OFFICE OF THE
STATE AUDITOR

BRIEF EXPLANATION

Revised January 2019

Depreciation

Overview

There is a principle in accounting standards which requires an expense transaction to be matched with a corresponding time period or income transaction. Depreciation is a way to match the expense of an asset purchase with the time period that asset is in use and contributing to the functions of the organization.

Governmental funds prepare two types of financial statements. One statement shows capital assets and recognizes depreciation expense for those assets each year, while the other statement shows the total expenditure as an expense when it is incurred.

Examples

A water district purchases a pump for $5,500. The board has an adopted policy that any equipment purchase over $5,000 will be capitalized and depreciated over 5 years. The pump would be capitalized and tracked as an asset, instead of being expensed at the time of purchase. Each year the district would recognize $1,100 (one fifth the cost of the asset) as depreciation expense so after the 5 year estimated life the asset would have a net value of zero. If the same pump only cost $2,000, then, per policy, it would be expensed when purchased.

A town completes a drainage project that cost $100,000. The project would be recorded as a capital asset and depreciated. The depreciation expense recognized each year depends on the governing body's adopted capitalization policy. In this case, we will use 40 years. So, the town would record an expense of $2,500 for depreciation each year for the 40 year project life.