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Governmental Accounting Standards Series

Statement No. 42 of the Governmental Accounting Standards Board

Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries

Governmental Accounting Standards Board
of the Financial Accounting Foundation

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Summary

This Statement establishes accounting and financial reporting standards for impairment of capital assets. A capital asset is considered impaired when its service utility has declined significantly and unexpectedly. This Statement also clarifies and establishes accounting requirements for insurance recoveries.

Governments are required to evaluate prominent events or changes in circumstances affecting capital assets to determine whether impairment of a capital asset has occurred. Such events or changes in circumstances that may be indicative of impairment include evidence of physical damage, enactment or approval of laws or regulations or other changes in environmental factors, technological changes or evidence of obsolescence, changes in the manner or duration of use of a capital asset, and construction stoppage. 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.

Impaired capital assets that will no longer be used by the government should be reported at the lower of carrying value or fair value. Impairment losses on capital assets that will continue to be used by the government should be measured using the method that best reflects the diminished service utility of the capital asset. Impairment of capital assets with physical damage generally should be measured using a restoration cost approach, an approach that uses the estimated cost to restore the capital asset to identify the portion of the historical cost of the capital asset that should be written off. Impairment of capital assets that are affected by enactment or approval of laws or regulations or other changes in environmental factors or are subject to technological changes or obsolescence generally should be measured using a service units approach, an approach that compares the service

units provided by the capital asset before and after the impairment event or change in circumstance. Impairment of capital assets that are subject to a change in manner or duration of use generally should be measured using a service units approach, as described above, or using deflated depreciated replacement cost, an approach that quantifies the cost of the service currently being provided by the capital asset and converts that cost to historical cost.

Impairment losses should be reported in accordance with the guidance in paragraphs 41 through 46, 55, 56, 101, and 102 of Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments,* and paragraphs 19 through 24 of Accounting Principles Board Opinion No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*. If not otherwise apparent from the face of the financial statements, the description, amount, and financial statement classification of impairment losses should be disclosed in the notes to the financial statements. If evidence is available to demonstrate that the impairment will be temporary, the capital asset should not be written down.

Impaired capital assets that are idle should be disclosed, regardless of whether the impairment is considered permanent or temporary.

An insurance recovery associated with events or changes in circumstances resulting in impairment of a capital asset should be netted with the impairment loss. Restoration or replacement of the capital asset using the insurance recovery should be reported as a separate transaction. Insurance recoveries should be disclosed if not apparent from the

face of the financial statements. Insurance recoveries for circumstances other than impairment of capital assets should be reported in the same manner.

The provisions of this Statement are effective for fiscal periods beginning after December 15, 2004. Earlier application is encouraged.

How the Changes in This Statement Improve Financial Reporting

This Statement improves financial reporting because it requires governments to report the effects of capital asset impairments in their financial statements when they occur rather than as a part of the ongoing depreciation expense for the capital asset or upon disposal of the capital asset. Users of financial statements will better understand when impairments have occurred and what their financial impact is on the government. This Statement also enhances comparability of financial statements between governments by requiring all governments to account for insurance recoveries in the same manner.

Unless otherwise specified, pronouncements of the GASB apply to financial reports of all state and local governmental entities, including general purpose governments; public benefit corporations and authorities; public employee retirement systems; and public utilities, hospitals and other healthcare providers, and colleges and universities. Paragraph 3 discusses the applicability of this Statement.

Statement No. 42 of the
Governmental Accounting
Standards Board

Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries

November 2003

Governmental Accounting Standards Board
of the Financial Accounting Foundation
401 Merritt 7, PO Box 5116, Norwalk, Connecticut 06856-5116

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INTRODUCTION

1. Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments,* requires capital assets, including infrastructure assets, to be reported in the statement of net assets. Statement 34 also requires that capital assets (with the exception of inexhaustible assets and those accounted for using the modified approach) be depreciated over their estimated useful lives. Current standards do not have a specific requirement to reduce the carrying value of a capital asset other than through the application of depreciation. The GASB also has not previously established requirements for accounting and reporting should these assets become impaired. Therefore, the primary objective of this Statement is to establish accounting and reporting requirements for the impairment of capital assets.

2. Financial Accounting Standards Board (FASB) Interpretation No. 30, *Accounting for Involuntary Conversions of Nonmonetary Assets to Monetary Assets,* an interpretation of APB Opinion No. 29, provides guidance on accounting for insurance recoveries and was applicable to government-wide and proprietary fund financial statements. Authoritative guidance for insurance recoveries, however, did not exist for governmental funds. Therefore, another objective of this Statement is to establish and clarify guidance for accounting for insurance recoveries for all funds and activities.

STANDARDS OF GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING

Scope and Applicability of This Statement

3. This Statement establishes guidance for accounting and reporting for the impairment of capital assets[1] and for insurance recoveries. This Statement applies to all state and local governments.[2]

4. The guidance related to accounting and reporting for impairment of assets applies to capital assets.[3] The guidance related to insurance recoveries applies to all such recoveries, not just those associated with impairment of capital assets.

Definition of Impairment

5. Asset impairment is *a significant, 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.

6. The service utility of a capital asset is 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. The *current usable capacity* of a capital asset may be

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[1]Capital assets are defined in paragraph 19 of Statement 34. Capital assets that have been or will be used in operations are also comprehended in that definition.

[2]This Statement applies to business-type activities and enterprise funds that apply FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation,* but does not preclude them from reporting a regulatory asset related to an impairment loss when appropriate in accordance with the provisions of FASB Statement 71.

[3]For purposes of this Statement, land is considered to be a separate capital asset from buildings and depreciable improvements and therefore should be evaluated separately for impairment.

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 service capacity may be different from *maximum service 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.

Assessment of Impairment

7. The determination of whether a capital asset is impaired as described in paragraph 5 is a two-step process of (a) identifying potential impairments and (b) testing for impairment. Capital assets that have potential for meeting the definition of impairment are identified through events or changes in circumstances that are prominent and that denote the presence of indicators of impairment, such as those described in paragraphs 9 and 10. For capital assets so identified, a test of impairment as described in paragraph 11 should be performed to determine whether the circumstance or change in condition results in an impairment as defined in paragraph 5.

Identification of Events or Changes in Circumstances That May Indicate Impairment

8. The events or changes in circumstances affecting a capital asset that may indicate impairment are prominent—that is, conspicuous or known to the government. Absent any such events or changes in circumstances, governments are not required to perform additional procedures to identify potential impairment of capital assets beyond those already performed as part of their normal operations. The events or circumstances that may indicate impairment generally are expected to have prompted discussion by the governing board, management, or the media.

Indicators of Impairment

9. Impairment is indicated when events or changes in circumstances suggest that the service utility of the capital asset may have significantly and unexpectedly declined. Common indicators of impairment include:

a. 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
b. Enactment or approval of laws or regulations or other changes in environmental factors, such as new water quality standards that a water treatment plant does not meet (and cannot be modified to meet)
c. Technological development or evidence of obsolescence, such as that related to a major piece of diagnostic or research equipment (for example, a magnetic resonance imaging machine or a scanning electron microscope) that is rarely used because newer equipment provides better service
d. A change in the manner or expected duration of use of a capital asset,[4] such as closure of a school prior to the end of its useful life
e. Construction stoppage, such as stoppage of construction of a building due to lack of funding.

10. A change in demand for the services of a capital asset is not considered a separate indicator of impairment. However, changes in demand may be caused by or associated with the indicators listed in paragraph 9, and capital assets in these circumstances should be tested for impairment. For example, decreased demand for the processing services of a mainframe computer because former users of the mainframe have transitioned to PC- and server-based systems should be considered a change in demand associated with an indicator of impairment—evidence of obsolescence—and the mainframe should be tested for impairment. However, a decrease in demand resulting from the conclusion of a special project requiring large amounts of processing time on a mainframe computer that runs other applications should not be considered a change in demand associated with an indicator of impairment, and a test of impairment is not required.

[4]A capital asset that a government has decided to sell, but is continuing to use as originally intended until the sale occurs, is not considered to exhibit a change in manner or expected duration of use. A capital asset that a government has decided to sell and is not continuing to use is considered to exhibit a change in manner or expected duration of use and should, therefore, be evaluated for impairment.

A decrease in school enrollment is another example of a change in demand. If this decrease in enrollment prompts management to close a school, a change in manner or duration of use has also resulted and a test for impairment should be performed. If, however, the decrease in enrollment results in the school's changing from an overcrowded condition to one in which classroom sizes are now below the state-required maximum and is not associated with another indicator of impairment, a test for impairment is not required.

Impairment Test

11. A capital asset identified through the processes described in paragraphs 7 through 10 should be tested for impairment by determining whether both of the following two factors are present:

a. ***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 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.
b. ***The decline in service utility is unexpected.*** The restoration cost or other impairment circumstance is not a part of the normal life cycle of the capital asset. 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.

Measurement of Impairment

Capital Assets That Will Continue to Be Used by the Government

12. For impaired capital assets that will continue to be used by the government, the amount of impairment—the portion of historical cost that should be written off—should be measured by the method described below that most appropriately reflects the decline in service utility of the capital asset. The methods for measuring impairment are:

a. ***Restoration cost approach.*** Under this approach, the amount of impairment is derived from the estimated costs to restore[5] 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.
b. ***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.
c. ***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.

13. Impairments resulting from physical damage generally should be measured using a restoration cost approach.

14. Impairments resulting from enactment or approval of laws or regulations or other changes in environmental factors or from technological development or obsolescence generally should be measured using a service units approach.

15. Impairments identified from a change in manner or duration of use generally should be measured using deflated depreciated replacement cost or using a service units approach.

Capital Assets That Will No Longer Be Used by the Government and Construction Stoppage

16. Impaired capital assets that will no longer be used by the government should be reported at the lower of carrying value or fair value. Capital assets impaired from construction stoppage also should be reported at the lower of carrying value or fair value.

[5]Restoration cost is the amount necessary to return the capital asset to its original condition and does not include any amount attributable to improvements and additions.

