

Capital Asset Impairment

Paragraph 5 of GASB Statement No. 42 defines asset impairment as “a significant, unexpected decline in the service utility of a capital asset.” The significant and unexpected decline is based on events or changes in circumstances that were not anticipated when the capital asset was placed in service. Service utility, as defined by GASB Statement No. 42, refers to the usable capacity that at acquisition was expected to be used to provide service, as distinguished from the level of utilization, which is the portion of the usable capacity currently being used.

Departments should contact FINOPS if it suspects that a capital asset is impaired. The determination of whether a capital asset is impaired is a two-step process of identifying potential impairments and testing for the impairment. Impairment losses recognized in accordance with this policy should not be reversed in a future year, even if events or circumstances that caused the impairment have changed.

10.10 Identifying potential impairments

When events or changes in circumstances suggest that the service utility of the capital asset may have significantly and unexpectedly declined, impairment is indicated. Common indicators of impairment, as stated by GASB Statement No. 42, paragraph 9, include:

1. Evidence of physical damage, such as for a building damaged by fire or flood, when the level of damage is such that restoration efforts are needed to restore service utility.
2. Enactment or approval of laws or regulations or other changes in environmental factors, such as new water quality standards that a water treatment plant does not meet (and cannot be modified to meet).
3. Technological development or evidence of obsolescence, such as that related to a major piece of diagnostic or research equipment (for example, a magnetic resonance imaging machine or a scanning electron microscope) that is rarely used because newer equipment provides better service.
4. A 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. If a government intends to sell an asset, but it is still being used until it is sold, it is not an indicator of potential impairment. However if the asset will not continue to be used, it may qualify as a potential impairment indicator.
5. Construction stoppage, such as stoppage of construction of a building due to lack of funding.

The list above is not all-inclusive. Professional judgment must be used to identify other events and changes that could indicate impairment.

10.20 Testing for the impairment

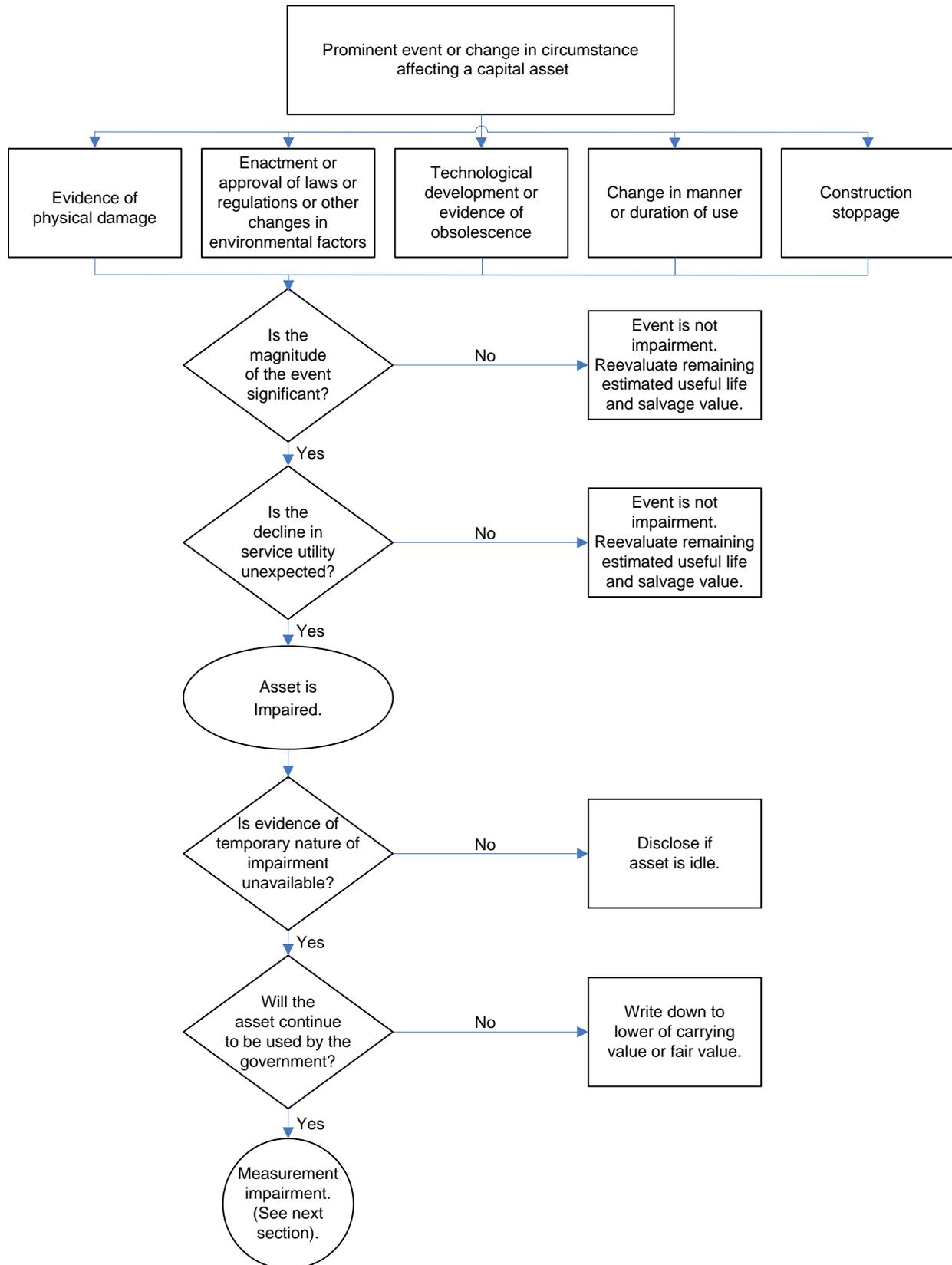
If a potential impairment is indicated by one of the five factors above, or by some other means, then the asset should be tested for impairment. GASB Statement No. 42 provides for the testing of capital asset impairment by determining whether both of the following factors are present:

