GASB 42 governs impairments of capital assets and insurance recoveries and is effective in FY 2005-06. The guidance in this statement related to impairments only applies to capital assets. The guidance in this statement related to insurance recoveries applies to all such recoveries, not just those associated with impairment of capital assets. The provisions of this statement will not be applied to immaterial items.

Asset impairment is a significant, unexpected decline in the service utility of a capital asset. Capital assets are held primarily to provide service to our constituents. When the asset’s ability to provide this service is significantly reduced in a way not anticipated, that event should be recognized in the financial statements as an impairment loss.

The following step should be followed in determining whether a capital asset is impaired and recognizing the loss:

Step 1: Identifying Potential Impairments

GASB 42 does not require that we test capital assets for impairment on an on-going basis. Instead, we are required to test for impairment if noticeable events or changes in circumstances indicate a possible impairment. These events will be prominent. The statement identifies five sets of events or changes in circumstances that indicate possible impairment:

a. Evidence of physical damage. Examples include natural disasters such as fire, flood, etc. Level of damage is such that restoration efforts are needed.

b. Enactment of laws, regulations, or other changes in environmental factors. Examples include a government ban of particular materials.

c. Technological development or evidence of obsolescence. This type of impairment occurs regularly with sophisticated scientific equipment but is different than the normal obsolescence expected with highly technical equipment.

d. Change in the manner or expected duration of use. Examples include abandonment of an athletic facility because of insufficient seating.

e. Construction stoppage.

Step 2: Testing for Impairment

If one of the five events above is identified, the second step is to test for impairment. The test involves determining if the decline in service utility is both significant and unexpected. Significance is demonstrated when either the expenses related to continued use of the asset (including maintenance and depreciation) or costs associated with restoration of the asset are significant relative to the current service utility. Unexpectedness is demonstrated when the event indicating a possible impairment is not part of the asset’s normal life cycle. While determining an assets useful life at acquisition...
is not an exact science, management does have a reasonable range of expectations regarding the asset and an occurrence outside of that range is unexpected. To be safe, an impairment test should be considered whenever the useful life of an asset is reduced significantly.

Step 3: Determining If Impairment Temporary or Permanent

If the decline in service utility is determined to be temporary, an impairment loss should not be recognized. An impairment loss that has been recognized should not be reversed in subsequent years, even if the circumstances causing the impairment have changed. If the decline in service utility is determined to be permanent, a loss must be recognized.

Step 4: Measuring the Impairment Loss

Impairment losses for assets that will continue to be used are measured using one of the following three methods:

a. Restoration cost approach. This measurement begins with an estimate of the cost to restore the lost utility of the asset. This cost estimate is then restated to historical cost by using a relevant cost index or by applying a ratio of estimated restoration cost over estimated replacement cost to the carrying value of the asset. This measurement method is most appropriate for impairments resulting from physical damage.

b. Service units approach. This measurement focuses on the historical cost of the service utility lost due to the impairment event. The amount of impairment is determined by evaluating the service provided by the asset before and after the impairment event. This measurement method is most appropriate for impairments resulting from new laws or regulations, other changes in environmental factors, technological developments, or obsolescence.

c. Deflated depreciation replacement cost approach. This measurement replicates the historical cost of the service produced. An estimate is made of the current cost of an asset that could replace the current level of service. That current cost estimate is then depreciated to reflect the fact that the capital asset is not new and then deflated to convert it to historical dollars. This measurement method is most appropriate for impairments resulting from a change in manner or duration of use.

Impaired capital assets that will no longer be used should be reported at the lower of carrying value or fair value. Capital assets impaired from construction stoppage should also be reported at the lower of carrying value or fair value.

Step 5: Reporting the Impairment Loss

Impairment losses will usually be reported on the SRECNA as an operating expense. If circumstances warrant, the impairment loss may be reported as a special item or
extraordinary item. If an insurance recovery related to an impairment loss is received in
the same year as the loss, the impairment loss is reduced by the amount of the insurance
recovery. This treatment does create the potential for an impairment to result in the
recognition of a gain if the insurance recovery exceeds the calculated loss. Related
insurance recoveries received in subsequent years should be reported as nonoperating
revenue (or extraordinary items if circumstances warrant). Similar treatment is required
for insurance recoveries unrelated to impairment losses. Insurance recoveries should not
be recognized unless they have been realized or the insurer has acknowledged coverage.

The statement requires disclosure in the Notes of a general description of the impairment,
the amount of impairment loss (or gain), and the financial statement classification (for
example, instruction) of the impairment loss. Additionally, the carrying amount of
impaired capital assets that are idle at year-end should be disclosed, regardless of whether
the impairment is considered temporary or permanent.

Step 6: Handling the Transition Period

This statement is effective beginning FY 2005-06. Any changes resulting from the
adoption of this statement should be applied retroactively by restating all prior financial
period presented, if practical. If impractical, the cumulative effect of applying this
statement should be reported as a restatement of beginning net assets for the earliest
period presented.