Reporting Impairment Losses

17. Unless the impairment is considered temporary as described in paragraph 18, the loss[6] from impairment should be reported in the statement of activities and statement of revenues, expenses, and changes in fund net assets, if appropriate, as a program or operating expense, special item, or extraordinary item in accordance with the guidance in paragraphs 41 through 46, 55, 56, 101, and 102 of Statement 34 and paragraphs 19 through 24 of Accounting Principles Board Opinion No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*. Impairment losses appropriately reported as program expense generally should be reported as a direct expense of the program that uses or used the impaired capital asset. Impairment loss should be reported as indicated regardless of whether the capital asset is being depreciated individually or as part of a composite group. If not otherwise apparent from the face of the financial statements, a general description, the amount, and the financial statement classification (for example, public works or instruction) of the impairment loss should be disclosed in the notes to the financial statements.

Permanent and Temporary Impairments

18. Generally, an impairment should be considered permanent. In certain circumstances involving capital assets impaired through enactment or approval of laws or regulations or other changes in environmental factors, change in technology or obsolescence, change in manner or duration of use, or construction stoppage, however, evidence may be available to demonstrate that the impairment will be temporary. In such circumstances, the capital asset should not be written down. For example, a middle school that is not being used due to declining enrollment

[6] This guidance also applies to insured impairments that result in accounting gains.

should not be written down if evidence, such as future middle school enrollment projections substantiated by current elementary school enrollment, residential development data, birth rates, or other economic indicators, demonstrates that the closing of the middle school will be temporary. Impairment losses recognized in accordance with this Statement should not be reversed in future years, even if the events or circumstances causing the impairment have changed.

Capital Assets That Do Not Meet the Impairment Test

19. If an event or circumstance indicates that a capital asset may be impaired, but the test of impairment determines that impairment has not occurred, the estimates used in depreciation calculations—remaining estimated useful life and salvage value—should be reevaluated and changed, if necessary.[7]

Disclosure of Idle Impaired Capital Assets

20. The carrying amount of impaired capital assets that are idle at year-end should be disclosed, regardless of whether the impairment is considered permanent or temporary.

Insurance Recoveries[8]

21. In governmental fund financial statements, restoration or replacement of an impaired capital asset should be reported as a separate transaction from the associated insurance recovery, which is reported as an other financing source or extraordinary item, as appropriate. In governmental and business-type activities in government-wide financial statements and in proprietary fund financial statements, restoration or replacement of an impaired capital asset

[7]Changes to estimated useful lives and salvage values are accounted for on a prospective basis in future depreciation expense.

[8]In accordance with the provisions of Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, recoveries received from internal service funds should be accounted for in accordance with the provisions of this paragraph. Recoveries received from the general fund should be accounted for as reimbursements to the extent of the impairment loss, if any, and be reported as transfers in the fund financial statements for amounts in excess of the impairment loss, if any.

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 when the recovery and loss occur in the same year. Insurance recoveries reported in subsequent years should be reported as a program revenue, nonoperating 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. If not otherwise apparent in the financial statements, the amount and financial statement classification of insurance recoveries should be disclosed.

22. Insurance recoveries other than those related to impairment of capital assets, such as for theft or embezzlement of cash or other monetary assets, should be accounted for as described in paragraph 21.

EFFECTIVE DATE AND TRANSITION

23. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2004. Earlier application is encouraged. Accounting changes adopted to conform to the provisions of this Statement should be applied retroactively by restating financial statements, if practical, for all prior periods presented. If restatement is not practical, the cumulative effect of applying this Statement, if any, should be reported as a restatement of beginning net assets, fund balances, or fund equity, as appropriate, for the earliest period restated. In the period this Statement is first applied, the financial statements should disclose the nature of any restatement and its effect. Also, the reason for not restating prior periods presented should be explained. Previously reported impairments, if any, resulted in a new cost basis for the impaired capital asset and should not be restated.

The provisions of this Statement need not be applied to immaterial items.

This Statement was issued by the affirmative vote of five members of the Governmental Accounting Standards Board. Messrs. Allen and Mazur dissented.

Messrs. Allen and Mazur dissent on the issue of not providing the opportunity for business-type activities and enterprise funds to measure impairment of capital assets using a cash flows approach.

The GASB and its predecessor organization have consistently recognized the differences between those activities of a government that are primarily financed by taxes (governmental activities/funds) and those activities that are generally self-supporting through charges for services (business-type activities/enterprise funds). Governmental financial reporting standards in Statement 34, as well as prior standards, require business-type activities and enterprise funds to report on an economic resources measurement focus and an accrual basis of accounting.

NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles,* paragraph 117, as amended, states:

> . . . Proprietary fund revenues should be reported by major sources, and expenses should be classified in essentially the same manner as similar business organizations or activities, unless that classification conflicts with or contradicts GASB pronouncements, as discussed in Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting.* Such classification is appropriate in view of the nature of these funds, and facilitates comparison of their operating results with those of like organizations in both the public and private sectors. Further, widely accepted account classifications are available for several types of enterprise and other commercial-type activities.

GASB Statement 34, paragraph 66, states:

> Proprietary fund reporting focuses on the determination of operating income, changes in net assets (or cost recovery), financial position, and cash flows. The proprietary fund category includes enterprise and internal service funds.

Cash flows statements are required for enterprise funds activities, and these activities are required to report operating and nonoperating activities separately. These economically focused accounting requirements exist for all enterprise funds, whether they are self-supporting or if the government does or is willing to subsidize the activity because it is a public benefit.

Messrs. Allen and Mazur believe that the measurement of impairment for capital assets of business-type activities and enterprise funds should be consistent with the economic focus of the financial statement presentation. They believe that the harmonization between a cash flows approach to reporting impairment and the economic focus of financial presentation for business-type activities and enterprise funds is more important than the harmonization of the approach to measurement of impairment between capital assets of governmental activities generally financed through taxes, which are not required to present cash flows statements, and business-type activities and enterprise fund capital assets.

Messrs. Allen and Mazur believe that in most cases an impairment that affects service capacity would also affect the cash flows of business-type activities and enterprise funds. However, they believe that cash flows–related impairments of business-type activities and enterprise fund capital assets should be reflected in their financial statements even if there are no declines in service utility and, correspondingly, that a business-type activity or enterprise fund that experiences a decline in service utility that does not economically impact the enterprise's ability to recover its investment in capital assets should not be required to write down its capital assets.

This cash flows approach to reporting impairment of capital assets is consistent with accounting standards of for-profit and not-for-profit business organizations and governmental business enterprises throughout the world. One reason for adding this project to the GASB technical agenda at the time it was added was that it provided the opportunity to work with the

Public Sector Committee (PSC) of the International Federation of Accountants. Although there was general harmonization with the measurement of the impairment of general governmental capital assets, the PSC has proposed to measure the asset impairment for governmental business enterprise capital assets using a cash flows approach consistent with existing standards for commercial enterprises.

Messrs. Allen and Mazur are not aware of financial statement user concerns with the current reporting of asset impairment by the business-type activities and enterprise funds that currently are following this cash flows approach.

They also believe the GASB is missing an opportunity for more consistent reporting by certain special entities with similar operations in both the public and private sectors.

Mr. Allen also does not support the conclusion that events that reverse the circumstances that initially resulted in the write-down of impaired capital assets should not be recognized in a government's financial statements.

Mr. Allen also notes that traditional accounting theory, particularly as it is applied to a historical cost model of reporting, specifies that the basis for reporting assets should be written down for certain events but should not be written back up if those events are reversed. For example, inventories written down to market value if lower than the cost basis of those inventories are not permitted to be written back up if the market value increases above the cost basis of these inventories. This traditional accounting theory has been applied by the GASB in this standard for impairment of capital assets. Such assets written down because the government does not have the evidence to demonstrate that an impairment will be temporary are not permitted to be written back up to historical cost if, in fact, it turns out that the impairment was temporary.

For example, an elementary school is closed and written off as a result of financial duress when the town's main employer leaves leading to a decline in population and school enrollment. If events and circumstances were to change several years later and the school were reopened, under this Statement the write-off of the school building would not be permitted to be reversed because at the time of closure the government did not have evidence to demonstrate that the closure would be temporary.

Another example would be the enactment or approval of a state law, such as one requiring all local school buildings to be earthquake-proof or vacated within a three-year period. The enactment of such a law may result in the local school district's recording capital asset impairment write-offs in the year the law was enacted for schools they believe will not be able to be brought up to the new earthquake standards. However, if the state legislature subsequently eases the standards such that local school districts are able to modify the buildings rather than close them, this Statement would not allow the reversal of the original write-off of the buildings based on the law as originally passed.

Mr. Allen believes that an accounting standard is not being faithfully representative if that standard only permits or requires one-way adjustments. Accordingly, Mr. Allen does not support the application of this "conservative" accounting theory to the GASB's proposed capital asset impairment standard. Rather, he believes that the reversal of circumstances that initially resulted in the impairment write-down of assets should also be recognized in the financial statements of the government through the reversal of the impairment write-down.

Mr. Allen notes that the Board's conclusions to base impairment of capital assets on a service utility approach is unique and does not follow existing accounting standards or theory. Therefore, Mr. Allen sees no reason that the GASB should be bound by traditional

"conservative" accounting theory, such as not allowing the reversal of capital asset impairment write-downs when circumstances would indicate otherwise.

Mr. Allen also notes that the PSC proposal does allow, in some circumstances, for the reversal of an impairment loss, and he believes that certain reversals would also be appropriate for the GASB based on its service utility approach.

Members of the Governmental Accounting Standards Board:

Tom L. Allen, *Chairman*
Cynthia B. Green
William W. Holder
Edward J. Mazur
Paul R. Reilly
Richard C. Tracy
James M. Williams

Appendix A

BACKGROUND

24. Statement 34, issued in June 1999, requires capital assets, including infrastructure assets, to be reported on the statement of net assets. GASB pronouncements to date have not addressed the issue of impairment of capital assets.

25. Public interest groups have expressed concerns over the condition of capital assets, such as schools, roads, bridges, and sewer systems, that are held by governments and are needed to provide essential public services. Without specific guidance on when and how impairment of capital assets should be reported, governments in similar circumstances may report those circumstances differently. Assets being reported on the statement of net assets may be overstated and the costs of providing services in that period may be understated. In response to these concerns, a project was added to the GASB's current technical agenda in June 2000.

