

Asset Capitalization Thresholds: The Case for Disclosure

By Jonathan Schiff, Ph.D., CMA; Hannah Rozen, Ph.D., CPA; and Abraham Fried, Ph.D.

EXECUTIVE SUMMARY

How much do management accountants know about asset capitalization threshold (ACT) practices? Here the authors share the results of their field research involving large and small, private and publicly held companies in a variety of industries that sheds light on current practices in this under-investigated space.

For many years, accounting and financial reporting rulemakers have focused on the balance between a proposed disclosure's informational value to the users of financial statements and the cost of producing the disclosure for the preparer community. Of course, new disclosures also must align with the auditor's ability to attest to management's representations as well as align with accepted accounting concepts and principles. Critics argue that, for some disclosure requirements, the cost/benefit test is not met as they are costly to comply with and yield limited value to the readers of financial statements.¹ But providing available decision-support information at little cost and without disclosure of a company's "trade secrets" should be embraced.²

Current accounting and finance textbooks pay little or no attention to asset capitalization threshold (ACT) practices. Additionally, the professional as well as academic literature is devoid of any meaningful research on the subject with respect to general purpose financial statements. This is due partly to the lack of available information in public disclosures on ACT. With a view toward illuminating and understanding this murky subject, we gathered pertinent information directly from management accounting executives via a brief online survey instrument. We are very grateful to the management accounting leadership community for their keen interest in

sharing their ACT and related information with us with a view toward furthering our profession.³

ACT disclosure is an opportunity that can improve the decision making of a variety of stakeholders, enhance the quality of our financial statements, and strengthen confidence in our financial markets more broadly. Every company is required to set a threshold for asset capitalization and apply it consistently. But the dollar amount that companies use to define whether a purchase is expensed or capitalized is not disclosed in the Notes to Financial Statements section of the annual report.

Given the importance of management accounting’s role in business decision support, Table 1 provides examples of business decisions, both strategic and operating, that can be affected as a result of a lack of ACT transparency. Table 2 presents comments made by sur-

vey respondents (all with CFO, corporate controller, or chief accounting officer (CAO) titles) regarding their perspectives on ACT disclosure.

We found that there is a significant diversity in asset capitalization thresholds independent of company size, profitability, and industry. We will demonstrate that the quality of a commonly used financial statement analysis measurement can be diminished by the absence of ACT disclosure with respect to the financial performance evaluation of specific companies over time or the comparative performance analysis of a company within an industry group. The lack of ACT disclosure can impact the quality of management accounting decisions including but not limited to:

- Qualifying suppliers,
- Granting customer credit,

Table 1: Business Decisions and ACT Transparency

Strategic Decisions	Mergers and acquisitions	Assessing the reported net income and net income dependent financial ratios of acquisition candidates can be clouded if the ACTs of the candidates are not known.
	Strategic partnering	The long-term financial health of a strategic partner is critical to consideration of a partner. Reported net income of strategic partner choices can be affected by each partners’ ACT and increases the risk of making of a suboptimal choice.
Operating Decisions	Credit extension	Reported profitability of a potential customer is an important factor in granting credit. Without understanding ACT, we are assuming that all customers have the same ACT.
	Supplier qualification	The financial well-being of a key supplier can be critical to the organization. Recent, highly publicized examples include Airbus and Boeing where suppliers’ deteriorating profitability may have been masked by supplier selection of ACT, resulting in costly delays in aircraft rollouts to customers.
	Business unit performance evaluation	Companies compare and analyze business unit performance. Frequently, these analyses use return on capital criteria or similar metrics. If ACT is not followed consistently across the business units of the organization, misleading results could lead to decisions that have serious negative results.
	Benchmarking profitability performance across an industry	Industry benchmarking is a fixture for organizations large and small. If we benchmark profitability without understanding each benchmark’s ACT, we may come to an incorrect conclusion regarding what is truly driving “first quartile” profitability.

Table 2: Sampling of Comments about ACT from Interviews with Management Accounting Leaders

“ACT disclosure in Form 10-K should be required to improve transparency.”

“We recently updated our 100-year-old ACT and that change impacted EPS by about 1%.”

“We have found more inconsistencies than one would expect in ACT compliance across our global company, particularly in newer markets.”

“Specific guidance from GAAP would be helpful for comparability.”

“Exceptions to our corporate ACT policy read like *War and Peace*.”

“ACT disclosure in Form 10-K should be required to improve transparency.”

- Evaluating the financial health of strategic partners,
- Benchmarking profitability within an industry, and
- Assessing acquisition targets.

