

A8.555 Impairment of Capital Assets

1. Purpose

To provide guidelines for the proper accounting of impaired capital assets in accordance with Governmental Accounting Standards Board (GASB) Statement No. 42.

2. Responsibilities

- a. **Fiscal Officers** of all University departments are required to report accurate, complete and timely capital asset information to the Property and Fund Management Office (PFMO) including the impairment of capital assets. Fiscal officers are responsible for reviewing the status of capital assets to ensure that impairments are reported to PFMO via a memorandum describing the incident as soon as they occur but not later than by the fiscal year end date.

Because the role of the Fiscal Officer is primarily to identify and report to PFMO any incidents of capital asset impairment, their primary focus with regard to this APM should be on the following sections:

3. *Definition*
4. *Identifying impairments*

- b. The **PFMO and the General Accounting and Loan Collection** sections are responsible for determining the proper accounting for impaired capital assets.

3. Definition

Impairment is defined as a significant, unexpected decline in the service utility of a capital asset. Service utility is defined as the usable capacity that a capital asset was expected to provide at its acquisition. The events or

changes in circumstances that lead to impairment are not considered normal or ordinary, i.e., at the time the capital asset was acquired, the events or changes in circumstance would not have been expected to occur during the life of the capital asset.

4. Assessment of Impairment

The determination of whether a capital asset has been impaired is a two-step process of (1) identifying potential impairments and (2) testing for impairment. The events or circumstances affecting a capital asset that may indicate impairment are prominent - that is, conspicuous or otherwise known to the University.

Identifying impairments:

- a. Evidence of physical damage, such as for a building damaged by fire or flood, when the level of damage requires restoration efforts to restore service utility.
- b. Enactment or approval of laws or regulations or other changes in environmental factors, such as a new water quality standard that a water treatment plant does not meet and cannot be modified to meet the new requirements.
- c. Technological change or evidence of obsolescence, such as that related to a major piece of diagnostic or research equipment (e.g., a magnetic resonance imaging machine or a scanning electron microscope) that is rarely used because newer equipment provides better service.
- d. Change in the manner or expected duration of use of a capital asset, such as closure of a school prior to the end of its useful life.
- e. Construction stoppage, such as stoppage of a building due to lack of funding.

Testing for Impairment:

Capital assets shall be considered impaired when both of the following factors are present:

- a. The magnitude of the decline in service utility is significant in relation to the current service utility of the asset.
- b. The decline in service utility is unexpected. The restoration cost or other impairment circumstance is not part of the normal life cycle of the capital asset.

If the above impairment tests are met, the capital asset is considered to be impaired. However, only losses from permanent impairments of capital assets should be recognized in the financial statements as GASB 42 provides that impairment losses recognized should not be reversed in future years. An example of an impairment that is likely to be temporary would be the closure of a middle school due to declining enrollment. This asset should not be written down if evidence of enrollment projections substantiated by elementary school enrollment, residential development data, birth rates, or other economic indicators demonstrates that the closure would be temporary.

When an event or circumstance indicates that a capital asset may be impaired, but the test determines that impairment has not occurred, the estimates used in depreciation calculation (i.e., remaining estimated useful life and salvage value) should be reevaluated and changed, if necessary.

5. Measurement of Impairment

- a. Losses on impaired capital assets that the University will continue to use should be determined using the method that best reflects the diminished service utility of the capital asset. GASB 42 prescribes three different methods.
 - 1) Restorations cost approach - This approach uses the estimated cost to restore the capital asset and to identify the portion of the historical cost of the capital asset that should be written

off. This approach should be used for impairments resulting from physical damage.

- 2) Service units approach - This method estimates the total or maximum service units that the asset could have provided both before and after the impairment event or change in circumstance. The percentage change in units would be applied to the carrying value of the capital asset to determine the amount of the impairment loss. Impairments resulting from enactment or approval of laws or regulations, changes in environmental factors, or from technological development or obsolescence generally should be measured with this approach.