1. The magnitude of the decline in service utility is significant. A significant decline is indicated if the continued operating expenses related to the use of the impaired asset or the cost to restore the asset is significant in relationship to the service utility of the asset.

2. The decline in service utility is unexpected. Restoration costs or other impairment circumstances are not part of the normal life cycle of a capital asset, and if they were contemplated because of an event or change, that development would suggest an unexpected decline in service utility. Normal maintenance costs or preservation costs do not suggest capital asset impairment.

The following page contains a flowchart used to determine whether a capital asset is impaired.

ASSET IMPAIRMENT DECISION PROCESS



10.30 Measuring the impairment of capital assets

10.31 Asset no longer used and construction stoppage

If the capital asset impaired will no longer be used, the asset should be written down to the lower of carrying value or fair value. Capital assets impaired from construction stoppage should also be written down to the lower of carrying or fair value. If the fair value exceeds the carrying value, it would not be appropriate to recognize a gain until the asset is sold or disposed. When the asset is sold or disposed, it should be retired in the AM system. If the carrying value exceeds the fair value, it would be appropriate to recognize a loss when the impairment event or change in circumstance occurs.

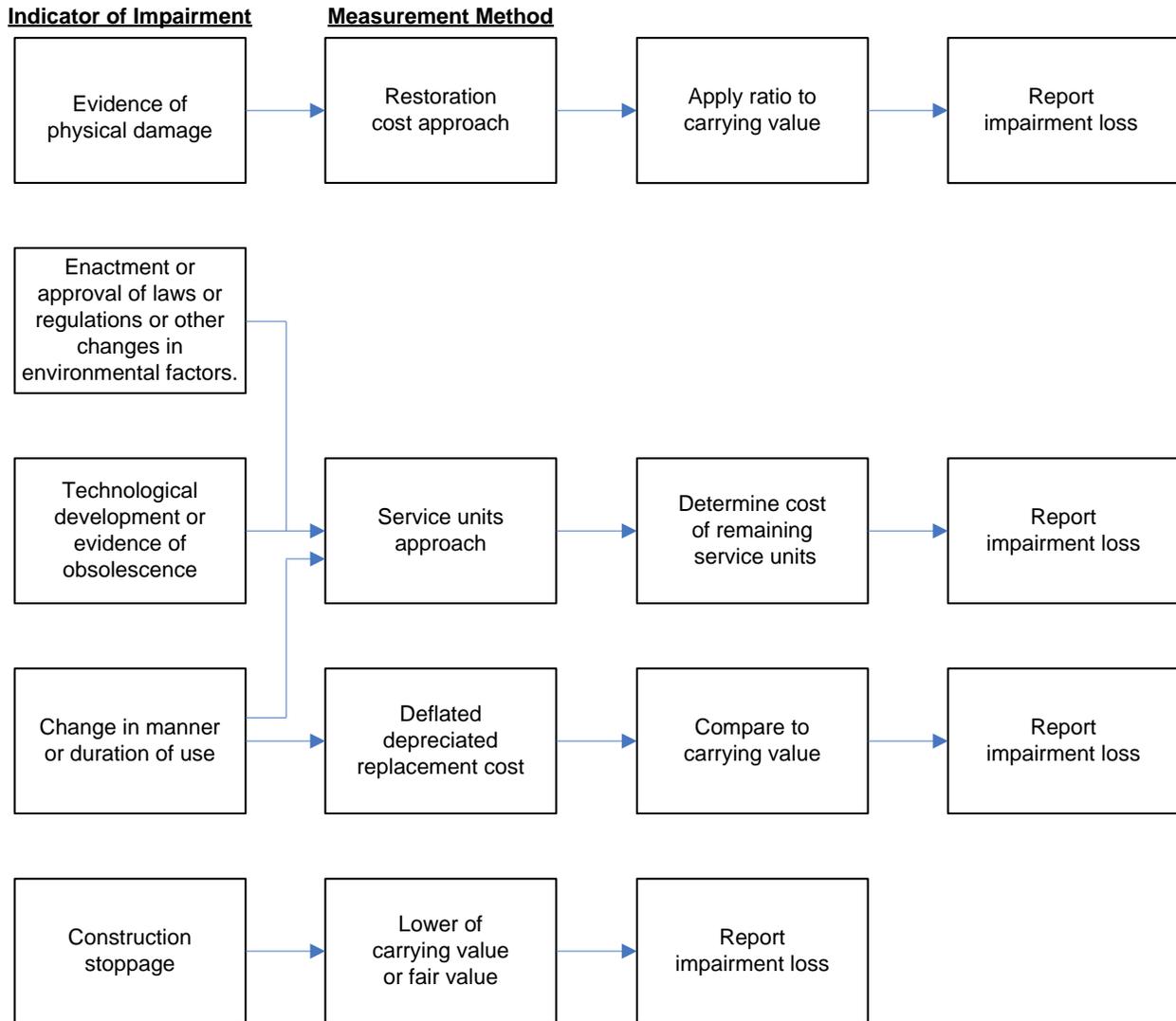
10.32 Asset will continue to be used

When a capital asset that will continue to be used is determined to be impaired, the amount of the impairment loss should be determined using one of the following measurement approaches:

1. Restoration cost approach, which is generally used to measure impairment losses from physical damage such as from fire, wind, and the like.
2. Service units approach, which is generally used to measure impairment losses from environmental factors, technological changes, obsolescence, or the change in the manner or duration of use.
3. Deflated depreciated replacement cost approach, which can also be used to measure impairment losses from the change in the manner or duration of use.

Ultimately, the specific method to be used should be the one that best reflects the service utility decline. The method used to measure impairment losses should be applied consistently to impairments with similar characteristics. The following flowchart is provided to help determine which impairment method should be used.