The first section of this article summarizes existing standards associated with ACT compliance, guidance, and reporting from a variety of perspectives. The second section provides a detailed data description of our sample. The third presents a statistical analysis of results. The final section includes the authors’ recommendations for the management accounting leadership community. A true-to-life ACT illustration for training purposes is provided in the Appendix.

SECTION 1: ACT GUIDELINES BY STANDARDS-SETTING BODIES

A variety of standards-setting bodies set guidelines regarding which assets must be capitalized and which must be expensed. In some cases, very clear guidelines are promulgated by regulators, complete with asset category and dollar amounts. In others, general principles are provided with specific capitalization/expense decisions left to the discretion of the organization’s management accounting team. Financial Accounting Standards Board (FASB) guidelines fall into the latter category, with a requirement for consistent—but not dollar amount—disclosures. Other standards-setting and regulatory bodies clearly agree with the importance of organizations disclosing their respective ACTs and requiring ACT disclosure. To provide the reader with the ability to compare and contrast FASB guidance with that of other standards-setting bodies, we present a synopsis of

guidance provided by the FASB, the International Accounting Standards Board (IASB), the Governmental Accounting Standards Board (GASB), and other U.S. regulators, as well as the Internal Revenue Service (IRS).

FASB: Costs are capitalized if an expense can be considered an investment of capital instead of an expense for the year, which is often tied to the future productivity of the asset. A company first must determine whether the asset will benefit future periods and not just the current operations of a business. Next, if the company determines that the asset will benefit future periods, it should apply its asset capitalization policy to the asset in question.

For the sake of consistency within a company, Generally Accepted Accounting Principles (GAAP) recommend that a company establish a policy regarding asset capitalization that would apply even if an item may be used for more than a year. The policy generally will define a certain threshold dollar amount below which assets are expensed and above which assets will be capitalized. Managers are motivated to display higher reported capital expenditures while, at the same time, minimizing reported operating expenses, resulting in higher reported net operating income. Similarly, financial analysts “reward” companies with higher cash flow from operations and later ignore related depreciation expenses since they do not affect cash flow. Therefore, maintaining a lower asset capitalization threshold may achieve these goals.

A significant number of companies have a policy of

capitalizing all assets acquired for more than \$500, but the threshold varies greatly. Some companies expense all fixed assets below a minimum threshold of \$25,000.⁴ Furthermore, a company may elect to capitalize multiple assets that function in similar ways as a group, thereby avoiding expensing items that may fall below the threshold individually. For example, Company A purchases 50 laptop computers, which would be expensed had they been classified on an individual rather than group basis. GAAP does not specifically state how much the threshold should be as long as it is applied consistently over time. Though the policy is documented, the company is not required to disclose its chosen threshold in the financial statements. Furthermore, no statutory guidance exists regarding asset capitalization thresholds despite the fact that three of the 10 generally accepted accounting assumptions and principles

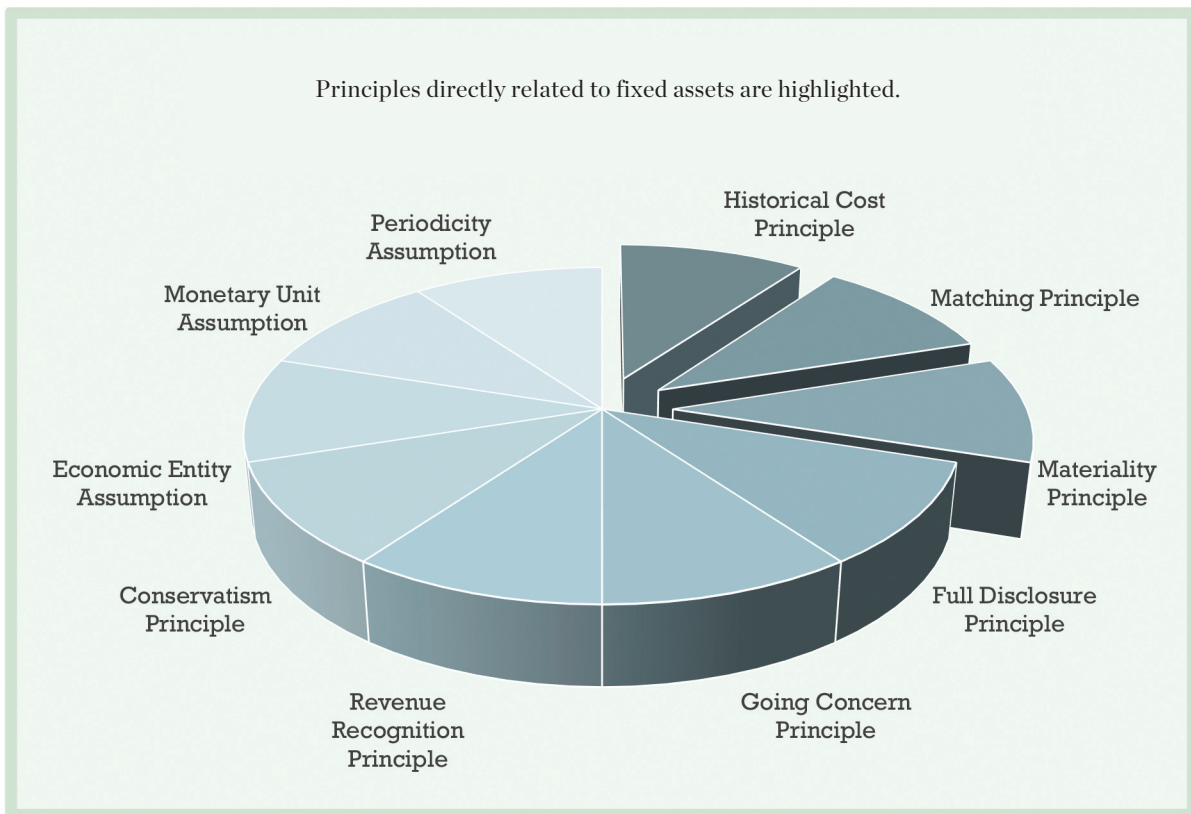
focus specifically on managing and accounting for fixed assets (see Figure 1).