26. The PSC has a project on this topic on its current technical agenda. In July 2000, the PSC issued an Invitation to Comment (ITC) on impairment of assets and in September 2003 issued an Exposure Draft taking into account the responses to the ITC. Due to a mutual interest in pursuing impairment of capital assets of governments, staffs of the PSC and the GASB have worked together to research potential methods of measuring impairment and to frame and explore approaches to accounting and reporting impairment of capital assets.

27. Considerations of impairment of capital assets, especially those impaired due to physical damage, raise the question of how insurance recoveries should affect accounting and reporting of impairment of capital assets. FASB Interpretation 30 provides guidance on involuntary conversions. The Interpretation requires that the gain or loss be recognized when a nonmonetary

asset is involuntarily converted to monetary assets. However, applicability of that guidance to financial statements presented for governmental funds on the modified accrual basis of accounting has been questioned.

28. In December 2002, the Board issued an Exposure Draft (ED), *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. Fifty-six organizations and individuals responded to the ED. In March 2003, the Board held a public hearing on the proposals put forth in the ED. The Board's response to this input is reflected in the Basis for Conclusions.

Appendix B

BASIS FOR CONCLUSIONS

29. This appendix summarizes factors considered significant by the Board members in reaching the conclusions in this Statement. It includes discussion of alternatives considered and the Board's reasons for accepting some and rejecting others. Individual Board members gave greater weight to some factors than to others.

30. Other standards setters have addressed the issue of capital asset impairment. The Board considered the approaches used in the following documents in evaluating an approach applicable to state and local governments in the United States:

- Accounting Standards Board of the United Kingdom, Financial Reporting Standard 11, *Impairment of Fixed Assets and Goodwill*
- Australian Accounting Standards Board, Exposure Draft 104, *Impairment of Assets*
- Canadian Institute of Chartered Accountants, *Public Sector Accounting Handbook*, Section 3150
- FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*
- Institute of Chartered Accountants of New Zealand, Financial Reporting Standard No. 3, *Accounting for Property, Plant, and Equipment*
- International Accounting Standards Board, International Accounting Standard 36, *Impairment of Assets*
- International Federation of Accountants, Public Sector Committee, Invitation to Comment, *Impairment of Assets,* and Exposure Draft, *Impairment of Assets.*

Scope of This Statement

31. This Statement is applicable to capital assets because the concern for potential overstatement of assets focuses on capital assets, such as buildings, infrastructure, heavy equipment, and computer systems. Capital assets often are the most substantial portion of the statement of net assets, now that Statement 34 requires infrastructure assets to be reported. Current standards do not have a specific requirement to reduce the carrying value of capital assets should anything other than normal deterioration over the estimated useful life occur or

should the capital asset become obsolete. The longer the life a capital asset has, the greater the possibility that unexpected events may affect the service utility of the capital asset and that the financial statements would be misstated for a number of years.

Other Requirements to Reassess Carrying Value

32. Other principal assets have generally accepted accounting principles (GAAP) requirements that result in periodic reconsideration of carrying value. For example, Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools,* requires most investments to be reported at fair value, necessitating a revaluation at year-end. Accounting Research Bulletin (ARB) No. 43, *Restatement and Revision of Accounting Research Bulletins,* requires short-term receivables to be reported at net realizable value, which necessitates a periodic consideration of net realizable value. ARB 43 also requires certain inventories to be reported at the lower of cost or market.

Application to Individual Capital Assets or Groups of Capital Assets

33. Recognizing that capital assets are recorded at varying levels of detail, the Board considered whether this Statement should be applied to individual capital assets or groups of related capital assets. For example, a building may be recorded as a single capital asset. Or the building may be broken down into components—such as roof, electrical, heating and ventilation, furnishings, structure, and so forth—and capitalized as a number of capital assets. Statement 34 requires that infrastructure be reported as capital assets, but it does not include requirements that infrastructure be accounted for as individual capital assets. Some governments may record infrastructure at the network or subsystem level, rather than recording individual capital assets within a network or subsystem. The Board was concerned that if the capital asset impairment standard were applied at the highest grouping level—a network, for example—the amount of impairment would have to be so high in relation to the amount of capital assets in a large

aggregation for the impairment to be significant, it would be unlikely that any capital asset impairments would be reported. At the other extreme, if the capital asset impairment standard were required to be applied to each component or individual capital asset, the standard might impose too great a cost burden on preparers and auditors because more impairment assessments would need to be made. The Board agreed that professional judgment should be used to determine the level at which the Statement is to be applied. The Board also agreed that land should not be grouped with associated buildings or depreciable improvements when assessing potential impairment because those capital assets are different in nature and potential for impairment, and the Board did not want an unrealized gain in fair value of land to be used to offset an impairment loss on buildings or depreciable improvements.

Deferred Maintenance

34. Some respondents to the ED expressed concern that the proposed Statement did not address the issues of deferred maintenance and reporting the condition of capital assets. The Board recognizes that users of financial statements are concerned about these issues; however, these issues could not be included in the scope of this Statement. The Board believes that additional time to study the results of Statement 34 implementation efforts and to allow condition assessment approaches to further develop is necessary before additional guidance on these issues can be considered.

Business Enterprise Capital Assets

35. Because other standards setters have not identified approaches to identifying and measuring capital asset impairment that seem conceptually congruous with the nature of most capital assets in governments, the Board first focused its deliberations on governmental and subsidized capital assets, rather than on business enterprise capital assets. Governmental and subsidized capital assets are held primarily for the services they provide, in contrast with business enterprise capital assets, which are held primarily for the revenue they produce. The following definitions were used during the deliberations:

> ***Governmental capital assets*** are assets that directly or indirectly are used in providing services that are not directly associated with fees or other revenues. Examples include roads, bridges, schools, and equipment used for fire protection.
>
> ***Subsidized capital assets*** are assets that are used to produce revenues through charges for services or fees, but that a government would subsidize, if needed, because the service provided by the capital assets is a public benefit. The revenues produced are set by the management of the government, perhaps based upon cost of services or political considerations, rather than set with consideration of market influences. Examples include water and sewer systems, stadiums, convention centers, metropolitan transportation systems, hospitals, and toll roads.
>
> ***Business enterprise capital assets*** are assets that are used to produce revenues by selling goods or services. They are established as, and are expected to be, a self-supporting enterprise. Revenues produced are subject to market influences. Examples include power generation and transmission and casino enterprises.

36. When agreement had been reached on the approach to capital asset impairment to be applied to governmental and subsidized capital assets, the Board considered whether the same approach should be applied to business enterprise capital assets or whether a cash flows approach should be applied. The Board recognized that the cash flows approach is well developed by other standards setters and is widely accepted, that an important feature of a business enterprise capital asset is its cash flow, and that funds that operate business enterprise capital assets may prefer to present financial statements as similar as possible to their private-sector counterparts. However,

the reasons for applying the approach for governmental and subsidized capital assets to business enterprise capital assets were considered stronger. The Board believes that using a different approach may be confusing to a reader of the financial statements. Business enterprises often are a subset of business-type activities, and different standards generally should not be applied to activities presented in a single column on the financial statements.[9] The instances in which capital assets of governments are held solely for the purpose of generating revenue are limited. Upon further consideration of the types of activities that potentially might be considered business enterprises, almost all of these enterprises initially were created to provide the service or product, rather than to generate revenue for the government. Some impairments identified through the approach developed for governmental and subsidized capital assets may not result in impairment for business enterprise capital assets using a cost recovery approach. In cases of physical damage, for example, if the damaged capital asset could still produce its product, but at a reduced capacity, and the present value of net cash flows from the reduced capacity was greater than the carrying costs, no impairment would be reported under a fair value/cash flows approach. The Board also was concerned that the cash flows approach would lead to grouping capital assets in discrete cash-generating units in such a manner that impairment to components within the cash-generating unit may not be identified and reported.

37. Some respondents to the ED requested that the Board reconsider its decision to apply the approach to impairment for governmental and subsidized capital assets and to business enterprise

[9]Even though governments may elect to apply or not to apply subsequent FASB pronouncements to individual enterprise funds, the GASB encourages governments to make the *same* election for all enterprise funds. (See paragraph 94 of Statement 34 and paragraph 8 of Statement 20)

capital assets. Additional research was conducted into the nature of impairments reported by business-type entities that have reported using the provisions in paragraph 7 of Statement 20, which allow the application of FASB Statements and Interpretations issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements. The Board redeliberated the issue, recognizing that there are valid arguments both for and against the decision. The strongest arguments against applying the approach for governmental and subsidized assets to business enterprise assets are recognition of economic impairments, conceptually reflecting the business use of the capital asset, and the responsibility to establish appropriate standards for even limited circumstances. The strongest argument in favor of applying the same approach to all capital assets is the basic concept that underlies this standard. The primary goal of all governmental capital assets is to provide service and not to generate cash flows; therefore, the Board concluded that the best method to measure any form of impairment is to base the assessment on service utility. In addition, the Board considered the importance of a single approach for similar impairments, such as from physical damage or enactment or approval of laws or regulations; the concern about introducing a reporting model for capital assets that mixes historical cost and fair value basis; and recognition that change statements already present information about recoverability of capital assets. After reviewing the additional research and assessing the positions on both sides of the issues, the Board still believes that the arguments for a single approach are stronger than the arguments against a single approach, and therefore retained the service utility approach for business enterprise capital assets.

Identification of Events Indicating Impairment

38. The Board views impairments of capital assets as events that are easily identifiable because of their unusual and significant nature. These events will have been identified by one or more

parties—such as the governing board, management, and the media—who have an interest in the government as a normal part of their duties. Reviews of media reports beyond those performed as a part of a government's normal operations are not required. Conversely, not all events and changes in circumstances discussed by the governing board, management, or the media would necessarily be considered significant to a government's financial statements. Consequently, every such event or circumstance so discussed need not be evaluated as a potential impairment.