MEASUREMENT OF ASSET IMPAIRMENT (for assets that will continue to be used by the government)



10.33 Restoration cost approach

Under this approach, the write-down is based on the cost to restore the utility of the capital asset. The current restoration cost is then converted to a historical cost basis using an appropriate cost index or by applying a ratio of estimated restoration cost over estimated replacement cost to the carrying value of the capital asset. To determine the ratio of estimated restoration costs over estimated replacement cost follow these steps:

1. Determine the restoration cost in current dollars. This amount should be based on the amount of the impairment caused by the change or event and should exclude costs related to demolition, cleanup, additions, and improvements.
2. Determine the replacement cost in current dollars for the capital asset.

3. Determine the carrying value of the impaired capital asset before adjustment (historical cost less accumulated depreciation).
4. Determine the relationship between the restoration cost in current dollars and the replacement cost in current dollars for the capital asset. This should be expressed as a percentage (restoration cost/replacement cost).
5. Determine the impairment lost by multiplying the carrying value of the asset by the restoration cost ratio computed in step 4.

10.34 Example of the restoration cost approach

Assume that a building has a historical cost of \$1,000,000, with an estimated useful life of 25 years, and was 60% depreciated when it was discovered that walls were structurally deficient. The estimated cost to restore the walls is \$200,000. The estimated current cost to replace the building is \$1,500,000. The building is still going to be used. The computation of the write-down is as follows:

Component of restoration cost approach	Amount
Historical cost of building	\$1,000,000
Minus accumulated depreciation of the asset	\$(600,000)
Carrying value of impaired asset	\$400,000
Restoration cost (\$200,000)/replacement cost (\$1,500,000)	13.33%
Impairment loss = carrying value (\$400,000) multiplied by restoration cost ratio (13.33%)	\$53,320

10.35 Service units approach

The write-down under the service units approach is based on the proportion of the capital asset, as expressed in service units that has been lost due to an event or change that created the impairment. The total service units can be based on either the maximum estimated service units or total estimated service units throughout the life of the capital asset. Service units can be measured in years of service, number of units produced, number of citizens benefited, etc.