- 3) Deflated depreciated replacement cost approach - This approach quantifies the cost of the service currently being provided by the capital asset and converts that cost to historical cost. The difference between the resulting depreciated, deflated replacement cost and the carrying value of the original asset represents the impairment loss. Assets impaired by a change in manner or duration of use should be measured using this approach or a service units approach.

INDICATOR OF IMPAIRMENT	METHOD USED TO CALCULATE IMPAIRMENT LOSS
Physical damage	Restoration cost approach
Enactment or approval of laws or regulations or changes in environmental factors	Service units approach
Technological development or evidence of obsolescence	Service units approach
Change in manner or duration of use	Service units approach or Deflated depreciated replacement cost approach

- b. Impaired assets that will no longer be used by the University should be reported at the lower of carrying value or fair value.

6. Reporting Impairment Losses

GASB 42 requires the recognition of capital asset impairments as soon as they occur. Losses from permanent impairments should be recognized in the statement of revenues, expenses, and changes in net assets as a program or operating expense, special item, or extraordinary item, in accordance with the guidance in paragraphs 41-46, 55, 56, 101, and 102 of GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*. The only impairment type that would typically qualify as a special item (i.e., within the control of management) would be a change in manner or duration of use.

7. Insurance Recoveries

- a. The restoration or replacement of the impaired capital asset should be reported as a separate transaction from the impairment loss and insurance recovery.
- b. The impairment loss should be reported net of the associated insurance recovery when the loss and recovery occur in the same fiscal year.
- c. Insurance recoveries reported in years subsequent to the impairment loss should be reported as program revenue, non-operating revenue, or extraordinary items, as appropriate.

8. Appropriations Received in Lieu of Insurance Recoveries

State appropriations and federal grants (i.e., FEMA grants) should not be netted against any associated impairment loss. Insurance recoveries are netted with associated impairment losses because the insurance recovery is received in accordance with an insurance contract in effect prior to the impairment event. Federal and state financial

assistance is provided after the impairment event occurs and in some instances only after a government applies for and meets applicable grant requirements. Such awards constitute separate transactions from the impairment event (GASB's Comprehensive Implementation Guide - 2005, question 7.469).

9. Reporting Summary

The table below summarizes the GASB 42 approach for reporting capital asset impairments:

Overview of GASB 42 Treatment of Capital Asset Impairment				
Statement of position	Out of Service		Still in service	
	Permanently Lower of carrying value or fair value	Temporarily Carrying value	Same useful life Impairment loss subtracted from carrying value	Shorter useful life Impairment loss subtracted from carrying value
Statement of activities	Write down to fair value if necessary	Suspend depreciation until service resumes	Impairment loss net of insurance recoveries	Impairment loss net of insurance recoveries