Indicators of Impairment

39. The Board considered all indicators of impairment used in pronouncements of other standards setters and their applicability to the types of capital assets reported by governments. The indicators pertinent to governmental capital assets were identified in this process. All examples of impaired capital assets used during discussions were reviewed in relation to the pertinent indicators, and the Board concluded that the indicators specified were as comprehensive as possible. However, the Board recognizes that it is not possible for them to identify every potential indicator of asset impairment. Therefore, the specified indicators are not all-inclusive. Additionally, the indicators of impairment are not mutually exclusive. Indicators in subparagraphs 9a, b, c, and e refer to sources of impairment to capital assets, and the indicator in subparagraph 9d refers to the effect of impairment on the capital asset. Consequently, it is possible for a single impairment event to exhibit more than one indicator of impairment.

40. The Board considered whether a change in the demand for the use of a capital asset should be an indicator of impairment and concluded that a reduction in demand for the use of a capital asset, whether decreases from prior or from projected demand levels, is a reduction in the level of utilization. Because the capital asset still retains the capacity to provide service, a reduction in the level of utilization does not reflect impairment of the capital asset. It is only when a change

in demand is coupled with one of the conditions in subparagraphs 9b through d that the existence of an impairment needs to be determined. For example, a school that has a current enrollment of 500 pupils but previously had an enrollment of 1,000—the maximum capacity of the school—would not be considered impaired based on that fact alone. Even with the reduced enrollment, the school retains the capacity for 1,000 students. Impairment may result when action, such as changing the way the capital asset is being used, has been taken to address the reduction in demand. In the school example, if current enrollment was transferred to other schools and the school was used only for storage, impairment may have occurred.

41. Technological development and obsolescence usually result in a reduction in demand for the affected capital asset. The capital asset has not experienced a decline in its physical ability to provide service; however, the product or service produced by the capital asset is no longer demanded because some other capital asset provides a better product or service or something has made the product or service undesirable. For example, many applications that once could run on only large, expensive mainframe computers have been adapted to run on small, inexpensive servers or personal computers. If a government had acquired a mainframe several years ago with the expectation that most applications of the government would run on the mainframe for another seven years before new technology would make it feasible to use less-expensive hardware, but found that the pace of development of servers and personal computers was so rapid that half of the applications had been moved to servers and personal computers in two years with no alternative uses for the mainframe, impairment would be indicated. The mainframe can still physically process applications as rapidly as it could initially and can continue to do so for its estimated useful life. However, because of the advancement in technology for servers and personal computers, the demand for the services of the mainframe has greatly decreased.

42. The Board considered how a government's decision to sell a capital asset would affect the applicability of the indicators and the associated implications for measurement of impairment. The Board was especially concerned with the possibility that a government may decide to sell a capital asset (a parking garage, for example), will continue to operate the asset pending sale, but will write down the capital asset to the lower of carrying value or fair value when the decision to sell the asset is made because the situation is evaluated as an impairment indicated by a change in manner or duration of use of a capital asset. Because the capital asset ultimately will not continue to be used by the government, the lower of cost or fair value approach would be applied. The Board concluded that it is not appropriate to write a capital asset down to fair value at the date a decision to sell the capital asset is made. The change in duration of use indicator refers to the entire estimated useful life of the capital asset, not just the portion of that estimated useful life that the government will use. In contrast, a government's decision to sell a capital asset that will not continue to be used to provide service should be evaluated for impairment because it has exhibited a change in manner of use—from providing service to being held for sale.

Legal, Regulatory, and Other Environmental Changes Affecting Capital Assets

43. The Board considered the circumstances in which a change in legal, regulatory, or other environmental factors should be an impairment test indicator potentially requiring an impairment loss to be reported. Some believe that such transactions should be reported when the legal, regulatory, or other environmental change becomes effective because the capital asset continues to provide service until the change goes into effect. The Board concluded, however, that such transactions should be reported when the change occurs. A government acquires a capital asset because its management has an expectation that this capital asset will provide future service.

When an event or change in circumstance affects this expectation of future service utility of the capital asset, the event or change in circumstance should be reported. The enactment of a law, adoption of a regulation, or other environmental change affecting the capital asset affects this management expectation about future service utility and consequently should be considered an indicator of impairment. The Board considered the timing of recognition only for changes in laws that affect impairment of capital assets. Other changes in laws were considered outside the scope of this project. Some respondents to the ED recommended that the Board reconsider its decision, citing instances when a law or regulation has been repealed or modified to grandfather in existing circumstances or to exclude application to certain entities such that the impairment to the capital asset would be reversed. The respondents suggested that either the impairment should be reported only when the law or regulation is effective or the impairment loss should be reversed if the law or regulation is repealed or modified. The Board weighed the significance of the potential errors based upon the point at which impairment is reported. If impairment is reported upon enactment of a law or adoption of a regulation, the potential error is that an actual loss in service potential may not ultimately be realized if changes are made to the law or regulation before it becomes effective. If impairment is reported when the law or regulation is effective and no changes are made to the law or regulation between enactment or adoption date and effective date, the potential error is that an impairment that was known at the date the law is enacted or the regulation is adopted is not reported until a subsequent date—when the law or regulation becomes effective. The Board concluded that the significance of the latter potential error is greater than that of the former potential error. For the reasons described in paragraph 58, the Board believes it is inappropriate to reverse reported impairments. Consequently, the Board decided to retain the provisions in the ED with respect to legal, regulatory, or other environmental changes affecting capital assets.

Approach to Identifying Impairment

44. The Board first considered the issues of impairment using the general approach used by other standards setters. This general approach consisted of a two-step process of (a) identifying potentially impaired capital assets through indictors of impairment and (b) testing to determine whether impairment had occurred by comparing the carrying value of the capital asset to a valuation reflecting the current state of the capital asset. Recognizing the cost involved in applying a test of impairment, the Board was concerned that the indicators were not sufficiently discriminating and would require a test of impairment in many unnecessary circumstances. For example, a fire that caused structural damage and extensive smoke damage could possibly indicate that a building might be impaired. If, however, the fire damage was confined to a single room with minimal smoke damage in the other parts of the building, it is unlikely that the building would be considered impaired. As another example, a ten-year-old bridge that was posted with a weight restriction after a routine inspection uncovered unexpected structural damage might be impaired. However, a bridge posted with a weight restriction after fifty years of service, as part of its normal life cycle, would not likely be considered impaired.

45. In order to limit the universe of capital assets tested for impairment because of cost–benefit considerations, the Board considered two potential modifiers to the indicators: (a) the magnitude of the decline in service utility is significant and (b) the decline in service utility is unexpected. The first modifier would limit testing capital assets for impairment to only those capital assets that have experienced significant events or changes in circumstances. The second modifier would limit testing capital assets for impairment to only those capital assets that have experienced events or circumstances other than a normal decline in utility during the capital asset's expected useful life and normal changes in estimated useful lives. A capital asset exhibits

this characteristic if the decline in utility is outside the reasonable range of initial expectations. Prudent management might have made different capital asset–acquisition choices if this event had been considered possible.

46. Application of these two modifiers to various examples of potentially impaired capital assets considered throughout discussions revealed that when both conditions are present, the capital asset generally should be considered impaired. When a capital asset is held for the service it provides, the decline in the service utility of the capital asset can be evaluated more readily through these two factors than through an effort to quantify the service decline in dollars. Consequently, the Board decided that the test of impairment should be changed to an evaluation of the magnitude of the event or change in circumstance and whether the event or change in circumstance was part of the expected life cycle of the capital asset.

Measurement Approaches

47. The initial differentiation in applying an approach to measurement of impairment is whether the government will continue to use the capital asset. For capital assets that the government will no longer continue to use, the value of the capital asset has shifted away from providing service. If a capital asset will no longer be used to provide service, its only use is the cash it could generate upon sale. Consequently, the Board decided that capital assets that will not continue to be used should be reported at the lower of carrying value or fair value. In circumstances in which fair value exceeds carrying value, it would not be appropriate to recognize a gain until the gain is realized through sale. However, if fair value is lower than carrying value, a loss should be recognized when the impairment event or change in circumstance occurs. Reporting at the lower of carrying value or fair value is appropriate for capital assets that the government will no longer continue to use and that are considered

impaired. In circumstances in which the government decides to sell a capital asset that has not been considered impaired, the capital asset should continue to be reported at carrying value. Because there is no impairment event or change in circumstance, any loss or gain should be reported when the capital asset is sold.

48. The Board concluded that when impaired capital assets will continue to be used, the impairment should be measured using the method that best reflects the decline in service utility of the capital asset. In order to enhance comparability among governments, the same method generally should be applied for similar events or changes in circumstances. The Board considered all measurement approaches used by other standards setters and developed additional methods that capture the crucial features of governmental and subsidized capital assets. The methods needed to be grounded in historical cost, because the Board believes that it is inappropriate to change the measurement attribute of a capital asset that will continue to be used. The methods also needed to reflect the diminished service utility of the capital asset. The only methods that meet both of these criteria are the restoration cost approach, the service units approach, and deflated depreciated replacement cost. The restoration cost approach identifies the portion of the capital asset that has been damaged. The cost to restore the damaged portion of the capital asset is converted to historical cost dollars by applying a ratio of historical cost of the capital asset to the current replacement cost or by applying a price index. The cost to restore the damaged portion of the capital asset generally excludes noncapitalizable costs, such as demolition or cleaning, and costs related to improvements or additions to the capital asset. The impairment of the capital asset and the subsequent restoration are two separate events that should not be offset. The service units 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 circumstance.

Examples of service units include hours or years of service, number of citizens benefited, number of times the capital asset is used, square feet of building space, and so forth. Deflated depreciated replacement cost attempts to replicate the historical cost of the service produced. A current cost for a capital asset to replace the current level of service is identified. This current cost is depreciated to reflect the fact that the capital asset is not new and is then deflated to convert it to historical cost dollars.

49. For impairments caused by physical damage, the Board concluded that the restoration cost approach is generally the most appropriate. This method most directly quantifies the reduction in service utility of the capital asset. Methods employing service units are not appropriate because physical damage to a part of a capital asset can make the entire capital asset unusable. Service units approaches do not capture the latent service capacity in a damaged capital asset. Deflated depreciated replacement cost is not appropriate because developing a comparable replacement cost for a capital asset with physical damage can be problematic.

50. For impairments caused by changes in laws, regulations, or other environmental factors, the Board concluded that a service units approach generally is most appropriate. The service units approach most directly quantifies the reduction in service utility of the capital asset. The restoration cost approach is not appropriate because the capital asset is not damaged. Deflated depreciated replacement cost is not appropriate because developing a comparable replacement cost for such a capital asset can be problematic.