10.36 Example of service units approach

Assume that equipment has a historical cost of \$500,000, and originally had an estimated useful life of 30 years. After 3 years of use, new regulations are enacted that will make the equipment obsolete in 3 years. The amount of service units lost, expressed in years, is 24. The amount of the impairment loss is \$400,000 ($\$500,000 \times (24/30)$).

10.37 Deflated depreciated replacement cost approach

This approach is based on determining the current cost of an asset needed for the current level of service. Based on the assumed carrying value of the theoretical asset, that carrying value is deflated to the historical cost basis for when the original asset was acquired.

10.38 Example of deflated depreciated replacement cost approach

Assume a building has an original cost of \$4,000,000 and was 40% depreciated. The building was to be used originally as an airplane hangar, but management has decided that it will now be used as a storage facility. The cost of a comparable storage facility is \$500,000, and the replacement cost of the airplane hangar is \$5,000,000.

Component of deflated depreciated replacement cost approach	Amount
Deflator (\$5,000,000/\$4,000,000)	1.25
Assumed carrying amount of a new storage facility (\$500,000 x 60%)	\$300,000
Carrying amount of old building (\$4,000,000 x 60%)	\$2,400,000
Deflated assumed carrying amount of a new warehouse (\$300,000/1.25)	\$240,000
Impairment loss (\$2,400,000 - \$240,000)	\$2,160,000

10.40 Insurance recoveries

An insurance recovery should be recorded in the fiscal year in which it is realized or realizable. For example, an insurance recovery would be realizable if an insurer has admitted or acknowledged coverage. The insurance recovery generally would not be realizable if the insurer has denied coverage.

10.41 Insurance recoveries in modified accrual funds

In modified accrual funds, costs related to the restoration or replacement of an impaired capital asset should be reported as a separate transaction from any associated insurance recovery. These costs should be recorded in the ACTUALS ledger, generally in a capital outlay expense account (522XXX). Insurance recoveries should be recorded in account 585903 (Insurance Proceeds Current Yr) if the recovery is realized or realizable in the same year as the impairment loss. Insurance recoveries realized or realizable in a year subsequent to the recognition of the impairment loss should be recorded in account 585904 (Insurance Pro Subsequent Yr).

10.42 Insurance recoveries in full accrual funds

In full accrual funds, costs related to the restoration or replacement of an impaired capital asset should be reported as a separate transaction from any associated insurance recovery. These costs should be recorded in the ACTUALS ledger, generally in a capital outlay expense account (522XXX). Insurance recoveries should be recorded in account 550401 (Impairment Gain Non-Gov) if the recovery is realized or realizable in the same year as the impairment loss. For financial statement reporting, insurance recoveries recorded in account 550401 (Impairment Gain Non-Gov) will be netted with the impairment loss and a net gain or loss will be reported. Insurance recoveries realized or realizable in a year subsequent to the recognition of the impairment loss should be recorded in account 585904 (Insurance Pro Subsequent Yr). Insurance recoveries recorded in account 585904 (Insurance Pro Subsequent Yr) will be reported in the financial statements of full accrual funds as a non-operating revenue.

10.50 Recording impairment write-down in a modified accrual fund

First, the asset should be changed to the impaired status in the AM basic information screen. Then, adjust accumulated depreciation in AM by the amount of the impairment loss. See VISION documentation on adjusting accumulated depreciation in the AM system.

Regardless of when insurance proceeds are realized or realizable, the following entry should be recorded in the ACCRL/ADJ ledger in the year the asset becomes impaired. If, for example, the impairment loss was valued at \$1,000,000, AM would create an entry similar to the following.

AM entry to write down impaired asset			
ACCRL/ADJ ledger			
Debit	523680	Depreciation expense	1,000,000
Credit	17X5XX	Accumulated depreciation	1,000,000

If the Department will receive a cash payment related to the insurance proceeds and the proceeds are not received by fiscal yearend, the receivable must be reported at fiscal yearend on the AA-F-17 form. When the cash payment is realized, the Department will record the deposit in AR, assuming the proceeds realized were \$900,000.

