State of Maine
GASB 42 Implementation Guidance

GASB Statement No. 42 establishes guidance for the accounting and reporting for the impairment of capital assets and insurance recoveries. This statement is retroactive and is effective for fiscal year ending June 30, 2006.

Definition of Impairment

Asset impairment is a **significant**, **unexpected** decline in the service utility of a capital asset. The events or changes that lead to impairments are not considered normal and ordinary and the types of circumstances that make a capital asset impaired are discussed below.

Determination of impairment of a capital asset is a two-step process: a) identifying potential impairments and b) testing for impairment. If the capital asset is identified as impaired, then testing for the impairment must be conducted.

1. Identification of Impairment – The events or changes in circumstances affecting a capital asset that may indicate impairment are prominent – that is, conspicuous or known to the government. These events generally would have prompted discussion by governing board, management, or media.

   Circumstances of Impairment – Common types of impairment include:

   a. Physical damage - asset damaged by fire or flood for which the level of damage is such that restoration efforts are needed to restore service utility.
   b. Enactment or approval of laws or regulations or other changes in environmental factors
   c. Technological development or obsolescence – major piece of asset (typically equipment) that is rarely used due to newer asset providing better service.
   d. Change in manner or expected duration of use – assets that are closed or abandoned before the end of its useful life, such as a school closure prior to the end of its useful life.
   e. Construction stoppage – stoppage of construction due to lack of funding.

2. Impairment Test – When a capital asset is identified as impaired in item 1, it should be tested for impairment. If both factors below are met, then the asset is considered impaired and the amount of impairment must be determined.

    a. The magnitude of the decline in service utility is significant - The expenses associated with the continued operation and maintenance (including depreciation), or costs associated with restoration of the capital asset are significant in relationship to the current service utility.
    b. The decline in service utility is unexpected – The restoration cost or other impairment circumstance is not a part of the normal life cycle of the capital asset.

    If the capital asset meets an impairment indicator, but does not meet the test of impairment, then the remaining useful life and salvage value should be reevaluated and changed, if necessary.

Measurement of Impairment

For impaired capital assets that will continue to be used by the government, the amount of impairment –the portion of historical cost that should be written off-should be measured using one of the following methods.

1. Restoration cost approach – The amount of impairment is derived from the estimated costs (excluding demolition and cleaning costs) to restore (to its original condition) the utility of the capital asset. The estimated restoration cost can be converted to historical cost either by restating the estimated restoration cost 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. This approach should be used for impairments resulting from physical damage.

2. Service units approach – This isolates the historical cost of the service utility of the capital asset that cannot be used due to the impairment event. The amount of impairment is determined by evaluating the service provided by the capital asset before and after the impairment. Impairments resulting from enactment or approval of laws or regulations or other changes in environmental factors or from technological development or obsolescence generally should be measured under this approach.

3. Deflated depreciated replacement cost approach – This replicates the historical cost of the service produced. A current cost for a capital asset to replace the current level of service is estimated. This estimated current cost is depreciated to reflect that the capital asset is not new, and this is deflated

to convert it to historical cost. Assets impaired by a change in manner or duration of use should be measured using this approach or a service units approach.

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

Permanent and Temporary Impairment

Generally, impairments should be considered permanent. If the impairment resulted from other than physical damage and evidence is demonstrated that the impairment will be temporary, then the capital asset should not be written down.

Insurance Recoveries

If an insurance recovery is used to restore or replace impaired capital assets, the amount and date of recovery must be disclosed for reporting purposes. Insurance recoveries, provided that claims are not denied, should be recognized only when it is realized or realizable. For example, if an insurer has admitted or acknowledged coverage an insurance recovery would be realizable. If the insurer has denied coverage, the insurance recovery generally would not be realizable. This would be the case for all insurance recoveries and not specifically insurance recoveries pertaining to capital asset impairments.

Recording Asset Impairments and insurance recoveries in Governmental Funds

Governmental funds use the current financial resource measurement focus and modified accrual basis of accounting. Capital assets are not recorded in these funds. Consequently, no impairment loss is recorded. Restoration and replacement costs should be recorded as an expenditure. All insurance recoveries would be recorded as revenue and reported as an other financing source or extraordinary item as appropriate in the Governmental Fund financial statements.

Recording Asset Impairments in Proprietary funds

Proprietary funds use the economic resource measurement focus and accrual basis of accounting. Capital assets are recorded and depreciated in these funds. A capital asset impairment would result in the write-off of a portion or all of the asset balance. Restoration or replacement costs would be capitalized. Insurance recoveries would be netted with the impairment loss if both occur in the same year. Insurance recoveries occurring in a subsequent period should be recorded as non-operating revenue.

Reporting Asset Impairments in the Government-Wide Statements

The economic resource measurement and accrual basis of accounting is used for reporting governmental and business type activities in the government- wide statements. Consequently, all capital assets of the government are recorded and depreciated. Capital asset impairments would result in the write-off of a portion of all of the asset balance. Restoration or replacement costs would be capitalized. Insurance recoveries would be netted with the impairment loss if both occur in the same year. If the insurance recovery occurs in a subsequent year it should be reported as program revenue, non-operating revenue, or an extraordinary item as appropriate.

Recording of Other Insurance Recoveries

Recoveries for other than impaired asset, such as theft should be accounted for in the same manner as impaired assets. In the governmental funds the recovery would be recorded as revenue and reported as an other financing source or extraordinary item as appropriate in the governmental fund financial statements. In the proprietary funds and for government-wide reporting the recovery would be treated the same as the insurance recovery for an impaired asset that is received in a subsequent period.

Financial Statement Note Disclosure

If not otherwise apparent on the face of the financial statements, a general description, the amount, and the financial statement classification of the impairment loss should be disclosed in the notes to the financial statements along with the amount and financial statement classification of any insurance recovery.

Office of the State Controller Reporting Requirements

Agencies must provide financial information on impaired capital assets to the Office of the State Controller's Financial Reporting Team as part of their FY 2006 GAAP Closing Package reporting. This information is due no later than September 1, 2006. Capital asset impairment losses of $100,000 or more for Enterprise Funds and 1,000,000 or more for all other fund types should be reported. Please provide the following information on asset impairment losses and insurance recoveries:

Fixed Asset Number
Fixed Asset Type
Description
Current book value (prior to impairment)

Date of Impairment
Amount of Loss (Write Off)
Amount and Date of Insurance Recovery