51. For impairments caused by technological development or obsolescence, the Board concluded that a service units approach is generally most appropriate. The service units approach most directly quantifies the reduction in service utility of the capital asset. The restoration cost

approach is not appropriate because the capital asset is not damaged. Deflated depreciated replacement cost is not appropriate because developing a comparable replacement cost for such an asset can be problematic. For example, the replacement cost for high-technology equipment often is less than the original purchase price.

52. For impairments identified by a change in the manner or expected duration of use of a capital asset, the Board concluded that either the deflated depreciated replacement cost approach or a service units approach may be appropriate. This category of impairment describes the effect on the capital asset, rather than the underlying source of impairment, and, as such, is broad. It is not appropriate to specify a single measurement method for such a broad category. The restoration cost approach, however, is not appropriate because the capital asset is not damaged.

53. Lower of carrying value or fair value is the best measure for capital assets impaired due to construction stoppage because these capital assets do not yet provide service. If the government intends to use the capital asset in the future, the construction will be completed and the impairment would be temporary. If the government does not intend to use the capital asset, its value is the cash it could generate upon sale. In circumstances in which fair value exceeds carrying value, the Board believes that it would not be appropriate to recognize a gain until the gain is realized through sale. However, if fair value is lower than carrying value, a loss should be recognized when the impairment event or change in circumstance occurs.

54. Some respondents to the ED suggested that fair value be allowed as an alternate measurement method for all impairments because it would be simpler to apply in circumstances when a fair value is readily available. The Board does not agree with that suggestion primarily because fair value measurement does not correspond conceptually with a reduction in service

utility and introduces a reporting model for capital assets that mixes historical cost and a fair value basis. Other respondents to the ED suggested that some impairments should be addressed by adjusting the remaining useful life of the capital asset. The Board does not agree with that suggestion because impairments are conceptually different from changes in estimates, which are appropriately accounted for by adjusting management estimates. Impairments are events or changes in circumstances that are outside the range of initial estimates of service utility of the capital asset.

Reporting an Impairment Loss

55. In evaluating many examples of impaired capital assets, the Board realized that existing guidance from Statement 34 would result in some impairment losses being reported on a separate line as a special or extraordinary item, whereas other losses would be reported as program or operating expense, depending on the specific details of the event or change in circumstance. The Board considered whether this guidance was appropriate or whether it would be better to present all impairment losses separately on the statement of activities and statement of revenues, expenses, and changes in fund net assets. The Board concluded that the guidance in Statement 34 was appropriate. Because impairments may result from varying events and changes in circumstances, it is appropriate that different impairment losses be reported in different ways. Should an impairment loss be the reason underlying a significant change in governmental or business-type activities from the prior year, management's discussion and analysis will include this information.

56. The Board considers impairment losses that should be reported as program expenses to be direct expenses of the program that uses or used the impaired capital asset. The primary reason is that an impairment loss represents service utility of a program that has been lost and that this is

directly associated with the program that uses or used the capital asset. For this reason, the Board 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 in accordance with question 7.204 of *Comprehensive Implementation Guide—2003*.

57. The Board recognized that the guidance in Statement 34 would result in some impairment losses being reported on a separate line and some being reported with other program expenses. Due to the nature of impairments, the Board considered it essential that users of the financial statements be aware when an impairment has occurred, even if the transaction is not presented as a separate line item. Consequently, the Board requires disclosure of the general description, amount, and financial statement classification of an impairment when that information is not already evident from the face of the financial statements.

Temporary Impairments and Consideration of Reversing Reported Impairments

58. The Board concluded that losses from temporary impairments should not be reported and subsequently reversed because they would create fluctuations in capital asset carrying values that are not expected to be realized and they would create potentially misleading volatility in the change statements. Requiring temporary impairments to be reported and reversed would foster a short-term focus in financial reporting of capital assets, when in actuality most property, plant, and equipment are held for their long-term benefit. The only current accounting treatment that would be similar to a reversal of impairment would be an increase in the fair value of investments following a prior-year decline in the fair value. The prior year's loss would be reversed in the subsequent year. The critical difference between investments and capital assets, however, is that investments are reported at fair value, whereas capital assets generally are reported at depreciated historical cost. Fair values can rise and fall, but historical cost does not.

59. The Board does not intend the exclusion for temporary impairments to be used to avoid reporting impairments in which reversal of the event or change in circumstances was not likely. Therefore, the Board concluded that all impairments should be considered permanent unless evidence shows that they are temporary. Some respondents to the ED questioned whether impairments from physical damage should be considered temporary when management intends to restore the capital asset to its previous level of service utility. The Board agreed and clarified the standard to explain that temporary impairments generally are only associated with enactment or approval of laws or regulations or other changes in environmental factors, changes in technology or obsolescence, changes in manner or duration of use, or construction stoppage. Generally, if management would have to take action to reverse the impairment, such as restoration of a capital asset with physical damage, the impairment should be considered permanent. The Board recognized that physical damage in capital assets accounted for using the modified approach might be viewed differently. Because the government has committed to maintaining a specific condition level, it has committed to perform the needed maintenance and preservation, not just the planned maintenance and preservation. Management is not viewed as needing to take action to restore the physical damage, because when they adopted the modified approach, they committed to take the action necessary to restore the assets. Therefore, impairment from physical damage of capital assets accounted for using the modified approach should be considered temporary in nature and should not be recorded unless the government concludes that it will no longer maintain that system or subsystem.

Disclosure of Idle Impaired Capital Assets

60. The Board believes that users of financial statements would consider it essential to know when impaired capital assets are idle because the nature of idle impaired capital assets is

different from other capital assets. Thus, this Statement requires disclosure of idle impaired capital assets. The Board considered whether this distinction between idle impaired capital assets and capital assets that will continue to be used should be extended to all capital assets, but concluded that it would be inappropriate to expand the scope of this project to include all capital assets. The Board also considered whether the distinction between idle impaired capital assets and those that will continue to be used should be made by requiring idle impaired capital assets to be reported separately from other capital assets on the face of the financial statements or should be made by considering idle impaired capital assets to be a separate major class and disclosed separately from other major classes of capital assets. The Board ultimately concluded that it was not essential to display the information on the face of the financial statements, nor was disclosure of the beginning balance and increases and decreases in the balance of idle impaired capital assets considered essential. The Board believes that a more general disclosure requirement allowing professional judgment to determine the extent of information provided is more appropriate. After considering comments made by respondents to the ED, the Board decided that the standard should specify that the disclosure applies to capital assets idle at year-end and that the carrying value of the idle capital assets specifically should be disclosed. The Board recognizes that governments generally view infrastructure assets accounted for using the modified approach from a network or subsystem perspective rather than as individual assets. Accordingly, such individual assets that are temporarily impaired and idle generally would not require disclosure.

61. In conjunction with the discussion of idle impaired capital assets, the Board recognized that a strict interpretation of the definition of capital assets in paragraph 19 of Statement 34, which indicates that capital assets are those used in operations, might be understood to exclude assets

that are not currently being used—including idle impaired capital assets. Consequently, a footnote explaining that the definition of capital assets was intended to be interpreted broadly and to include capital assets that will be used or have been used in operation was incorporated into this Statement.

Insurance Recoveries

62. FASB Interpretation 30 provides guidance on insurance recoveries. That pronouncement was issued in September 1979 and is considered category (a) GAAP both for governmental and business-type activities and for proprietary funds; however, it does not have category (a) standing for governmental funds. The Interpretation uses a total or partial destruction or theft of insured nonmonetary assets as an example of an involuntary conversion. The Interpretation clarifies that the gain or loss for the difference between the cost of the nonmonetary asset and the amount of monetary assets received should be reported in income of the period of the involuntary conversion, and not as an adjustment to the cost basis of a nonmonetary asset that is subsequently acquired as replacement property. Because the Interpretation addresses insurance recoveries only in the context of the accrual basis of accounting, some practitioners still question the appropriate treatment in modified accrual financial statements. The Board believes it appropriate to extend this guidance to governmental funds. Because governmental funds do not report capital assets, the only amount to be reported is the insurance recovery. The requirement that the insurance recovery be reported as an other financing source, special item, or extraordinary item is consistent with the guidance in paragraphs 88 and 89 of Statement 34. Subsequent expenditures to acquire a replacement capital asset should be reported separately.

63. Paragraph 3 of the Interpretation provides guidance when the insurance recovery is not received in the same year as the loss: “In some cases, a nonmonetary asset may be destroyed or

damaged in one accounting period, and the amount of monetary assets to be received is not determinable until a subsequent accounting period. In those cases, gain or loss shall be recognized in accordance with FASB Statement No. 5, *Accounting for Contingencies.*" Paragraph 17a of FASB Statement 5 states that "contingencies that might result in gains usually are not reflected in the accounts since to do so might be to recognize revenue prior to its realization." The guidance on recording receivables for insurance recoveries is consistent with that paragraph. The guidance on reporting insurance recoveries recognized in a subsequent year as revenue is consistent with the guidance in paragraph 26 of Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions.* After considering comments made by respondents to the ED, the Board decided to clarify what is meant by the term *realized or realizable* by providing an example in the standard and to provide guidance on accounting for insurance recoveries when risk is retained by the government.

64. Due to the nature of insurance recoveries, the Board considers it essential that users of the financial statements be aware when an insurance recovery has been reported, even if the transaction is not presented as a separate line item. Therefore, the Board believes that a disclosure of the amount and financial statement classification of insurance recoveries should be provided if that information is not already evident from the face of the financial statements.

Effective Date and Transition

65. The effective date of this Statement is for financial statements for periods beginning after December 15, 2004. Earlier application is encouraged. The Board sees no conflict with implementation of Statement 34 and its phase-in periods. Governments that retroactively report infrastructure after the effective date of this Statement would consider impairment issues for those assets, if appropriate, at the date of retroactive reporting. The Board believes the effective

date allows a sufficient period of time for the identification and analysis of issues pursuant to retroactive application of this Statement. Some respondents to the ED questioned whether it was appropriate for governments that have previously reported impairments to retroactively apply this Statement and potentially restate the amounts reported for impairment losses reported in prior years. The Board concluded that previously reported impairment losses created new cost bases for the affected capital assets and, therefore, retroactive application of this Statement does not require previously reported impairments to be restated.

