

GASB 42 IMPLEMENTATION ISSUES

Treatment of the Impairment Loss

Issue

To determine the requirements for reporting impairment losses per GASB 42 on the Operating Statement.

Background

The State's capital assets have been damaged by Hurricanes Katrina and Rita. An impairment loss will have to be calculated based on GASB 42 for this damage. How the impairment loss is reported depends on whether the impairment is considered a program expense in the Statement of Activities or an operating expense in the Statement of Revenues, Expenses, and Changes in Fund Net Assets, a special item, or an extraordinary item. If the loss is reported as a program expense in the Statement of Activities, it should be reported as a direct expense of the program that uses or used the impaired capital asset. Per GASB, an impairment loss represents lost service utility of a program, and it is directly related to the program that used the capital asset. GASB does not consider an impairment loss to be similar in nature to a gain or loss on the disposal of a capital asset, which should be reported as general government expense or general revenue (GASB 42, paragraph 56). This paper discusses whether the impairment loss from Hurricanes Katrina and Rita should be considered a program or operating expense, a special item, or an extraordinary item.

Program or Operating Expense, Special Item, or Extraordinary Item

GASB 42 discusses that an impairment loss should be reported in an entity's operating statement as included with program or operating expenses, as a special item, or as an extraordinary item, as appropriate. GASB 42 references GASB 34, paragraph 41, which states that all expenses should be reported by function (this is referring to the statement of activities) except for those that meet the definitions of special or extraordinary items. The impairment losses caused by the hurricanes will be reviewed to see if they meet the criteria of special or extraordinary items.

Per GASB 34, paragraph 56, a special item is a significant transaction or other event within the control of management that is either unusual in nature or infrequent in occurrence. The impairment losses calculated per GASB 42 resulting from the hurricanes were not within the control of management, so do not meet the criteria to be classified as special items.

Extraordinary items are transactions or other events that are both unusual in nature and infrequent in occurrence (GASB 34, paragraph 55). APB Opinion No. 30, *Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*, as amended and interpreted, defines **unusual in nature** as "the underlying event or transaction should possess a *high degree of abnormality* and be of a type *clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the entity*, taking into account the environment in which the entity operates" (APB Opinion No. 30, paragraph 20a). The losses from Hurricane Katrina and Rita are definitely unrelated to the

ordinary and typical activities of the various entities reporting under the umbrella of the State. APB Opinion No. 30, paragraph 21, states that the *environment* in which an entity operates is a primary consideration in determining whether an underlying event or transaction is abnormal and that the environment of an entity includes the geographical location of its operations.

Does the impairment loss from Hurricanes Katrina/Rita possess a high degree of abnormality? It is not abnormal for Louisiana to be struck by a hurricane. However, the storm surge from Hurricane Katrina resulted in failure of several levees causing the flooding that led to widespread devastation in New Orleans. Hurricane Rita less than a month later caused additional flooding in the New Orleans area. Fiscal year 2006 marks the first time since 1900 that two major hurricanes have struck Louisiana in the same year (www.geocities.com/hurricane/gulfcoast.htm). This could be considered an event with a high degree of abnormality.

APB Opinion No. 30 defines **infrequency of occurrence** as an underlying event or transaction that should be of a type that *would not reasonably be expected to recur in the foreseeable future*, taking into account the environment in which the entity operates (paragraph 20b). This type of event is considered to occur infrequently. The past occurrence of an event or transaction for a particular entity provides evidence to assess the probability of recurrence of a similar event in the foreseeable future. An event or transaction of a type that occurs frequently in the environment in which the entity operates cannot by definition be considered extraordinary, regardless of its financial effect (APB Opinion No. 30, paragraph 22). According to the National Weather Service, a hurricane should make landfall in Louisiana every 2.8 years, with 14 major hurricanes (category 3 or above) striking Louisiana since 1900 (National Oceanic and Atmospheric Administration). However, fiscal year 2006 is the first time since 1900 that two major hurricanes have struck Louisiana in the same year. This would be considered an event that occurs infrequently.

OSRAP contacted Roberta Reese, project manager from GASB, in order to get guidance on whether the impairment losses from Katrina/Rita should be an extraordinary item. Ms. Reese responded that the November 2005 issue of *The GASB Report* says that determining whether a loss is extraordinary should be based on a facts-and-circumstances approach. She clarified that this means blanket conclusions are not appropriate (such as concluding that no losses from hurricane damage in hurricane-prone regions could be considered extraordinary losses). She also commented that the AICPA had issued a Technical Practice Aid (TPA 5400.05) providing guidance for losses from natural disasters. This TPA states that the magnitude of a loss from a natural disaster does not cause that event to be unusual in nature or unlikely to re-occur. However, this guidance does NOT apply to governmental entities. Ms. Reese noted that she does not see anything in the authoritative literature pertaining to governments that would prevent us from reporting the losses as an extraordinary item.

Recommendation

APB Opinion No. 30, paragraph 23, states that in rare situations, an event or transaction may occur that clearly meets both the unusual nature and infrequency of occurrence. In these circumstances, gains or losses should be included in the extraordinary item if they are a direct result of a major casualty (such as an earthquake). It is evident that the impairment losses resulting from Hurricanes Katrina and Rita meet *both* the unusual nature and infrequency of occurrence criteria of APB Opinion No. 30; therefore, OSRAP feels that the loss should be reported in an entity's operating statement as an extraordinary item.

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