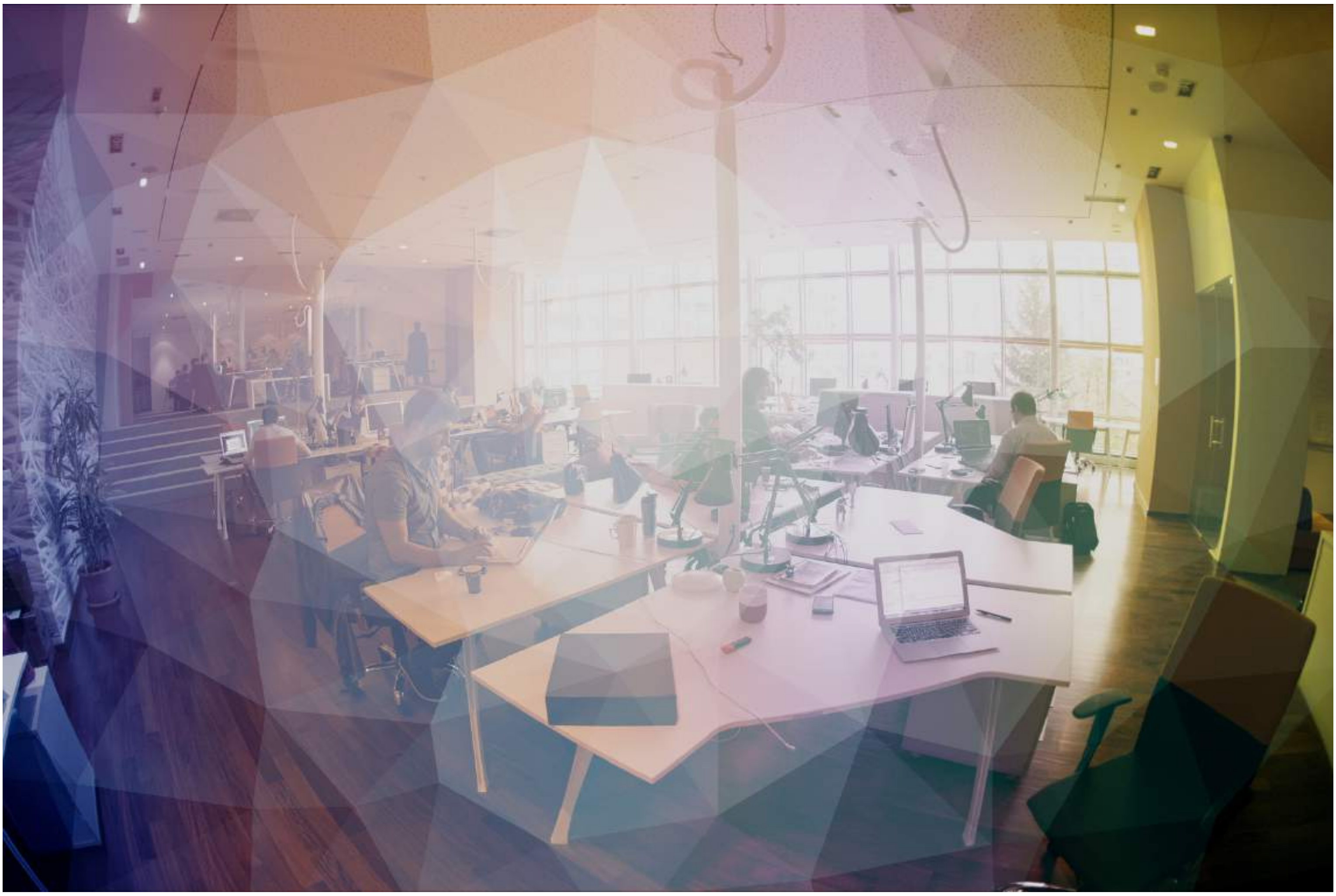
By year four in the example above, the value would have fallen below $5,000 if we had kept depreciating it by 40%. When this happens, the correct thing to do is to make the asset's book value the same as its salvage value (as illustrated in the graph below). You may also choose to switch back to straight-line depreciation at year three or later to have enough value to depreciate through the full life cycle.