Appendix C

ILLUSTRATIONS

Contents

66. The facts assumed in these examples are illustrative only and are not intended to modify or limit the requirements of this Statement or to indicate the Board's endorsement of the situations or methods illustrated. These illustrations also are not intended to provide general guidance on the application of Accounting Principles Board Opinion No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*, in determining whether a transaction is considered unusual in nature or infrequent in occurrence. Additionally, these illustrations are not intended to provide guidance on determining the application of materiality. Application of the provisions of this Statement may require assessing facts and circumstances other than those illustrated here.

Illustration 1

Physical Damage—School with Mold Contamination

Assumptions

The Rhoam School District has identified extensive mold contamination at one of its elementary schools. Management considers this event to be unusual in nature but not infrequent in occurrence, as defined by APB Opinion 30, and does not consider the event to be within control of management. The elementary school was constructed in 1973 at a cost of $1.3 million, including $100,000 for acquisition of the building site. The school had an expected useful life of sixty years. During its life a few improvements were made: a small renovation costing $135,000 in 1988 and a classroom addition and air conditioning costing $1.1 million in 1993. These improvements did not extend the useful life of the building. In 2003, the district became aware of extensive mold contamination in the walls of the school and closed the school due to concerns for the health of the students. The mold remediation involves removal and rebuilding of the interior walls and site drainage improvements costing $4 million. In accordance with the capitalization policies of the Rhoam School District, 40 percent of the remediation cost is allocable to demolition and mold removal, and 60 percent is allocable to rebuilding the walls of the school. The estimated replacement cost of the school is $6.2 million.

Evaluation of Impairment

The mold contamination is the evidence of physical damage providing the indication of impairment. The magnitude of the event would be evaluated as significant. The ongoing costs of the school, especially depreciation and operating costs, would be viewed as significant in relation to the zero utility it was providing. This circumstance is not part of the normal life cycle of a school. Impairment loss using the restoration cost approach is determined as follows:

	Historical Cost	Estimated Useful Life	Accumulated Depreciation, 2003	Carrying Amount, 2003
Land	$ 100,000			
Building acquisition, 1973	$1,200,000	60	$600,000	$ 600,000
Renovation, 1988	135,000	45	45,000	90,000
Classroom addition/air conditioning, 1993	1,100,000	40	275,000	825,000
Total buildings	$2,435,000		$920,000	$1,515,000

Total mold remediation cost	$4,000,000
Percentage rebuilding cost	60%
Restoration cost	$2,400,000
Restoration cost (current dollars)	$2,400,000
Replacement cost (current dollars)	6,200,000
Restoration cost ratio	38.7097%
Carrying amount (historical cost)	1,515,000
Impairment loss	$ 586,452

Reporting

The impairment loss and mold remediation expenses would be allocated to the applicable programs and be reported as program expenses in the statement of activities. The following disclosure would be presented in the notes to the financial statements:

> Program expenses include an impairment loss of $586,452 due to mold contamination at an elementary school and also include $1,600,000 in mold remediation costs as follows:

	Impairment Loss	Mold Remediation
Regular instruction	$322,550	$ 880,000
Special education instruction	87,967	240,000
Pupil support services	58,645	160,000
Instructional staff services	58,645	160,000
School administration services	58,645	160,000
	$586,452	$1,600,000

Illustration 2

Physical Damage—Office Building with Structural Damage

Assumptions

An earthquake damaged an office building in the City of Kirow. Management of the city considers the event to be both unusual in nature and infrequent in occurrence, as defined by APB Opinion 30. The office building was constructed in 1996 at a cost of $28 million and was expected to provide service for thirty years. In 2003, after seven years of use, an earthquake caused severe structural problems to the office building. Due to safety concerns, the office building is closed and structural repairs costing $3.5 million are made to restore the office building to a usable condition. All of the restoration costs are capitalizable costs in accordance with the capitalization policies of the City of Kirow. Insurance is carried for property damage in excess of $1 million. Replacement cost of the office building is not available. However, building construction costs have been increasing an average of 3 percent per year over the past seven years.

Evaluation of Impairment

The evidence of physical damage indicates impairment. The magnitude of the physical damage would be considered significant. Both the ongoing costs associated with the office building and the $3.5 million repair cost would be considered significant in relation to the service provided, which is zero because the office building cannot be used until structural repairs are made. Earthquake damage would not be part of the normal life cycle of a building. Impairment loss using the restoration cost approach is determined as follows:

a	Historical cost, 1996	$28,000,000
	Accumulated depreciation (*a* / 30 × 7)	6,533,333
b	Carrying value, 2003	$21,466,667
	Restoration cost	$ 3,500,000
	Deflation factor, compounded $(1/(1.03)^7)$	0.81309
c	Deflated restoration cost	$ 2,845,815
d	Restoration cost ratio *(c* / *a)*	10.1636%
	Impairment loss *(b* × *d)*	$ 2,181,786
	Insurance recovery	2,500,000
	Net gain	$ 318,214

Reporting

The net gain after insurance recovery of $318,214 would be reported as an extraordinary item, described in the statement of activities as impairment gain on earthquake damage net of insurance recovery. The governmental fund financial statements would report the insurance recovery as an other financing source and would report the restoration costs as expenditures.

Illustration 3

Change in Legal or Environmental Factors—Underground Storage Tanks

Assumptions

In 2003, a federal agency adopts a regulation requiring all underground gas tanks to be rustproof, double-walled tanks with spill-protection devices. The period for compliance with the regulation is ten years. The City of Prog installed new underground tanks in its public works fuel facility in 2002, one year before the regulation was adopted. The new tanks do not meet the requirements that will go into effect in 2013. The tanks installed in 2002 cost $700,000 and had been expected to provide service for forty years. Management of the city does not consider this

event unusual in nature but does consider it infrequent in occurrence, as defined by APB Opinion 30. Management does not consider this event to be within its control.

Evaluation of Impairment

The indicator of impairment is the adoption of a regulation that affects capital assets. The evaluation of magnitude would consider the cost of operating the capital asset, which includes capital costs as well as operating costs, in relation to its service potential. The cost of the capital asset has not changed as a result of the new regulation, but its service potential has. If service potential is measured by the estimated useful life of the underground tanks, their service potential has been reduced from forty years to eleven years. This magnitude would be evaluated as significant. The other test of not being part of the normal life cycle of the asset has also been met. If Prog management had known adoption of the regulation was imminent, they most likely would have installed tanks in 2002 that would have met the requirements of the new regulation even if they cost more than the tanks they did install. Thus, in 2003, impairment of the underground tanks should be reported. Impairment loss using the service units approach would be determined as follows:

Historical cost	$700,000
Total service units—years	40
Cost per service unit	17,500
Number of service units made unusable by regulation (40 years – 11 years)	29
Impairment loss	$507,500

Reporting

The impairment loss of $507,500 would be reported in the statement of activities as public works program expenses. The following disclosure would be presented in the notes to the financial statements:

Public works expenses include an impairment loss of $507,500 on underground tanks due to federal environmental regulations.

Illustration 4

Technological Development or Evidence of Obsolescence—Underutilized Magnetic Resonance Imaging Machine

Assumptions

In 2000, the County of Veyena General Hospital purchased a magnetic resonance imaging (MRI) system at a cost of $2.25 million. The hospital estimated that the system would have an estimated useful life of seven years and that on average the system would be used for ten tests per day for five days per week. After installation, the utilization of the system was approximately at the levels estimated. In 2003, a local medical equipment manufacturer donated an "open" MRI system that previously had been used as a demonstration model. The donated MRI system began to be used more frequently than the original "closed" MRI system because the "open" MRI was more comfortable for patients and provided a superior image. Instead of providing ten images a day, the original MRI system was being used only on an overflow basis and averaged one image per day. Management of the hospital does not consider this event to be unusual in nature or infrequent in occurrence, as defined by APB Opinion 30.

Evaluation of Impairment

The indicator of impairment is the change in technology, which has resulted in a permanent reduction in the usage of the "closed" MRI. The magnitude test has been met due to the fact that the cost of operating the "closed" MRI system has remained the same while the service provided has decreased to 10 percent of prior levels. The second test also has been met in that the 10 percent utilization rate could not have been predicted, or the hospital would have chosen another

method to provide imaging services. Impairment loss using the service units approach would be determined as follows:

a	Acquisition cost, 2000	$2,250,000
	Accumulated depreciation, 2003 (3 / 7 years)	964,286
b	Carrying amount, 2003	$1,285,714
c	Original service units (7 years × 52 weeks per year × 5 days per week × 10 uses per day)	18,200
d	Acquisition cost per service unit *(a / c)*	124
e	Remaining service units (4 years × 52 weeks per year × 5 days per week × 1 use per day)	1,040
f	Remaining service units × average cost *(d × e)*	$ 128,960
	Impairment loss *(b – f)*	$1,156,754

Reporting

The impairment loss of $1,156,754 would be reported as program expenses in the statement of activities. The following disclosure would be presented in the notes to the financial statements:

> Hospital program expenses include an impairment loss of $1,156,754 related to a magnetic resonance imaging machine that has become impaired due to unexpected obsolescence.

Illustration 5

Change in Manner or Duration of Use—School Used for Storage

Assumptions

In 2003, Lunden School District closed an elementary school because enrollments in the district declined unexpectedly due to the bankruptcy of the major employer in the area. The closed school has been converted to use as storage. Management does not consider this event to be unusual in nature or infrequent in occurrence, as defined in APB Opinion 30. This elementary school was constructed in 1991 at a cost of $10 million. The estimated useful life of the school is fifty years. Lunden School District has no evidence that enrollments will increase in the future

such that the building would be reopened for use as a school. The current replacement cost for a warehouse of the same size is $4.2 million. A commercial construction index was at 100 and 150 in 1991 and 2003, respectively.