IASB: Like GAAP, International Financial Reporting Standards (IFRS) do not provide any specific guidance regarding asset capitalization thresholds.

GASB, IRS, and U.S. Regulatory Bodies: Various governmental bodies and organizations with federal contracts, or, similarly, school boards, colleges, and other educational institutions, will base their capitalization thresholds on the limits established by the organizations that fund them as a means of standardizing policy.

Unlike GAAP or IFRS, whose rulemaking objectives are to enhance financial statement reliability and protect investor wealth, Governmental Accounting Standards generally serve to protect taxpayer funds

Figure 1: 10 Generally Accepted Accounting Assumptions and Principles



from loss and/or misuse and therefore are designed to maintain control over all assets.⁵ GASB Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, requires the recording and tracking of infrastructure along with customary fixed assets necessitating capital asset records, which include more auditable information than fixed assets records. Office of Management and Budget Circular A-87 (OMB A-87), *Cost Principles for State, Local, and Indian Tribal Governments*, addresses capitalization limits and provides specific guidance.

GFOA: The Government Finance Officers Association (GFOA) provides guidelines but maintains that a “government may establish a single capitalization threshold for all of its fixed assets or establish multiple capitalization thresholds for different classes of fixed assets.” Overall, a governmental entity should set its capitalization thresholds for capital assets solely from the perspective of the requirements of sound financial reporting. The GFOA recommends that state and local governments consider the following detailed guidelines in establishing capitalization thresholds:⁶

- (1) Potentially capitalizable items in terms of materiality should only be capitalized if they have an estimated useful life of at least two years following the date of acquisition;
- (2) Capitalization thresholds are best applied to individual items rather than to groups of similar items (e.g., desks and tables) unless the effect of doing so would be to eliminate a significant portion of total capital assets (e.g., spare truck parts);
- (3) In no case should a government establish a capitalization threshold of *less than \$5,000* for any individual item;
- (4) In establishing capitalization thresholds, governments that are recipients of federal awards should be aware of federal requirements that prevent the use of capitalization thresholds in excess of certain specified maximum amounts (i.e., currently \$5,000) for purposes of federal reimbursement; and
- (5) Governments should exercise control over potentially capitalizable items that fall under the operative capitalization threshold.

DCAA: The Defense Contract Audit Agency (DCAA) provides audit and financial advisory services to the Department of Defense and other federal entities. The DCAA provides very specific requirements for asset capitalization threshold policies.⁷ Requirements are designed to ensure transparency and fairness in the bidding process and to reduce instances of fraud. Cost Accounting Standard 404—*Capitalization of Tangible Assets* requires contractors to capitalize the acquisition cost of tangible assets in accordance with a written policy that is reasonable and applied consistently. The policy must include:⁸

- (1) A minimum service life criterion which shall not exceed two years, but which may be a shorter period.
- (2) A minimum acquisition cost criterion which shall not exceed \$5,000 but which may be a smaller amount.
- (3) Identification of asset accountability units to the maximum extent practicable.
- (4) Establishment of minimum dollar amounts for the capitalization of low-cost equipment and for improvements. These minimum amounts may exceed the \$5,000 limitation provided the higher limitations are reasonable in the contractor’s circumstances.

