State Accounting Office of Georgia
Fiscal Leadership for Georgia

Statewide Accounting Policy & Procedure

Accounting Manual Reference:	**Effective Date:** 07/01/2010
Section: Capital Assets	**Revision Date:** 06/30/2011
Sub-section: Impairments	

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Policy Summary:

After GASB Statement No. 34, issued in June 1999, required that capital assets, including infrastructure and intangible assets, be reported on the statement of net assets, concern was expressed over the condition of capital assets included on government financial statements. Assets reported on the statement of net assets could be overstated. Also, the costs of services provided by an asset in the period covered by a set of financial statements could be understated. With long lived capital assets often being the most substantial component of assets included on the statement of net assets, and the possibility that unexpected events may affect the service utility of capital assets, financial statements could be misstated for a number of years. To address the various types of potential misstatements, GASB issued several statements to ensure adequate accounting for capital asset values:

- GASB Statement No. 42, issued in November 2003, requires governments to report the effects of capital asset impairments in the financial statements when impairments occur and establishes a uniform reporting standard for insurance recoveries.
- GASB Statement No. 49, issued in November 2006, defines the point at which pollution remediation obligations must be reported and/or disclosed and how to record remediation of pollution-caused capital asset impairments.
- GASB Statement No. 51, issued in June 2007, clarifies the reporting requirements for intangible assets and amends the list of Statement No. 42 impairment indicators to include "development stoppage."

The scope of this policy is to provide guidance on the accounting for and reporting of impairment of capital assets and related insurance recoveries for all organizations included in the State of Georgia reporting entity. It is important for the accounting staff at each State organization to recognize changes in circumstances affecting capital assets and to properly account for the impairment, when applicable, as required by GAAP.

Policy Requirements:

The management of each organization bears the responsibility for ensuring that proper accounting procedures are employed and for establishing effective internal controls to ensure compliance with this policy.

Additionally, each organization must notify SAO electronically within 20 business days of discovery of a potential impairment. The message must at a minimum include the asset description and the nature of the impairment. Please use "Impairment Notification" in the subject line and send all correspondence to:

SAO_Reporting@sao.ga.gov

Accounting Requirements

GASB Statement No. 42 states that "A capital asset is considered impaired when its service utility has declined significantly and unexpectedly." A capital asset determined to be permanently impaired must have the carrying value of the asset written down by the amount of the impairment loss. Capital assets that experience a temporary impairment will not have the carrying value adjusted.

All reporting organizations included in the State of Georgia reporting entity must record an impairment loss, net of any realizable insurance recoveries, if the loss exceeds the following materiality thresholds:

Governmental activities (in the government-wide financial statements):

- Equipment $100,000
- All other Capital Assets $250,000

Proprietary and fiduciary funds: Case-by-case materiality threshold – coordinate with SAO to determine whether impairment should be recorded.

The determination of capital asset impairment is a two-step process of first identifying potential impairments and then testing for impairment as described in the Recognition and Measurement section of this policy.

When a capital asset is accounted for in a proprietary fund or fiduciary fund, both of which use the accrual basis of accounting and the economic resources measurement focus, the impairment loss and related insurance recovery are accounted for within that fund. When a capital asset is accounted for in the government-wide financial statements, the impairment loss is recorded at the government-wide level. The impairment costs are not reported in the governmental fund financial statements which use the modified accrual basis of accounting and the current financial resources measurement focus; however the related insurance recovery is recorded within the individual governmental fund.

All organizations must provide required disclosure information to SAO for financial statement note disclosure purposes.

Infrastructure assets that are part of a network or subsystem of a network are exempt from this sub-section provided that adherence to the guidelines stated within GASB Statement No. 34 is maintained.

Recognition and Measurement

Impairment is indicated when events or changes in circumstances suggest that the service utility of a capital asset may have significantly and unexpectedly declined. State organizations are not required to perform additional procedures to identify impaired capital assets beyond normal operational processes unless a prominent event or circumstance affecting capital assets occurs. The determination of capital asset impairment is a two-step process:

1. Identifying potential impairments, and
2. Testing for impairment.

Potential Impairment Indicators

Five common indicators of potential impairment are (please note this list should not be construed as all inclusive):

1. Evidence of physical damage, such as a building damaged by fire or flood, when the level of damage requires restoration efforts to restore service utility.
2. Enactment or approval of laws or regulations or changes in environmental factors, such as new water quality standards that a water treatment plant does not meet (and cannot be modified to meet).
3. Advanced technological development or evidence of obsolescence.
4. Change of usage or duration of a capital asset, such as closure of a school prior to the end of its useful life.
5. Construction or development stoppage, for example the construction stoppage of a building due to lack of funding or stoppage of development of computer software due to a change in the priorities of management.

When one or more of the above circumstances exist, reporting organizations are required to apply the impairment test before impairment is recognized and reported.

Impairment Test

State organizations should recognize an impairment loss if the situation meets the materiality threshold defined above and both elements of the following test for impairment:

- Magnitude test: The magnitude of the decline in service utility is so significant that the cost of maintaining or restoring the asset outweighs the benefits that would be provided.
- Unexpected nature test: The decline in service utility is unexpected and not part of the normal life cycle of the asset.