Evaluation of Impairment

Impairment is indicated because the manner of use of the school has changed from educating students to storage. The situation passes the magnitude test because the ongoing costs of the school—depreciation, insurance, utilities, security—would likely be considered high in relation to the benefit it is providing—storage. The circumstance also passes the test of not being predicted because it seems likely that if management had known that they needed space for students for only twelve years, they would have selected a less expensive method of providing classrooms for those twelve years. Impairment loss using deflated depreciated replacement cost would be determined as follows:

	Historical cost, 1991	$10,000,000
	Accumulated depreciation (12 / 50 years)	2,400,000
a	Carrying amount, 2003	$ 7,600,000
	Replacement cost of warehouse, 2003	$ 4,200,000
	Accumulated depreciation (12 / 50 years)	1,008,000
b	Depreciated replacement cost	$ 3,192,000
c	Commercial construction index, 1991	100
d	Commercial construction index, 2003	150
e	Deflation factor *(c / d)*	0.6667
f	Deflated depreciated replacement cost *(b × e)*	$ 2,128,000
	Impairment loss *(a – f)*	$ 5,472,000

Reporting

The impairment loss of $5,472,000 would be allocated to the applicable programs and reported as program expenses in the statement of activities. The following disclosure would be presented in the notes to the financial statements:

> Program expenses include an impairment loss of $5,472,000 due to the change in use of an elementary school from education to storage as follows:

	Impairment Loss
Regular instruction	$3,009,600
Special education instruction	820,800
Pupil support services	547,200
Instructional staff services	547,200
School administration services	547,200
	$5,472,000

Illustration 6

Change in Manner or Duration of Use—Stadium

Assumptions

Spayne County built a major league baseball stadium in 1990 at a cost of $120 million. The stadium was estimated to have a thirty-year useful life. The county expected the stadium to be rented by the major league baseball team it had attracted to the area for eighty-one games each year. As a secondary use, the stadium would be rented for smaller events such as soccer games, equestrian events, and monster truck racing. The county expected on average to hold twenty-four secondary events per year. In 2007, the major league reduced the number of franchises, and one of the eliminated teams was the tenant of Spayne County's stadium. Alternative use for another major sport is not expected, because separate stadiums have been built elsewhere in the county for football and for basketball and hockey. Moreover, the stadium in question was designed specifically for baseball, so teams from other sports are not viable candidates as tenants. The number of major league baseball teams has been reduced, so it is highly unlikely to attract

another baseball team. There is no evidence to suggest that the reduction in rental of the stadium will be temporary. Spayne County has increased marketing of the stadium for use for small events and expects to increase the number of those events held by 50 percent, to an average of thirty-six per year. Based upon average attendance, it takes five small events to equate to one major league game. County management considered this event unusual in nature and infrequent in occurrence, as defined in APB Opinion 30.

Evaluation of Impairment

The stadium has presented an indicator of impairment because the use of the stadium has changed from primarily a major league baseball park to a small-events arena. The magnitude of this change would be considered significant. The total annual cost of the stadium, which includes operating costs and depreciation, remains approximately the same. However, the benefit of the stadium—the number and impact of the events held in the stadium—has decreased significantly. This change in circumstance would not be part of the normal life cycle of the stadium. Spayne County would not have made this large an investment if they did not expect to have a major league tenant for the life of the stadium. Impairment loss using the service units approach is determined as follows:

	Historical cost, 1990	$120,000,000
	Accumulated depreciation (17 / 30 years)	68,000,000
a	Carrying value, 2007	$ 52,000,000
	Service potential before impairment:	
	Baseball games	81.00
	Small events (24 @ 20%)	4.80
b	Total original service potential	85.80
c	Service potential after impairment:	
	Small events (36 @ 20%)	7.20
d	Percentage decrease in service potential ($1 - (c / b)$)	91.61%
	Impairment loss ($a \times d$)	$ 47,637,200

Reporting

The impairment loss of $47,637,200 would be reported in the statement of activities as an extraordinary item, described as impairment loss on Spayne Stadium due to conversion from major league stadium to small events arena.

Illustration 7

Change in Manner or Duration of Use—Rail System

Assumptions

In 2003, Haulend City decided to close 40 percent of the stations in its rail system and reduce the number of trains by an average of 50 percent. Management does not consider this event to be unusual in nature or infrequent in occurrence, as defined by APB Opinion 30. Haulend City built a thirty-mile rail system at a cost of $1.5 billion that opened for service in 1991. The components of the system—stations, rolling stock, and rails—had estimated useful lives ranging from thirty to fifty years. Prior to construction, ridership was projected to grow to 300,000 riders per day by 1996. By 1996 ridership was 60,000 per day and through 2002 held constant at 60,000 per day. Even at the projected ridership level of 300,000, the rail system was

expected to require modest subsidies to operate. However, operating costs are 50 percent higher than was projected, with the result that the cost per ride is about six times higher than projected. Haulend is unable to continue to supply the high level of subsidies needed to continue full operations of the rail system, and consequently decided to close major portions of the system as indicated above. The unneeded rolling stock will be sold. Haulend cannot demonstrate that this impairment is temporary because the source for part of the subsidy has been exhausted and no alternative funding sources are available.

Evaluation of Impairment

The station closings and reduction in number of trains are the indictors of impairment. The magnitude of the change would be considered significant. The benefit provided by the system has been reduced by half. The operating costs of the system would be reduced, but the high depreciation cost would remain. The change in usage is not part of the normal life cycle of the system. The rail component of the system would not be considered impaired because it is continuing to be used in the same manner as originally expected. The stations are considered to be a system of stations and will be evaluated for impairment using the service units approach, and the rolling stock will be evaluated separately for impairment at the lower of cost or fair value because the rolling stock will no longer continue to be used.

	Historical Cost	Estimated Useful Life	Accumulated Depreciation, 2003
Stations	$ 375,000,000	50	$ 90,000,000
Rolling stock	750,000,000	30	300,000,000
Rail	375,000,000	50	90,000,000
Total	$ 1,500,000,000		$480,000,000

Stations:	
Historical cost	$ 375,000,000
Accumulated depreciation	90,000,000
Carrying amount	285,000,000
Percentage reduction in number of stations served is equivalent to the percentage reduction in service units	40%
Impairment loss, stations	$ 114,000,000
Rolling stock:	
Historical cost	$ 750,000,000
Accumulated depreciation	300,000,000
Carrying amount	450,000,000
Percentage of rolling stock to be sold	50%
Carrying amount, rolling stock to be sold	225,000,000
Estimated fair value	200,000,000
Impairment loss, rolling stock	$ 25,000,000

Reporting

The impairment losses of $114,000,000 and $25,000,000 would be reported as program expenses in the statement of activities. The following disclosure would be presented in the notes to the financial statements:

> Transportation expenses include an impairment loss of $114,000,000 due to the closing of 40 percent of the train stations and an impairment loss of $25,000,000 due to taking 50 percent of the trains out of service and making them available for sale.

Illustration 8

Change in Manner or Duration of Use—Street Closure

Assumptions

The City of Perris has a 150-mile road system that has a total historical cost of $90 million and accumulated depreciation of $30 million at 2003. Shortcut Street, which is one-quarter of a mile long, is a part of a popular route of residential streets used by commuters to avoid traffic lights on the main artery. After receiving a petition from the residents of Shortcut Street and investigating the traffic condition, Perris closed Shortcut Street to through traffic.

Evaluation of Impairment

The indicator of impairment is a change in manner of use—the street being closed to vehicular traffic. In testing the event for impairment, the event would likely be considered unexpected because the street would not have been constructed with the expectation that it would be closed to protect the safety of the residents; rather, a common driveway or other form of access for those houses would have been constructed. However, the event probably would not be considered to meet the magnitude test. Shortcut Street is only one-quarter of a mile in size, representing one six-hundredth of the total streets in Perris. Because the arterial streets provide adequate service for commuters of the city, the closure of Shortcut Street has not resulted in an overall reduction in service.

Illustration 9

Construction Stoppage—Airport Pavements

Assumptions

In 2003, management of Sygone Airport Authority stopped construction on their runway expansion project. Management does not consider this event unusual in nature or infrequent in occurrence, as defined by APB Opinion 30. Sygone Airport Authority operates a large urban

airport and accounts for its pavements—runways, taxiways, and aprons—using the modified approach. A major factor in deciding that the runway expansion was necessary was the expectation of growth of its largest air carrier. Early in 2003, this air carrier filed for bankruptcy. Several months into the bankruptcy process, it appeared likely that the air carrier would be drastically scaling back its operations and renegotiating its airport facility leases. Consequently, management of the authority halted further construction on the runway airport expansion. The authority had accumulated costs totaling $110 million and was approximately 20 percent complete with the project. There is no evidence to demonstrate that the construction stoppage is temporary.

Evaluation of Impairment

The indicator of impairment is the construction stoppage. It appears to meet the test of impairment in that management would not have initiated the runway expansion if it had expected the major air carrier to file for bankruptcy, and it is assumed that the costs incurring to date on the project are material. The accumulated construction cost of $110 million would be written off in 2003 as an impairment loss.

Reporting

The impairment loss of $110 million would be reported as program expenses in the statement of activities. The following disclosure would be presented in the notes to the financial statements:

> Transportation expenses include an impairment loss of $110 million due to stopping construction on the runway expansion project.

Illustration 10

Demand for Service—Water Treatment Plant

Assumptions

The City of San Pedro Sula built a new water treatment plant with a 40 million gallon per day (MGD) capacity in 1985 to replace an aging 20 MGD plant. The new plant has an expected useful life of forty years. Using the best information on future growth in the city available in the planning stage, planners expected 5 percent per year growth in connections to the city sewer system. Because of these expectations, usage of the plant also would be expected to grow 5 percent per year. Consequently, the additional 20 MGD capacity would be expected to be absorbed in about twenty years. In 2003, eighteen years after building the new plant, used capacity is 25 MGDs, instead of approximately 38 MGDs as estimated by planners in 1985.