Federal Reserve Bank: In its role as steward over investor funds, the Fed provides very specific guidance on capitalization thresholds, but it still allows different banks to choose from a spectrum of ACTs as long as that threshold is applied consistently throughout the district in which the bank operates. The thresholds vary by industry sector. (See Table 3.)

IRS: The IRS provides specific guidelines to companies regarding which assets to expense and which to capitalize. In 2013, the U.S. Department of the Treasury and the IRS issued regulations combining case law and other authorities into a framework to provide guidance for required capitalization of certain assets, applicable for tax years beginning in 2014. Generally, the asset capitalization threshold for companies with an applicable financial statement (AFS) is \$5,000.⁹ Furthermore, in order to simplify paperwork and

Table 3: Federal Reserve Bank Fixed Asset Capitalization Thresholds

Asset Classification	Capitalization Thresholds (Individual Assets)
Land	Any acquisitions
Land Improvements	\$100,000
Building and Improvements	\$100,000
Building Machinery and Equipment	\$50,000
Equipment and Improvements	\$5,000
Furniture, Furnishings, and Fixtures	All using the pooled asset method
Externally Purchased Software	\$25,000
Internally Developed Software	\$100,000
Leasehold Improvements	\$25,000
Tenant Improvements	\$25,000

recordkeeping for smaller businesses, the IRS released a notice changing the capitalization threshold for taxpayers *without* an applicable financial statement. For tax years beginning after January 1, 2016, the IRS released Notice 2015-82 allowing businesses without an AFS to expense fixed assets costing \$2,500 or less. This limit is \$2,000 higher than the previous limit of \$500 in the regulations. The purpose of the increase was to effectively reduce the administrative burden on small businesses and to take into account standard pricing for normally expensed items such as tablets, personal computers, and smartphones, which generally surpass the previous \$500 threshold.¹⁰

There are two exceptions to capitalization requirements. First, the IRS focuses on economic useful life. If the items purchased are used for one year and have no value after 12 months, then they may be expensed. Second, the *de minimis* rule is limited to the lesser of the

threshold or the taxpayer's accounting policy. This rule allows a company to expense any item that potentially may be capitalized if the expense does not significantly distort the company's bottom line.¹¹ (See Table 4.)

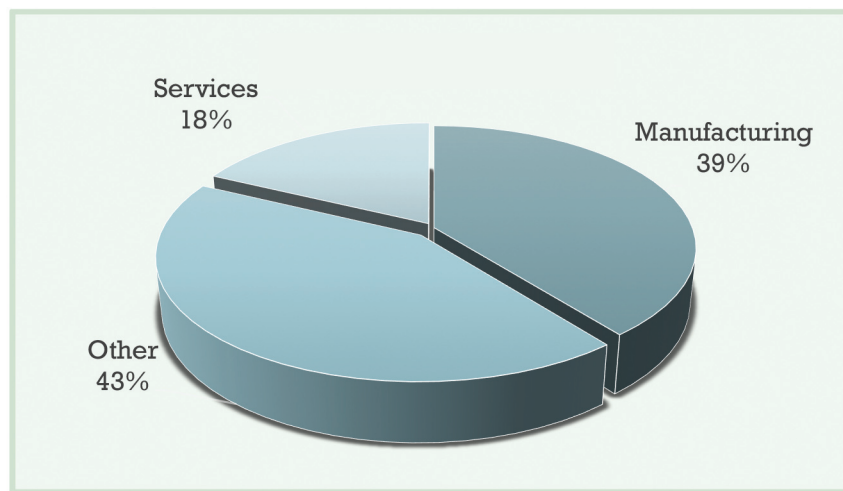
SECTION 2: SAMPLE STUDY OF PUBLIC COMPANIES

As delineated in Section 1, FASB requirements for capitalization thresholds are vague and extremely broad when compared to those of other standards-setting bodies. Given the lack of control over asset capitalization thresholds, coupled with the lack of a disclosure requirement by the FASB, we set out to find whether there was any consistency in the ACTs that companies were choosing. First, we thought that ACT choice should be related to a higher level of investment of property, plant, and equipment (PP&E). This may be due to company size and/or to the industry to which a

Table 4: Summary of ACT Guidance and Disclosure Requirements

Standards Setter	ACT Guidance \$ Amount	Consistency Required?
FASB	Not prescribed	Yes
IASB	Not prescribed	Yes
GASB	Specific	Yes
GFOA	Specific	Yes
DCAA	Specific	Yes
Federal Reserve	Very specific	Yes
IRS	Very specific	Yes

Figure 2: Survey Sample by Sector



company belongs. Therefore, we studied ACT in relation to both company size and company sector. We expected service industry companies, which are generally less invested in long-lived tangible assets, to choose lower ACTs than would manufacturing companies, which are more heavily invested in long-lived assets and generally have higher materiality thresholds. Second, we analyzed whether ACTs were related to company profitability, with ACT choices made with an eye toward potential impact on the company's reported net income.