Fixed Asset Depreciation Methods Cont.

Because the double declining-balance method has larger depreciation expenses at the beginning of the asset's life and much smaller depreciation expenses later on, it makes way more sense to use this method with those assets that tend to lose value quickly, like a car or a computer.

Note: For this eBook, we're only going to discuss these two types of depreciation methods as they are the most common. For a complete list of all the methods, please go to accountingtools.com.



When Does Depreciation End?

Now that we've read all about fixed assets and how to depreciate them, we thought we'd close with a simple explanation on knowing when to stop the depreciation of an asset.

You cannot claim depreciation of a fixed asset when:

1. You've fully depreciated it down to its salvage value
2. You've retired the asset from service, including:
   - Having it sold
   - Abandoned, destroyed or converted it to scrap
   - Converting it to personal use

Note >> You cannot continue depreciating an item once it reaches its salvage value. Remember, to figure out the salvage value, make a reasonable estimate of what the asset will be worth at the end of its useful life.

A fixed asset should remain on the books until it is disposed of — even if it has been fully depreciated. Once the asset is properly disposed of, you'll need to remove the net book value of the asset from your chart of accounts. It's rare to have an asset that's sold or disposed of for the same dollar amount as the book value. If the sales price exceeds book value, you'll need to record a gain. When the sales price is below book value, you'll need to record a loss.

Depreciation in Action

Now that we know all there is to know about fixed assets and how to depreciate them — let's put it to practice in our books with some simple journal entries. To do this, your chart of accounts will need these accounts:

- Assets
  - Cash Account (ex: checking)
  - Fixed Asset Account (ex: vehicle fixed asset)
    - Accumulated Depreciation Account
- Liability
  - Auto Loan Account (if applicable)
- Expense
  - Depreciation Expense

Using our same example from earlier with the purchase of a car, let's break down what happens when you first record it.

Below is a sample journal entry you would make on the date you purchased the vehicle.

		Debit	Credit
5/15/16	Vehicle Finance	$25,000	
	Cash		$5,000
	Auto Loan		$20,000

At the end of the year, assuming you are going to depreciate over the next five years using the straight-line method, you'll want to show a debit of $5,000 for the depreciable expense, and a credit of $5,000 for the accumulated depreciation. You'll do this with another journal entry that will look something like the one below.

		Debit	Credit
12/31/16	Depr. Expense	$5,000	
	Accum Depr.		$5,000

Lastly, your balance sheet should reflect the current value of the vehicle (as an asset) as part of your total assets.