Evaluation of Impairment

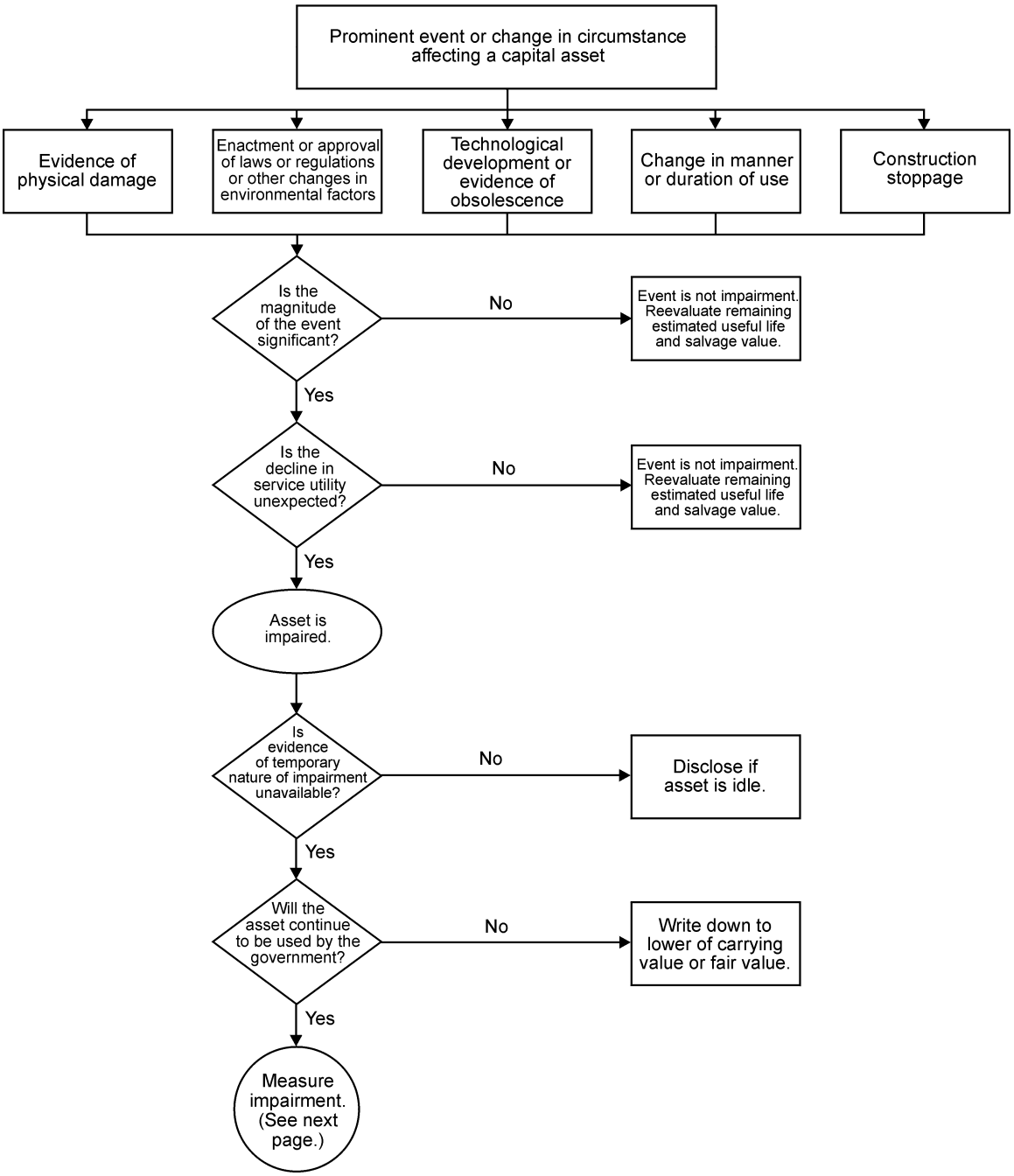
The demand for the plant is not as great as anticipated by the planners in 1985, but there has been no change in manner of use, or other indicator of impairment. A change in demand, either from prior levels of demand or from forecasted demand, not associated with the indicators of demand in paragraph 9 does require an impairment assessment.

Appendix D

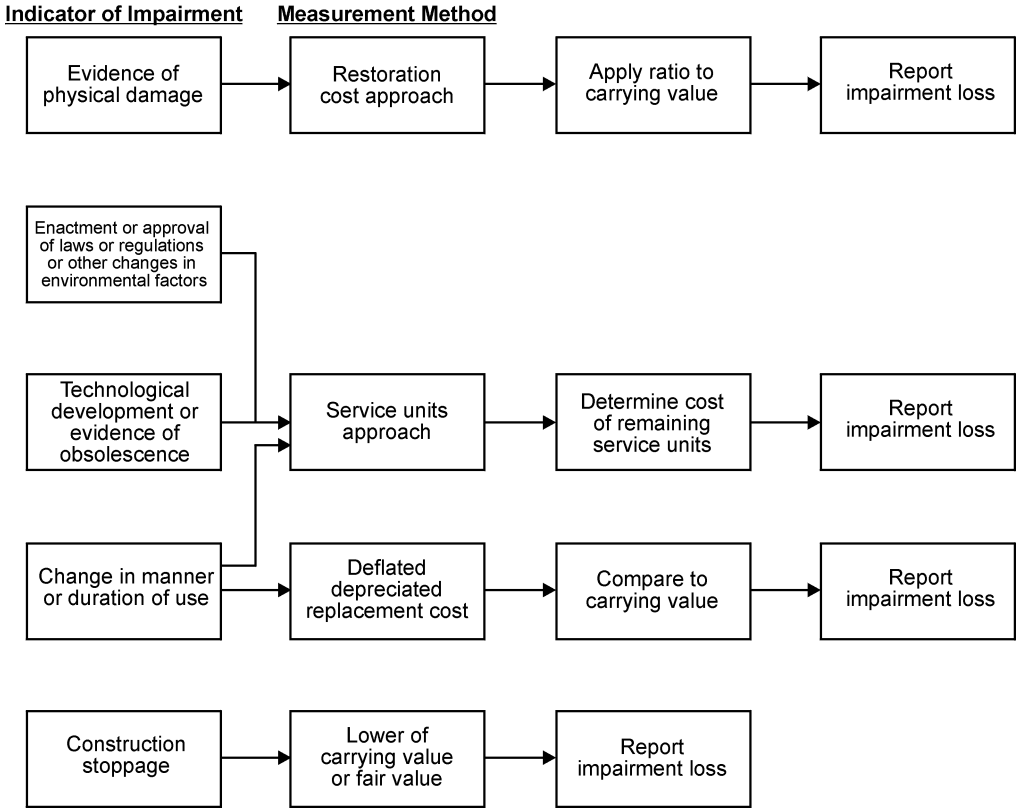
FLOWCHART FOR EVALUATING AND MEASURING IMPAIRMENT OF CAPITAL ASSETS

67. The following flowchart is intended to aid in the application of the provisions of this Statement. The flowchart is nonauthoritative and should not be used in place of the Statement itself.

ASSET IMPAIRMENT DECISION PROCESS



MEASUREMENT OF ASSET IMPAIRMENT
(for assets that will continue to be used by the government)



Appendix E

SUMMARY OF INDICATORS AND METHODS OF MEASUREMENT

68. This exhibit summarizes the general types of impairments and the methods of measuring impairment in these circumstances. Refer to paragraphs 12 through 16 for more detailed—and authoritative—guidance.

Selection of Methods of Measuring Impairment	
Indicator of Impairment	**Method Generally Used in Measuring Impairment**
Evidence of physical damage	If the capital asset will continue to be used by the government (or will be upon restoration of the capital asset), use the restoration cost approach. If the capital asset will no longer be used by the government, use lower of carrying value or fair value.
Enactment or approval of laws or regulations or other changes in environmental factors	If the capital asset will continue to be used by the government, use service units approach. If the capital asset will no longer be used by the government, use lower of carrying value or fair value.
Technological development or evidence of obsolescence	If the capital asset will continue to be used by the government, use service units approach. If the capital asset will no longer be used by the government, use lower of carrying value or fair value.
Change in manner or duration of use	If the capital asset will continue to be used by the government, use deflated depreciated replacement cost or service units approach. If the capital asset will no longer be used by the government, use lower of carrying value or fair value.
Construction stoppage	Use lower of carrying value or fair value.

Appendix F

CODIFICATION INSTRUCTIONS

69. The sections that follow update the June 30, 2003 *Codification of Governmental Accounting and Financial Reporting Standards* for the effects of this Statement. Only the paragraph number of this Statement is listed if the paragraph will be cited in full in the Codification.

* * *

REPORTING CAPITAL ASSETS **SECTION 1400**

Sources: [Add the following:] GASB Statement 42

[Insert new paragraphs as follows:]

Impairment of Capital Assets

Definition of Impairment

.144–.145 [GASBS 42, ¶5 and ¶6]

Assessment of Impairment

.146 [GASBS 42, ¶7] [Change cross-references.]

Identification of Events or Changes in Circumstances That May Indicate Impairment

.147 [GASBS 42, ¶8]

Indicators of Impairment

.148–.149 [GASBS 42, ¶9 and ¶10]

Impairment Test

.150 [GASBS 42, ¶11] [Change cross-references.]

Measurement of Impairment

Capital Assets That Will Continue to Be Used by the Government

.151–.154 [GASBS 42, ¶12–¶15]

Capital Assets That Will No Longer Be Used by the Government and Construction Stoppage

.155 [GASBS 42, ¶16]

Reporting Impairment Losses

.156 [GASBS 42, ¶17] [Change cross-references.]

Permanent and Temporary Impairments

.157 [GASBS 42, ¶18]

Capital Assets That Do Not Meet the Impairment Test

.158 [GASBS 42, ¶19]

Disclosure of Idle Impaired Capital Assets

.159 [GASBS 42, ¶20]

Insurance Recoveries

.160 [GASBS 42, ¶21] [Change cross-reference in footnote.]

* * *

CLAIMS AND JUDGMENTS SECTION C50

Sources: [Add the following:] GASB Statement 42

.110 [Revise subparagraph a as follows:]

a. Information available before the financial statements are issued indicates that it is **probable** that an asset had been impaired (see Section 1400, "Reporting Capital Assets," paragraphs .144–.160) or a liability had been incurred at the date of the financial statements.[4] It is implicit in this condition that it must be probable that one or more future events will also occur confirming the fact of the loss.

[4][Insert current Codification footnote 4.]

[Insert new paragraph .125 as follows and renumber subsequent paragraphs.]

.125 [GASBS 42, ¶22] [Change cross-reference.]