Data Collection

Because companies are not required to disclose their ACTs in order to analyze ACT choice in current practice, we solicited the information directly from the source. To that end, we distributed a multiquestion survey to financial leaders across a broad range of large,

mostly publicly held companies at an annual CFO Leadership conference.

Sample Characteristics

To further analyze our sample companies, we collected financial statement data for the publicly traded companies we could identify.¹² Additionally, related financial data was collected from Compustat. Of the 40 public companies that responded to our survey, we were able to identify and collect all necessary data items for 28 publicly held companies. (See Figure 2.)

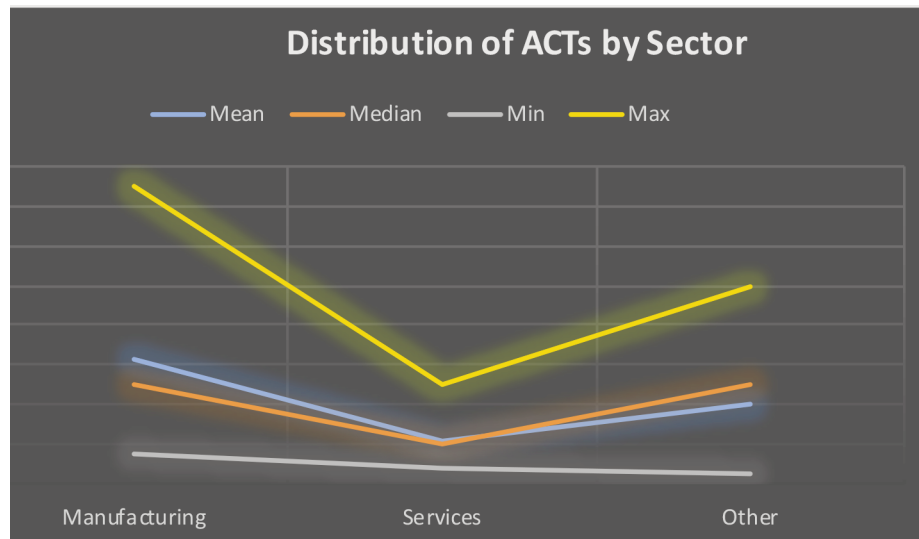
Our sample represented a cross-section of companies including manufacturing companies, service industry companies, and companies from other sectors. Descriptive statistics for the ACTs of the full sample, as well as for each sector, are reported in Table 5.

The range of ACTs for our sample companies was large—from as small as \$500 to as large as \$15,000.

Table 5: Descriptive Statistics for ACTs by Sector

	Mean	Median	Standard Deviation	Min	Max
Manufacturing	6,273	5,000	3,882	1,500	15,000
Services	2,150	2,000	1,692	750	5,000
Other	4,000	5,000	2,985	500	10,000
Full sample	4,563	5,000	3,471	500	15,000

Figure 3: Distribution of ACTs by Sector



Within each sector, there also was a range of reported ACTs. Manufacturing companies reported ACTs as low as \$500 and as high as \$15,000. For service industry companies, the range was narrower, from a low of \$750 to a high of \$5,000. The other sector reported the largest range, with the high of \$10,000 being 20 times larger than the low of \$500. (See Figure 3.)

The average ACT for our sample was about \$4,500. By sector, the manufacturing companies had the highest average ACT, just over \$6,200. The average ACT for our service industry companies was lowest at \$2,150. The remaining companies had an average ACT of \$4,000. This difference in average ACTs between sectors was found to be statistically significant and is consistent with our expectation that manufacturing companies would have higher levels of ACTs than would service industry companies.

Company-specific data was collected from Compustat. The variables included in our analysis were measures of size (revenue and total assets), measures of the companies' investment in long-lived tangible assets (PP&E), and measure of profitability (gross profit, operating income—with and without depreciation—and net income).

