

GASB 42 IMPLEMENTATION ISSUES

Movable Property

Issue

What are the criteria and methods for measuring the GASB 42 impairments for movable property?

Background

Approximately 82% of the state’s movable property cost less than \$20,000. It has been proposed that the impairment threshold for restoration cost will be the higher of 20% of the capitalized asset (damaged movable property) or \$20,000. LPAA does not expect that most damaged property will be restored, but will be disposed of through transfer disposals in the protégé system.

OSRAP proposes that impairment losses generally should only be reported for movable property that is known to be impaired. However, per Roberta Reese from GASB, “If the entity feels that a significant number of impaired assets will not be identified until a subsequent fiscal year, then the entity may be able to extrapolate an amount of impairment loss to assets that have not been evaluated by the end of the year by comparing them to similar assets that are known to be impaired.”

If agencies are planning on restoring property, they should obtain an estimate on the restoration cost. The agency should document the method or process used to estimate the restoration cost. Items that will not be restored are not considered impaired and should be reported in the protégé system via transfer disposals. OSRAP has sent memorandum 6-21 to agencies informing them to report their disposed property to LPAA.

Movable Property - Current and Deflated Restoration Cost Approach

The Restoration Cost Approach is the best method for determining the amount of the impairment for capital assets with physical damage. However, in order to use the restoration cost approach, a damage ratio must be calculated by comparing either a) restoration cost (today’s dollars) to replacement cost of the entire asset (today’s dollars) or b) deflated restoration cost (acquisition year’s dollars) to original historical cost (acquisition year dollars). If the replacement value of the property is unknown, a deflation factor must be used to deflate the estimated restoration costs to acquisition year dollars.

Deflated Restoration Cost Method		
<u>Deflated Restoration Cost</u> Historical Cost	X	Carrying Value = Impairment Loss
Current Restoration Cost Method		

<u>Current Restoration Cost</u> Current Total Replacement Cost	X	Carrying Value = Impairment Loss
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Either the deflated restoration approach or the current restoration approach is acceptable. Capital Asset Consultant, Mike Nielson, provided producer price indexes for motor vehicles and machinery & equipment, which list deflation factors by year. From the index, the deflation factor that would correspond to the year in which the property was acquired should be used.

Example

Assume that a piece of equipment has a historical cost of \$500,000 and accumulated depreciation of \$200,000 (carrying value of \$300,000). The restoration costs are estimated to amount to \$110,000 all of which qualify for capitalization. The equipment is considered impaired because the estimated restoration cost exceeds the \$20,000 impairment threshold and it is greater than 20% of the capitalized cost of the asset (\$500,000 * 20% = \$100,000).

Assumptions:

Reporting Year:	2006	Estimated Restoration Cost:	\$110,000
Carrying Value:	\$300,000	Replacement Cost:	\$550,000
Original Cost:	\$500,000	Remaining Useful Life:	6 years
Year placed in service:	2002		

Calculating the Impairment Loss Using the Deflated Restoration Approach

A ratio of comparing restoration costs to the total original cost of the capital asset is calculated. If the replacement cost is not available, the Deflated Restoration Approach can be used to calculate the impairment loss. Because restoration costs are in current year dollars and the historical cost is in year of acquisition dollars, we need to deflate the cost of restoration to restate the amount on the basis of acquisition year dollars. Since the appropriate deflator is determined to be .994, restoration costs in acquisition year dollars equal \$109,340 (\$110,000 x .994).

- The ratio of restated restoration costs applied to the original historical cost of the asset (\$109,340 / \$500,000 = .21868) is then applied to the current carrying value of the asset to determine the portion of the historical cost that has been impaired (\$300,000 x .21868% = \$65,604). Any insurance recoveries received in the same year as the loss would be netted against this amount.

$$\begin{array}{r}
 \$109,340 \text{ (deflated estimated restoration cost)} \\
 \text{-----} \times \$300,000 \text{ (carrying value)} = \$65,604 \text{ impairment loss} \\
 \$500,000 \text{ (historical cost)}
 \end{array}$$

New carrying value: \$300,000 - \$65,604 = \$234,396 (before depreciation)

The equipment would be depreciated at the new carrying value of \$234,396 until the restoration is complete and then the restoration cost would be added to the carrying value. The new carrying value would be depreciated over the remaining useful life or 6 years $234,396/6 = \$39,066$. The 2006 carrying value after depreciation would be \$195, 330 ($234,396 - 39,066$).

Assume that the equipment was fully restored in 2007. The new carrying value would be as follows:

2006 carrying value:	\$195,330
Restoration cost:	<u>+110,000</u>
2007 carrying value before depreciation	\$305,330
Remaining useful life:	5 years
Depreciation:	\$61,066 ($305,330/5$)
2007 new carrying value:	\$244,264

Calculating the Impairment Loss using the Current Restoration Approach

A ratio of comparing restoration costs to the total original cost of the capital asset is calculated. Since the replacement cost is available, the Current Restoration Approach will be used. The ratio of the restoration cost (current dollars) applied to the replacement cost (current dollars) will be the restoration cost ratio ($\$110,000/\$550,000 = .20$). This ratio is then applied to the current carrying value of the asset to determine the portion of the historical cost that has been impaired ($\$300,000 \times .20 = \$60,000$). Any insurance recoveries received in the same year as the loss would be netted against this amount.

$$\begin{array}{l}
 \$110,000 \text{ (estimated restoration cost)} \\
 \text{-----} \times \$300,000 \text{ (carrying value)} = \$60,000 \text{ impairment loss} \\
 \$550,000 \text{ (replacement cost)}
 \end{array}$$

New carrying value: $\$300,000 - \$60,000 = \$240,000$ (before depreciation)

The equipment would be depreciated at the new carrying value of \$240,000 until the restoration is complete and then the restoration cost would be added to the carrying value. The new carrying value would be depreciated over the remaining useful life or 6 years $\$240,000/6 = \$40,000$. The 2006 carrying value after depreciation would be \$200,000 ($\$240,000 - \$40,000$).

Assume that the equipment was fully restored in 2007. The new carrying value would be as follows:

2006 carrying value:	\$200,000
Restoration cost:	<u>+110,000</u>
2007 carrying value before depreciation	\$310,000
Remaining useful life:	5 years
Depreciation:	\$62,000 ($310,000/5$)
2007 new carrying value:	\$248,000

If you have information available to use either the current restoration approach or the deflated restoration approach, it is likely that a different impairment loss will result for each approach, as seen in the example here. However, either approach is acceptable to GASB.

Per discussion with Roberta Reese from GASB, depreciation should be suspended for all assets that are temporarily out of service due to needed repairs, recertification, or recertification if being idle extends the asset's useful life, and the only factor affecting the useful life is the asset being used. However, the more technical the asset, the more likely that depreciation should not be suspended, because its useful life is not being extended by being idle. In fact, its useful life may be shortened if it is being subjected to an adverse condition, such as a lack of climate control.

Recommendation

This loss should only be calculated on those items whose restoration cost is the higher of 20% of the capitalized asset or \$20,000.

OSRAP will include a note in the AFR packet to capture required disclosures per GASB 42, paragraph 20. These disclosures include the carrying amount of impaired capital assets that are idle at year-end regardless of whether the impairment is considered permanent or temporary.

OSRAP will calculate the impairment losses for governmental state agencies based on note disclosure information. Agencies should disclose the following information concerning the impaired movable property (if known):

- a) carrying value,
- b) original cost,
- c) estimated restoration cost,
- d) replacement cost,
- e) remaining useful life.

Component units and proprietary entities will be responsible for calculating their own impairment losses.