Reporting organizations owning capital assets that are affected by one of the impairment indicators but that do not meet the impairment test should reevaluate the asset’s useful life, salvage value and depreciation. Changes to estimated useful lives and salvage values are accounted for on a prospective basis in future depreciation expense.

Measuring Impairment

Impaired capital assets that will no longer be used should be reported at the lower of net book value or net realizable value. Construction stoppages should also be reported at the lower of net book value or net realizable value.

The amount of impairment should be measured using the method that best reflects the decline in service utility of the capital asset. For assets that will remain in service, the method used to calculate the impairment loss should be based on the indicator of impairment as follows:

Indicator of Impairment	**Method Used to Calculate Impairment Loss**
Physical Damage	Restoration Cost Approach
Changes in Legal or Environmental Factors	Service Units Approach
Technological Change or Obsolescence	Service Units Approach
Change in Manner or Duration of Use	Service Units Approach **or** Depreciated Replacement Cost Approach

1. *Restoration cost approach:* Under this approach, the amount of impairment is derived from the estimated costs to restore 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. The two calculation formulas are described below:

i. Adjusted Restoration Cost = Restoration Cost × Historical Cost Index

$$\text{Impairment} = \left(\frac{\text{Adjusted Restoration Cost}}{\text{Historical Cost}}\right) \times \text{Net Book Value}$$

ii. $$\text{Impairment} = \left(\frac{\text{Restoration Cost}}{\text{Replacement Cost}}\right) \times \text{Net Book Value}$$

2. *Service units approach:* This approach isolates the historical cost of the service utility of the capital asset that cannot be used due to the impairment event or change in circumstances. The amount of impairment is determined by evaluating the service provided by the capital asset – either maximum estimated service units or total estimated service units throughout the life of the capital asset – before and after the event or change in circumstance. The three alternative calculation formulas are described below:

i. $$\text{Impairment} = \left(\frac{\text{Lost Service Units}}{\text{Estimated Life Service Units}}\right) \times \text{Net Book Value}$$

ii. $$\text{Impairment} = \left(\frac{\text{Lost Service Units per Period}}{\text{Estimated Life Service Units per Period}}\right) \times \text{Net Book Value}$$

iii. $$\text{Cost per Service Unit} = \left(\frac{\text{Historical Cost}}{\text{Estimated Life Service Units}}\right)$$

Impairment = Net Book Value – (Cost per Service Unit × Remaining Service Units)

3. *Deflated depreciated replacement cost approach:* This approach 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 the fact that the capital asset is not new, and then is deflated to convert it to historical cost dollars. The calculation process is described below:

Obtain a replacement cost estimate.

$$\text{Depreciated Replacement Cost} = \text{Replacement Cost Estimate} \times \left(\frac{\text{Net Book Value}}{\text{Historical Cost}}\right)$$

Deflated Replacement Cost = Depreciated Replacement Cost × Historical Cost Index

Impairment = Net Book Value - Deflated Replacement Cost

In governmental and business-type activities in government-wide financial statements and in proprietary and fiduciary fund financial statements, restoration or replacement of an impaired capital asset should be reported as a separate transaction from the impairment loss and associated insurance recovery. The impairment loss should be reported net of the associated insurance recovery if the recovery and loss occur in the same fiscal year. Insurance recoveries reported in subsequent fiscal years should be reported as a program revenue, non-operating revenue, or extraordinary item, as appropriate. Insurance recoveries should be recognized only when 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.

Basis of Accounting

Funds that operate on a statutory basis must convert their accounting activity to the modified accrual and/or accrual bases of accounting for the Comprehensive Annual Financial Report (CAFR). Proprietary and fiduciary funds that do not operate on a statutory basis use the accrual basis of accounting throughout the year.

- Statutory Basis for Budgetary Compliance Reporting
  Impairment losses are not reported on the statutory basis because budgetary compliance statements are prepared using bases of accounting which are designed to emphasize accountability and budgetary control of appropriations. Impairment losses are not budgetary expenditure transactions.

  Insurance recoveries, and expenditures incurred to restore or replace an impaired capital asset, should be recorded as described below for modified accrual basis transactions.

- Converting to Modified Accrual Basis for CAFR Reporting
  Impairment losses relate to capital assets which are not recorded under the modified accrual basis of accounting because governmental fund statements are prepared using the flow of current financial resources measurement focus. Therefore, losses due to the impairment of capital assets are not reported under the modified accrual basis.

  In governmental fund financial statements, expenses related to restoration or replacement of an impaired capital asset should be reported as separate transactions from the associated insurance recovery, which is reported as an other financing source or extraordinary item, as appropriate.