Our research reports descriptive statistics for these companies' characteristics for the full sample and by sector. The largest companies as measured by revenue were in the manufacturing sector, with a mean revenue of \$15.9 billion. The smallest average revenue was reported by the service sector (\$8.1 billion), and the other sector had average revenue of \$11.2 billion. There was a large range of revenue reported by our sample firms, ranging from as low as \$359 million to a high of more than \$65 billion.

The range of total assets was also large, going from a low of \$547 million to a high of \$127.1 billion. The largest companies in terms of total assets were in the service sector with an average of \$36.9 billion as compared to manufacturing, where the total assets averaged \$26.2 billion, and the other sector, with an average of \$21.4 billion. The differences in company size across sectors, when measured by either revenue or total assets, was not statistically significant.

For PP&E, our measure of investment in long-lived fixed assets, the companies in the other sector had the highest average at \$17.2 million. The average PP&E for the manufacturing sector was \$12.7 million, while the service sector reported a relatively small average PP&E

Table 6: Descriptive Statistics by Sector

Descriptive Statistics for Manufacturing Sector

(In millions)	Mean	Median	Standard Deviation	Min	Max
Revenue	15,906	12,399	17,748	1,431	65,299
Total Assets	26,205	15,265	35,823	1,300	127,136
PP&E, Gross	12,772	4,114	14,957	183	39,866
Gross Profit	6,951	5,319	10,065	350	36,186
Operating Income w/o Depreciation	3,502	2,899	4,849	119	17,439
Operating Income with Depreciation	2,475	1,493	4,080	81	14,361
Net Income	1,610	614	3,079	(276)	10,508

Descriptive Statistics for Services Sector

(In millions)	Mean	Median	Standard Deviation	Min	Max
Revenue	8,101	3,061	8,821	863	20,872
Total Assets	36,947	18,515	48,936	553	118,296
PP&E, Gross	1,743	895	1,981	231	5,186
Gross Profit	2,042	883	1,987	209	4,425
Operating Income w/o Depreciation	1,634	883	1,834	73	4,425
Operating Income with Depreciation	1,444	782	1,798	49	4,381
Net Income	580	268	1,107	(158)	2,533

Descriptive Statistics for Other Sector

(In millions)	Mean	Median	Standard Deviation	Min	Max
Revenue	11,272	8,991	9,296	359	31,356
Total Assets	21,397	6,746	36,287	547	118,953
PP&E, Gross	17,226	3,582	43,318	182	154,211
Gross Profit	4,123	2,490	5,305	235	19,595
Operating Income w/o Depreciation	2,173	1,101	3,014	33	10,711
Operating Income with Depreciation	1,054	804	2,929	(4,463)	8,603
Net Income	385	419	2,865	(6,385)	6,939

Descriptive Statistics for Full Sample

(In millions)	Mean	Median	Standard Deviation	Min	Max
Revenue	12,526	9,702	13,129	359	65,299
Total Assets	26,063	8,950	37,392	547	127,136
PP&E, Gross	12,711	3,582	29,652	182	154,211
Gross Profit	4,862	2,883	7,285	209	36,186
Operating Income w/o Depreciation	2,599	1,153	3,673	33	17,439
Operating Income with Depreciation	1,682	804	3,253	(4,463)	14,361
Net Income	901	399	2,717	(6,385)	10,508

Table 7: Correlation Coefficients between ACT and the Variables Listed

	Sample	Manufacturing	Service	Other
Revenue	0.258	0.157	-0.373	0.347
Total Assets	0.198	0.050	-0.032	0.616**
PP&E, Gross	0.495***	0.596*	0.004	0.651**
Gross Profit	0.109	-0.056	-0.266	0.125
Operating Income w/o Depreciation	0.188	0.047	-0.249	0.276
Operating Income with Depreciation	-0.043	-0.028	-0.261	-0.287
Net Income	-0.113	-0.093	-0.263	-0.386
n	28	11	5	12

Note: *, **, and *** indicate significance at the 10%, 5%, and 1%, levels, respectively.

of \$1.7 million. This smaller investment in long-lived assets is consistent with the nature of service industry companies. For the full sample, investment in PP&E ranged from a low of \$182 million to a high of \$154 billion. The differences across sectors of the level of PP&E were not statistically significant.

For our measures of profitability, the manufacturing sector reported the highest averages across all four measures of profitability. The service sector reported a higher average net income (\$580 million) than the other sector (\$385 million). For gross profit, the average of \$2.4 billion for the service industry was lower than the \$4.1 billion of the other sector. This likely is due to cost of sales being a relatively smaller proportion of total costs for service industry companies.

