GASB 42 IMPLEMENTATION ISSUES

Impairment Test Criteria

Issue

To determine the impairment test criteria to be used to evaluate potentially impaired assets per GASB 42.

Background

GASB 42 establishes accounting and financial reporting standards for impairment of capital assets. Governments are required to evaluate prominent events or changes in circumstances affecting capital assets to determine whether impairment of a capital asset has occurred. GASB 42, paragraph 9 outlines five (5) common "indicators of impairment." They are:

- 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.
- Enactment or approval of laws or regulations or other changes in environmental factors, such as new earthquake standards that a facility does not meet, and cannot be modified to meet.
- Technological development or evidence of obsolescence, such as that related to a major piece of diagnostic or research equipment.
- A change in the manner or expected duration of use of a capital asset, such as closure of a building prior to the end of its useful life.
- Construction stoppage, such as stoppage of construction as a result of a lack of funding.

Paragraph 5 in GASB 42 defines asset impairment as "a significant, unexpected decline in the service utility of a capital asset."

- Significant: The events or changes in circumstances that lead to impairments are not considered to be normal and ordinary.
- Unexpected: At the time the capital asset was acquired, the event or change in circumstance would not have been expected to occur during the useful life of the asset.
- Decline in service utility: A reduction in 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.

A capital asset generally should be considered impaired if both (a) the decline in service utility of the capital asset is large in magnitude and (b) the event or change in circumstance is outside the normal life cycle of the capital asset.

Testing for Impairment

The possible population of capital assets that have potential for meeting the definition of impairment are identified through significant events or changes in circumstances that may suggest that the service utility of a capital asset may have declined significantly and unexpectedly. If it has been determined that an asset is potentially impaired based on one of the five indicators of impairment described above, then a test for impairment must be performed on the capital asset.

The test for impairment includes two (2) factors. BOTH factors must be present in order to conclude that the capital asset is, in fact, impaired. The tests are:

- **The decline in service utility is unexpected**. Management is not expected to foresee with precision the useful life of a capital asset or the service utility throughout its useful life; however, there is a reasonable range of expectations about the service utility and useful life at the time of acquisition. Accordingly, if the impairment circumstance is not a part of the normal cycle of the capital asset, the asset's decline in service utility would be considered to be unexpected. This criteria is clearly met with the devastation caused by Hurricanes Katrina and Rita for fiscal year 2006.

- **The magnitude of the decline in service utility is significant**. The expenses associated with continued operation and maintenance (including depreciation) or costs associated with restoration of the capital asset are significant in relationship to the current service utility. In cases where there is physical damage to a capital asset, the costs of restoration may be relatively easy to determine, at least within a range of estimates, and therefore the significance can be objectively assessed. In circumstances other than those involving physical damage, management's action to address the situation is an indication that the expenses are too high in relation to the benefit. If the agency has not addressed the matter, and management has not initiated any action, there may be a presumption, absent from other facts, that the magnitude of the decline is not significant and this test would not be met.

If both factors are not present, there is no impairment loss to measure and record.

Recommendation

OSRAP's current capitalization thresholds are $5,000 for movable property, $100,000 for buildings, and $3 million per agency, per year, for infrastructure. If the capitalized cost of the asset is very large, then these thresholds may not be significant to the cost of the asset. Therefore, in order for an asset to be considered impaired, we propose the restoration costs of the impaired asset be equal to or greater than the following:

Infrastructure	For agencies using the Wooster Method – procedures for agencies using the Wooster Method are still being developed. For discrete component units not using the Wooster Method – $3 million per entity, per year, or if a lower threshold is used to capitalize infrastructure, then the entity's capitalization threshold
Buildings	Greater of $100,000 or 20% of the capitalized cost of the building
Movable Property	Greater of $20,000 or 20% of the capitalized cost of the asset

Infrastructure – Procedures for state agencies using the Wooster Method to capitalize their infrastructure expenditures are still being developed. We recommend that for discrete component units that do not use the Wooster Method, infrastructure will only be considered impaired if the total estimated restoration costs are equal to or greater than the capitalization threshold for infrastructure, or $3 million per agency, per year. Using this threshold, an impairment loss would be calculated on all infrastructure impaired during that year, regardless of the actual dollar value of the restoration cost of each individual infrastructure asset.

Buildings – We recommend that the greater of the capitalization threshold, $100,000, or 20 percent of the capitalized costs of the building impaired by physical damage be used as the test of whether the magnitude in the decline in service utility is significant. If the cost to restore the building is lower than the capitalization threshold or 20 percent of the capitalized cost of the impaired building (whichever is higher), we will not consider that the "magnitude in the decline in service utility is significant" component of the impairment test to be met. If, however, the building's restoration costs is equal to or greater than the capitalization threshold or equal to or greater than 20 percent of the capitalized costs of the impaired building (whichever is higher), and the building's decline in service utility is unexpected, we will conclude that the asset has met the impairment test criteria, and is impaired according to the provisions of GASB 42.

Movable property – Since the capitalization threshold is so low ($5,000) for movable property, we suggest that the impairment threshold be set at $20,000. In addition, we suggest that the greater of the impairment threshold for movable property, $20,000, or 20 percent of the capitalized cost of the movable property be used as the test of whether the magnitude in the decline in service utility is significant. If the cost to restore the movable property is equal to or greater than the impairment threshold, $20,000, or 20 percent of the capitalized cost of the impaired movable property (whichever is greater), and the building's decline in service utility is unexpected, we will conclude that the asset has met the impairment test criteria, and is impaired according to the provisions of GASB 42.