Balance Sheet

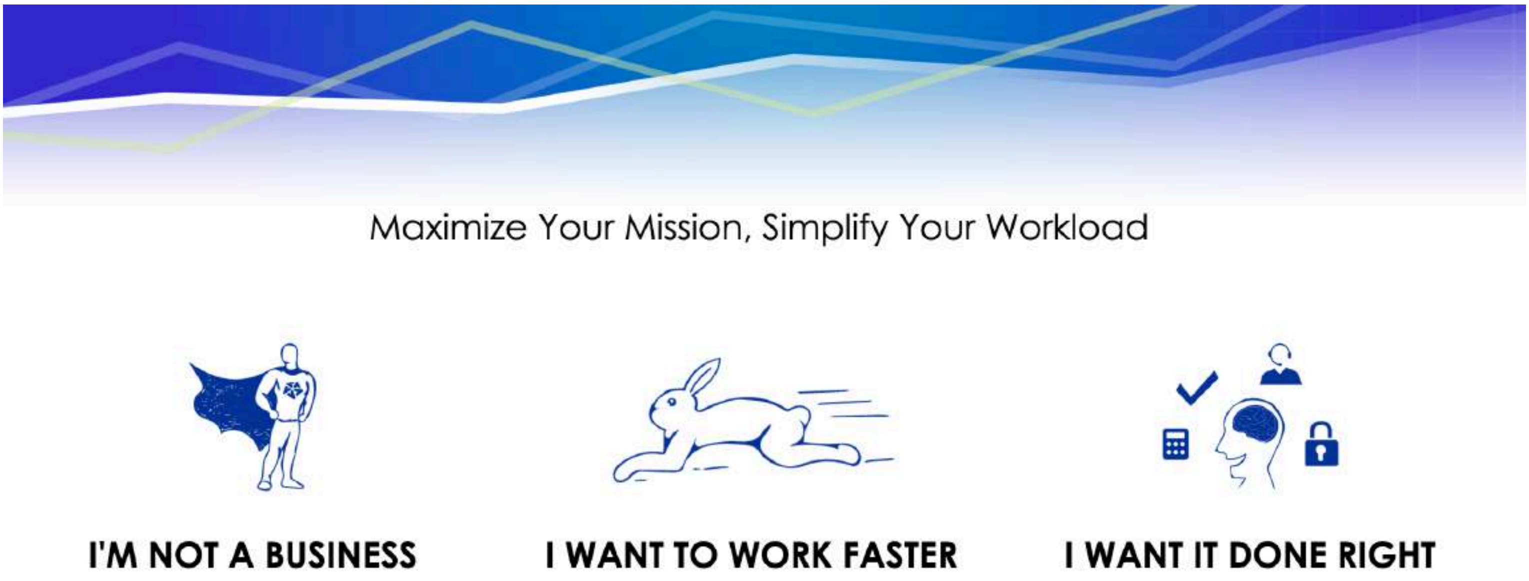
Cash	$1,000
Vehicle	$25,000
Accum Depr.	$5,000
Total Assets	$21,000

CONCLUSION

We hope that you've found this eBook on fixed assets to be helpful! As a reminder, the information in this eBook is for educational purposes only and you should always consult a licensed tax consultant if you have any questions about the contents contained here.

If you are a small shop, a solid accounting software made for nonprofits or churches like **Aplos Standard Accounting** should work for your needs. However, if you want to increase your fixed asset tracking with more automated options and richer reports, check out **Aplos Advanced Accounting**.

Aplos was specifically tailored for nonprofits and churches with powerful features like fund accounting, budget by fund, fixed asset tracking, and cost allocation. We encourage you to check us out at https://www.aplos.com for more information.



Fixed Asset Glossary of Terms

Book Value — The cost of a fixed asset minus accumulated depreciation on the asset.

Capitalization Policy — Used by a company or organization to set a threshold, above which qualifying expenditures are recorded as fixed assets, and below which they are charged to expense as incurred.

Depreciation — The systematic periodic transfer of the cost of a fixed asset to an expense account during its expected useful life.

Double-declining-balance Method — A method of depreciation that provides periodic depreciation expense based on the declining book value of a fixed asset over its useful life.

Fixed Assets — Long term or relatively permanent tangible assets such as equipment, machinery, and buildings that are used in the normal business operations and that depreciate over time.

GAAP — Generally Accepted Accounting Principles. GAAP is a standard structure of guidelines for financial accounting, most often used in the US, but also prominent in the UK.

Intangible Assets — Long-term assets that are useful in business operations, are not held for sale, and are without physical qualities.

Placed-in-Service Date — This is the date on which depreciation may begin to be claimed.

Salvage or Residual Value — The estimated value of a fixed asset at the end of its useful life.

Straight-line Method — A method of depreciation that provides for equal periodic depreciation expense over the estimated useful life of a fixed asset.

Useful Life — The estimated lifespan of a depreciable fixed asset, during which it can be expected to contribute to company operations.