Interestingly, operating income without depreciation is higher for the other sector (\$2.2 billion) than for service (\$1.6 billion), while operating income after depreciation is the reverse—higher for service (\$1.4 billion) than for other (\$1.1 billion). This reversal is consistent with the higher level of PP&E reported by the other sector relative to the service sector, which results in a greater amount of depreciation. (See Table 6.)

To summarize, our sample companies are diverse in terms of company size, level of investment in PP&E, and profitability. There is no statistically significant difference between the sectors of our sample companies across these measures and company characteristics. The only variable where we found a statistically significant difference between sectors is in the level of ACTs these

companies chose. This finding of a difference in the level of ACTs reported by companies that are similar in so many other respects supports our proposal of a disclosure requirement for ACTs.

SECTION 3: ANALYSIS OF SURVEY RESULTS

To understand the determinants of a company's choice of ACT, we analyzed the correlation of the variables in our study with the reported ACTs. We looked at the correlation between a company's ACT and measures of company size, investment in long-lived assets, and profitability.

Company Size

We included two measures of company size in our analysis to see if larger companies, independent of industry, chose higher ACTs. We used total assets and total revenues as measures of company size. We found that both measures were positively related to the company's ACT, but neither correlation was statistically significant.

PP&E

To further investigate the correlation between the ACT and a company's level of assets, we looked at the correlation between the ACT and specific categories of assets. We found a statistically significant and positive correlation between a company's ACT and its PP&E. This finding is consistent with companies that have higher levels of capital expenditures and higher levels of investment in long-lived fixed assets setting higher ACTs. (See Table 7.)

Table 8: Summary of Key Findings of Statistical Analysis

Variable	Relation to ACT
Company Size	Positive
Level of Investment in Fixed Assets	Significantly Positive
Gross Profit	Positive
Profitability before Depreciation	Positive
Profitability after Depreciation	Negative
Net Income	Negative

Profitability

We also were interested in investigating the relationship between a company's choice of ACT and its profitability. If companies chose their ACTs based on how the subsequent depreciation of the capitalized costs would influence their profitability, we would expect to find a correlation between profitability and ACTs. We included several measures of profitability in our analysis: gross profit, operating income (with and without depreciation), and net income. We found ACTs to be positively related to gross profit but negatively related to net income. Although not statistically significant, the change in direction of the correlation from positive to negative as we move down the income statement from gross profit through operating income down to net income, is consistent with our illustration. Higher thresholds result in higher levels of costs that are expensed as incurred and thus lower levels of profitability. Similarly, while the ACT was positively correlated with gross profit without depreciation, it exhibited a negative correlation to operating income with depreciation. This is consistent with the greater depreciation expense associated with higher ACTs leading to lower operating income after depreciation.

Sectors

Finally, we repeated the correlation analysis by sector to see whether there were any differences between sectors or if a particular one was driving our results. Our statistically significant finding that ACT is positively related to a company's level of PP&E is valid for both the manufacturing and other sectors. For those in the other category, we also found a significant relationship between ACT and total assets. As expected, because of its lower

level of PP&E, there were no significant results for the services industry sector. Table 8 summarizes the key findings of the statistical analysis.

RECOMMENDATIONS

As demonstrated, federal agencies and the IRS provide clear guidance for companies to follow in terms of asset capitalization. Though there is no requirement for companies to capitalize their assets in the same manner for book and tax purposes, we believe that there is great value from a cost/benefit perspective for all stakeholders in encouraging the FASB and the IASB to consider requiring annual disclosure of ACT in the notes to the financial statements of the annual report. This recommendation is with a view toward more coherent, consistent, and comparable operating performance reporting.

In our small sample study, average ACTs range from approximately \$2,000 to \$6,000, depending on sector. Many individual companies, however, have reported that they employ a \$500 or \$1,000 threshold that has been in place for decades. Clearly, the \$500 threshold is outdated because of price inflation, as is reflected in updated guidance published by the IRS and other governmental bodies that generally require a minimum \$5,000 threshold depending on asset type. Therefore, we recommend that the FASB and the IASB consider this matter in an accelerated manner.

We want to note that the proposed ACT disclosure requirement would strengthen internal controls. During our interviews with management accounting leaders, we found that the rise of inconsistent application of a company's ACT policy across its many business units is viewed as a potentially serious exposure. Additionally, reviewing and updating the company's ACT policy

should yield a reduction in cost, given the savings that result from fewer plant and equipment assets requiring capital budgeting, tracking, and accounting. This means that fewer plant and equipment assets can enable greater focus on both business planning and risk management—keys to realizing the future of management accounting. ■

Jonathan Schiff, Ph.D., CMA, is a professor of accounting at Fairleigh Dickinson University and is a member of IMA's Bergen-Rockland-Meadowlands Chapter. He can be reached at schiff@fdu.edu.