- Converting to Accrual Basis for CAFR Reporting
  Impairment losses are reported only under the accrual basis of accounting which uses the economic resources measurement focus. The losses are reported as program/operating expenses, special items or extraordinary items, as appropriate, in the government-wide statement of activities and proprietary statement of revenues, expenses and changes in net assets. Generally, impairments should be considered permanent. However, evidence may be available to demonstrate that the impairment will be temporary. In such circumstances, the capital asset should not be written down. Impairment losses recognized in accordance with this policy should not be reversed in future years, even if the events or circumstances causing the impairment have changed.

  Insurance recoveries under the accrual basis of accounting are recorded as described in the Accounting Requirements section, above.

- Accrual Basis for Funds Not Reporting on a Statutory Basis
  Proprietary funds, fiduciary funds and component units which are maintained on the accrual basis of accounting must also recognize and report impairment losses and insurance recoveries in compliance with this policy.

Disclosure Requirements

All reporting organizations included in the State of Georgia reporting entity at year-end must provide the State Accounting Office with information about capital asset impairments for disclosure in the notes to the State's financial statements. Reporting organizations with audited financial statements must also disclose capital asset impairments within the notes to their statements, and those disclosures must comply with this policy.

Specific disclosure requirements include:

- Impairment losses must be disclosed in the notes to the financial statements if not readily apparent on the face of the financial statements. The disclosure must include a general description, the amount and the financial statement classification of the impairment loss.
- The amount and financial statement classification of insurance recoveries also must be disclosed in the notes if not readily apparent on the face of the financial statements.
- The carrying amount of impaired capital assets that are idle at year-end must be disclosed, regardless of whether the impairment is considered permanent or temporary. No impairment loss would have been recorded on capital assets deemed to have a temporary impairment.

General Accounting Procedures:

Identifying Transactions

The fiscal officer of each reporting organization, or his or her designee, must establish internal controls to ensure that the accounting staff is notified when potential impairments occur. A communication process between accounting and the personnel managing the capital assets should be established. The accounting section of each reporting organization is ultimately responsible for ensuring that the accounting policies regarding impairments and insurance recoveries are properly followed.

Refer to Attachment A for a flowchart that describes the asset impairment decision process. This decision process will be helpful when identifying and assessing potential impairment events.

Accounting Transactions and Journal Entries

No accounting entries are required for impairment losses at the governmental fund level. Proprietary and fiduciary funds and government-wide activities should record the calculated impairment amount as:

- An extraordinary item if the impairment event was unusual and infrequent.
- A special item if the impairment event was unusual or infrequent and within management control.
- An operating/program expense if the impairment event was neither infrequent nor unusual, and it reduced the service utility of the capital asset in question.

GASB allows recognition of the impairment of capital assets in two ways:

- By increasing accumulated depreciation by the amount of the impairment loss.
- By reducing both the historical cost and accumulated depreciation proportionately so that the decrease in net carrying value equals the impairment loss.

For consistency, the statewide policy is to increase accumulated depreciation.

Reporting organizations should use the following journal entry to record an impairment:

Debit	$ xxx,xxx	Operating Expense/Extraordinary Item/Special Item (Various accounts)
Credit	$ xxx,xxx	Accumulated Depreciation (Various accounts, depends on the asset class)

After an impairment loss has been recognized, it must not be reversed in future years even if the events or circumstances causing the impairment have changed. Reporting organizations with a permanently impaired capital asset should contact SAO if they need assistance in recording an impairment loss.

Year-End Accounting Procedures
The SAO will request information about impairment losses and insurance recoveries as part of its year-end information package. All organizations included in the State of Georgia reporting entity that have impaired capital assets must either provide audited impairment disclosures that comply with this policy or complete the information for impairments and insurance recoveries on the Additional Information tab of the Capital Assets form. This information is required to ensure that appropriate accrual basis adjusting entries are recorded for the annual financial reports.

Authority:

- GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*
- GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*
- GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*
- GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*
- GASB Codification Section 1400, *Reporting Capital Assets*

Applicability:
Personnel at all reporting organizations included in the State of Georgia reporting entity that have capital asset accounting and reporting responsibilities should be knowledgeable of this policy, as should personnel responsible for maintaining capital asset inventory records.

Definitions:
Impairment – The significant and unexpected decline in the service utility of a capital asset. Governments generally hold capital assets because of the services the capital assets provide; consequently, capital asset impairments affect the service utility of the assets. The events or changes in circumstances that lead to impairments are not considered normal and ordinary. That is 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 capital asset. [GASB 42, ¶5]

Service utility – The usable capacity which at acquisition was expected to be used to provide service for the reporting organization. This is distinguished from the level of utilization, which is the portion of usable capacity currently being employed. The current usable capacity of a capital asset may be less than its original usable capacity due to the normal or expected decline in useful life or to impairing events or changes in circumstances, such as physical damage, obsolescence, enactment or approval of laws or regulations or other changes in environmental factors, or change in manner or duration of use. Usable capacity may be different from maximum capacity in circumstances in which surplus capacity is needed for safety, economic, or other reasons. Decreases in utilization and existence of or increases in surplus capacity that are not associated with a decline in service utility are not considered to be impairment.

Capital Asset Impairment Decision Process **Attachment A**