Source: Government Finance Officers Association's GAAFR Review, November 2003

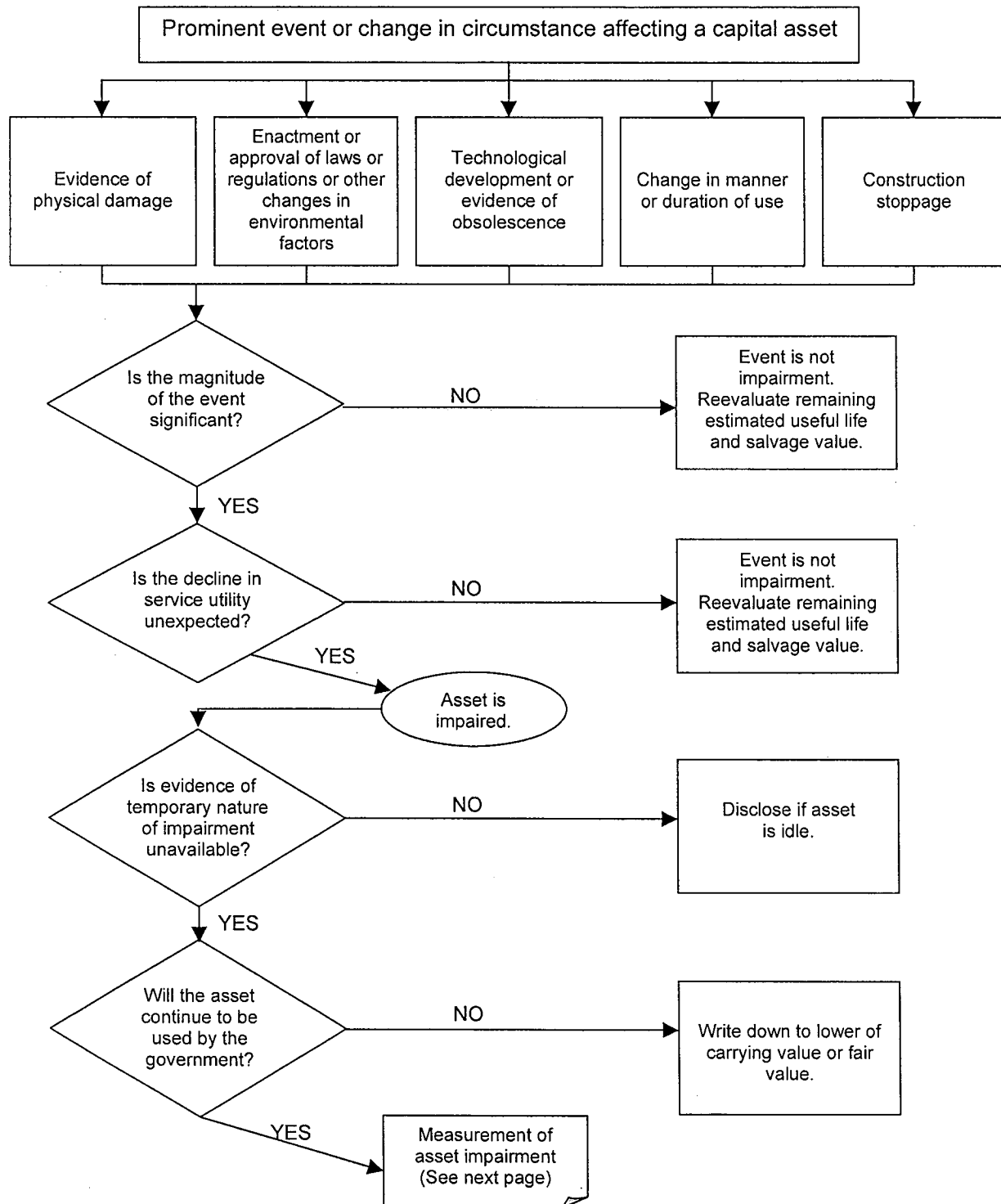
Note Disclosures:

- a. A general description of the impairment, the amount of the loss, and the financial statement classification of the impairment loss if not apparent from the face of the financial statements.
- b. The carrying amount of impaired capital assets that are idle at year-end, regardless of whether the impairment is considered permanent or temporary.
- c. The amount and financial statement classification of insurance recoveries if not apparent from the face of the financial statements.

Indicator of Impairment	Examples
Physical damage	<ul style="list-style-type: none"> ▪ Fire ▪ Flood ▪ Hurricane ▪ Vandalism
Enactment or approval of laws or regulations or changes in environmental factors	<ul style="list-style-type: none"> ▪ New water quality standards that cannot be met at a water treatment plant and the plant cannot be modified to meet the new standards. ▪ Recently installed underground gas tanks cannot meet new Federal regulations adopted for underground gas tanks.
Technical development or evidence of obsolescence	<ul style="list-style-type: none"> ▪ Major asset (usually equipment) that is rarely used due to newer asset providing better service such as medical imaging assets.
Change in manner or duration of use	<ul style="list-style-type: none"> ▪ Assets closed or abandoned before the end of its useful life such as a closure due to permanent decrease in enrollment. ▪ Mental health facility shutting its doors due to permanent decrease in patients. ▪ Facility closed due to bankruptcy of a major occupant and existing space is converted to a storage facility.