Hannah Rozen, Ph.D., CPA, is an associate professor of accounting at Fairleigh Dickinson University. She can be reached at hrozen@fdu.edu.

Abraham Fried, Ph.D., is an associate professor of accounting at Seton Hall University. His email is abraham.fried@shu.edu.

© 2019 by IMA® (Institute of Management Accountants), Montvale, N.J., www.imanet.org. Used with permission.

ENDNOTES

- 1 Edward W. Trott, "The Struggle to Simplify Accounting," *CFO.com*, January 22, 2015. Trott is a former member of the Financial Accounting Standards Board; Michael Rapoport, "FASB Looks to Uncomplicate Accounting—A Little, At Least," *The Wall Street Journal*, August 15, 2014.
- 2 For example, United States Steel's 1902 annual report, audited by Price Waterhouse, contains robust segment reporting disclosure.
- 3 Our initial research findings appear in the July 2015 issue of *Strategic Finance*, pp. 30-37.
- 4 Alfred M. King, *Internal Control of Fixed Assets: A Controller and Auditor's Guide*, Wiley, Hoboken, N.J., 2011; ProQuest Ebook Central.
- 5 Information found in "Capital Fixed Asset Guide for Financial Reporting Purposes," CAFR Group, Revised 7/01/2012; https://archive.org/stream/4ACapitalFixedAssetGuide/4A-CapitalFixedAssetGuide_djvu.txt.
- 6 Government Finance Officers Association, www.gfoa.org/capitalization-thresholds-capital-assets.
- 7 Detailed guidance is provided in "Cost Accounting Standard 404 (CAS 404-40(a)(1), and 40(b)(1)) - Capitalization of Tangible Assets"; www.dcaa.mil/Content/Documents/CAM/chapter_08_-_cost_accounting_standards.pdf.
- 8 "8-404 Cost Accounting Standard 404 - Capitalization of Tangible Assets; www.dcaa.mil/Content/Documents/CAM/chapter_08_-_cost_accounting_standards.pdf.
- 9 Generally determined by whether the financial statements are audited.
- 10 IRS.gov, "Tangible Property Regulations—Frequently Asked Questions," www.irs.gov/businesses/small-businesses-self-employed/tangible-property-final-regulations.
- 11 Stephen Drucker, "Applying the Tangible Property Regulations for Tax Year 2015," *The Tax Adviser*, December 2015.
- 12 Approximately 40 private companies also responded to our survey, but we did not include responses by private companies in this article given the lack of access to private company financial statements.

APPENDIX: ACT TRAINING ILLUSTRATION

The REACT Company is a profitable \$200 million global niche manufacturer listed on NASDAQ. CFO Nancy Thayer is leading its financial planning exercise for the next three years. Given the current focus by the Public Company Accounting Oversight Board (PCAOB) on accounting estimates used in financial reporting, Nancy has included this topic in the context of the annual planning exercise. Nancy asks her controller, David Atkins, to research, report, and advise at their next meeting on REACT's use of accounting estimates. David begins his inquiry concentrating on estimates used in accounting for plant and equipment, including estimated useful lives and salvage values. During his work, David notices that REACT's asset capitalization threshold is \$500 and has been so since the company was founded in 1974. David joined the company three years ago after eight years with a large public accounting firm. His "gut" tells him that although the company's ACT is not an accounting "estimate," he should bring it up to the CFO along with the results of his plant and equipment review. He prepares the following analysis in advance of his session with Nancy.

The REACT Company	Under \$5,000 ACT Policy	Under Current \$500 ACT Policy	Difference
Revenue	\$200 million	\$200 million	-
Incremental annual depreciation expense on plant assets with purchase prices from \$500 to \$4,999*	-	\$6 million	\$6 million
Annual cost of the plant assets above, if expensed as incurred	\$30 million	-	\$30 million
All other costs	\$150 million	\$150 million	-
Reported net income	\$20 million	\$44 million	\$24 million
If REACT has 200 million common shares outstanding, EPS would =	\$.10	\$.22	\$.12

*The REACT Company purchases about \$30 million annually in equipment and amortizes these assets over an estimated useful life of five years with zero salvage value. Annual depreciation is \$6 million for the plant and equipment in the \$500–\$4,999 cost range.

If REACT changes its current ACT policy to a level in alignment with contemporary industry practices, there will be a material impact on reported earnings and earnings per share.

1. What stakeholder issues should David address in his presentation?
2. How should David influence his executives with respect to changing REACT's ACT policy?