AR deposit entry			
Debit	101050	AR cash clearing	900,000
Credit	48XXXX	Insurance Proceeds	900,000

If the insurer agrees to cover the loss, but elects to pay for the repair or replacement costs directly (i.e., the insurer will not send a cash payment to the Department), the following entry should be recorded. Assume the costs covered by the insurer will be \$900,000.

To record insurance proceeds when the insurer will pay the repair or replacement costs directly (i.e., the Department will not receive a cash payment)			
ACCRL/ADJ ledger			
Debit	522XXX	Capital outlay expenditure	900,000
Credit	48XXXX	Insurance Proceeds	900,000

In the ACCRL/ADJ ledger, modified accrual funds must net any insurance proceeds realized or realizable in the same fiscal year as the loss with the impairment loss and a net gain or loss must be recorded.

To record net impairment gain or loss			
ACCRL/ADJ			
Debit	5XXXXX	Loss on Asset Impairment (difference between the proceeds received and depreciation expense generated from the AM entry above) See Note 1 below	100,000
Debit	48XXXX	Insurance Proceeds	900,000
Credit	523680	Depreciation expense (for the amount of the impairment loss)	1,000,000

Note 1 – If the insurance proceeds are more than the impairment loss, this line on the entry would be a credit to account 48XXXXX (Capital Asset Impairment Gain). If the insurance proceeds are equal to the impairment loss, this line on the entry is not required.

10.60 Recording impairment write-down in a full accrual fund

First, the asset should be changed to the impaired status in the AM basic information screen. Then, adjust accumulated depreciation in AM by the amount the asset is impaired by. See VISION documentation on adjusting accumulated depreciation in the AM system.

Regardless of when insurance proceeds are realized or realizable, the following entry should be recorded in the ACCRL/ADJ ledger in the year the asset becomes impaired. AM will create an entry similar to the following assuming the impairment loss was valued at \$500,000.

AM entry to write down impaired asset			
ACCRL/ADJ ledger			
Debit	523680	Depreciation expense	500,000
Credit	17X5XX	Accumulated depreciation	500,000

If the Department will receive a cash payment related to the insurance proceeds, record the following AR entry assuming the proceeds realized were \$700,000.

To record insurance proceeds received as a cash payment			
ACTUALS ledger			
Debit	101050	AR cash clearing	700,000
Credit	48XXXX	Capital Asset Impairment Gain	700,000

If the insurer agrees to cover the loss, but elects to pay for the repair or replacement costs directly (i.e., the insurer will not send a cash payment to the Department), the following journal entry should be recorded. Assume the costs covered by the insurer will be \$700,000.

To record insurance proceeds when the insurer will pay the repair or replacement costs directly (i.e., the Department will not receive a cash payment)			
ACCRL/ADJ ledger			
Debit	522XXX (or 110001)	Capital asset expense (or receivable if insurance company acknowledged coverage, but repair or replacement costs have not yet been incurred)	700,000
Credit	48XXXX	Capital Asset Impairment Gain	700,000

If a receivable was recognized in this scenario, when costs are incurred to repair or replace the asset, debit the proper 522XXX expense account and credit the receivable established.

Any insurance proceeds realized or realizable in the same fiscal year as the impairment must be netted with the impairment loss and a net gain or loss recorded.

10.70 Replacement or repair costs of the impaired asset

If an impaired asset is being repaired, the repairs should be added as an improvement or as a new asset. If a new asset is being added to replace the old asset, the new asset should be added to AM and the old asset retired in the same manner that you would add and retire any other asset. The new asset should be added in the same year the replacement costs are incurred and the old asset should be retired in the year it is disposed.

10.80 Other asset impairment topics

10.81 Temporary impairments

Generally impairment is considered permanent. If the impairment is temporary, the historical cost of the capital asset should not be written down. An asset should only be considered

temporarily impaired if there is evidence to support such a conclusion. Temporary impairments are generally only associated with enactment or approval of laws or regulations or other changes in environmental factors, changes in technology or obsolescence, changes in manner or duration of use, or construction stoppage. If management would be required to take action to reverse the impairment, the impairment would be considered permanent. Thus, if physical damage causes impairment to a capital asset, the impairment would be considered to be permanent.

10.82 Disclosure of asset impairment

Agencies should contact FINOPS if an impairment loss has occurred. The amount of the loss and a short description of the cause of the impairment should be provided. Also, the carrying value of any impaired capital assets that are idle at year-end should be disclosed, regardless of whether the impairment is permanent or temporary.