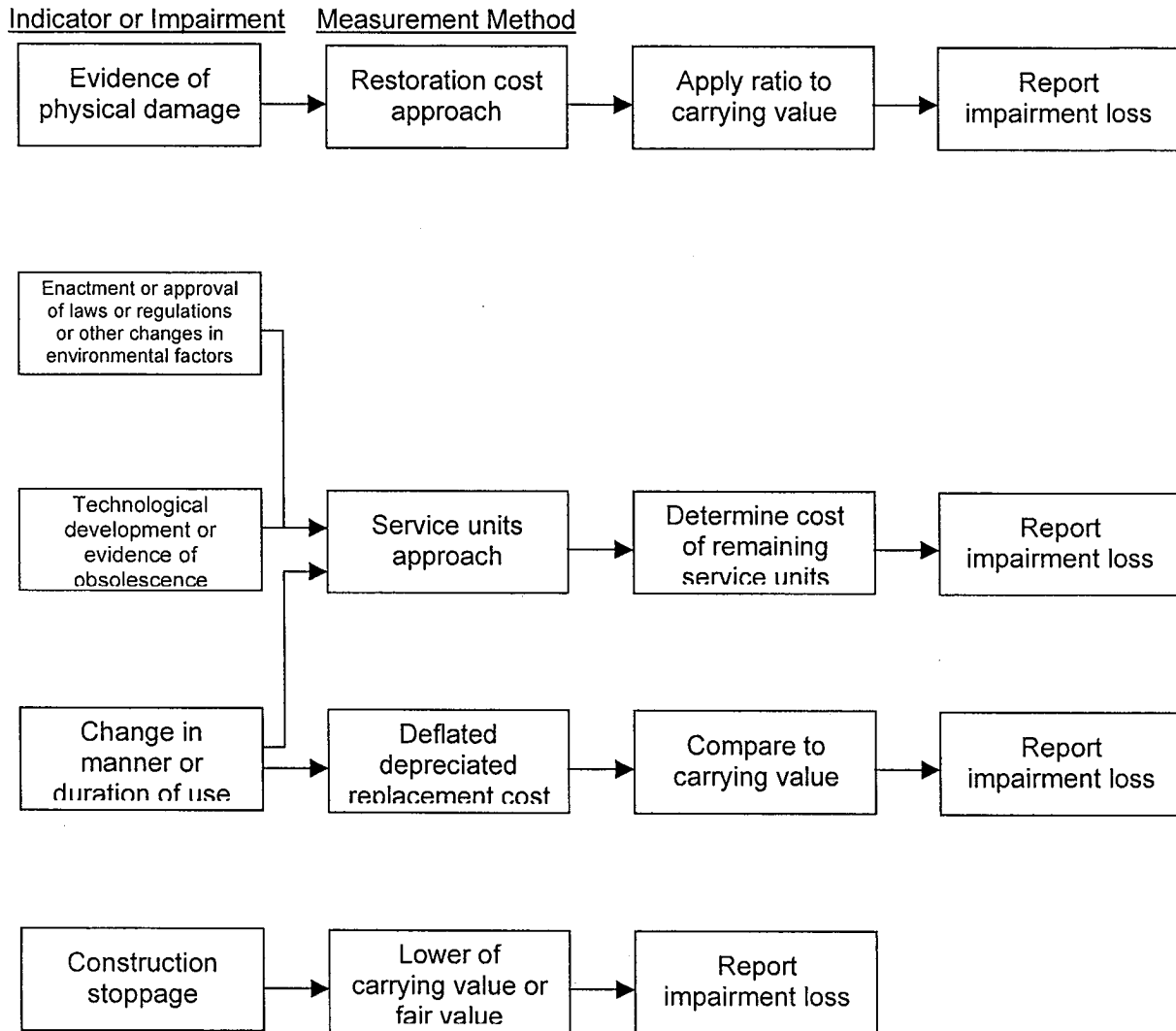
ACCOUNTING AND FINANCIAL REPORTING FOR IMPAIRMENT OF CAPITAL ASSETS AND FOR INSURANCE RECOVERIES

APPENDIX A Capital Asset Impairment Decision Process



ACCOUNTING AND FINANCIAL REPORTING FOR IMPAIRMENT OF CAPITAL ASSETS AND FOR INSURANCE RECOVERIES

APPENDIX A (continued) Measurement of Asset Impairment (for assets that will continue to be used by the government)



Source: GASB No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, Appendix D