State of Rhode Island
Department of Administration

OFFICE OF ACCOUNTS AND CONTROL

SECTION **Accounting**	**POLICY/PROCEDURE NUMBER** **A-65**
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POLICY / PROCEDURE **Accounting and Financial Reporting for Impairment of Capital Assets and Insurance Recoveries**	**AMENDMENT / REVISION** **March 18, 2016**

GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and Insurance Recoveries*, which was effective for the State of Rhode Island beginning in fiscal year 2006, governs impairments of capital assets and insurance recoveries. 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 GASB 42 are not 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 citizens. 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 steps should be followed in determining whether a capital asset is impaired and recognizing the loss:

<u>Step 1: Identifying Potential Impairments</u>

GASB 42 does not require testing capital assets for impairment on an on-going basis. Instead, it requires testing for impairment if noticeable events or changes in circumstances indicate a possible impairment. These events should be prominent. The statement identified 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.

There is no requirement to identify potential impairments beyond those discovered during the normal course of operations. Any event or circumstance that potentially leads to impairment should be conspicuous and should prompt discussion by management or the media. State agencies are not obligated to conduct a search for hidden impairments.

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 asset's 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

GASB 42 states that impaired capital assets which will no longer be used should be reported at the lower of net book value or fair value. A common example of an impaired asset is a building which is vacant and abandoned. A list of impaired assets should be included with the response to the yearly Financial Statement Disclosure Questionnaire which is distributed to agency directors and chief financial officers. The Fixed Assets section of the Office of Accounts and Control will prepare an adjustment to write off the net book value of the impaired asset to the appropriate amount, usually zero. Capital assets impaired from construction stoppage will also be reported at the lower of net book value or fair value.

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.

<u>Step 5: Reporting the Impairment Loss</u>

Impairment losses will usually be reported on the Statement of Activities (Government-Wide) or on the Statement of Revenues, Expenses, and Change in Net Position (Proprietary Funds) 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 of the loss.

GASB 42 requires disclosure of, in the Notes to the Comprehensive Annual Financial Report, a general description of the impairment, the amount of impairment loss (or gain), and the financial statement classification 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: Prior Period Restatements

Any changes resulting from the identification and calculation of the financial impact of impaired assets should be applied retroactively, by reporting the cumulative effect as a restatement of beginning net position for the earliest period presented.