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Acting Controller

TO: Agency Heads

FROM: L. Joe McDaniel, Acting Controller

DATE: May 26, 2023

SUBJECT: GASB Statement No. 42 – Accounting and Financial Reporting for Impairment of Capital Assets

The Governmental Accounting Standards Board (GASB) is the body responsible for setting accounting and financial reporting standards for governmental entities. GASB Statement No. 42 establishes accounting for assets which have been impaired. A capital asset is considered impaired when its service utility has declined significantly and unexpectedly. Prior to the issuance of GASB 42 there was no requirement to reduce the carrying value of fixed assets other than through depreciation.

The requirements of GASB 42 are in effect for the Commonwealth's Comprehensive Annual Financial Report. The Controller's Office is seeking your help in identifying any **material impairment** due to circumstances. These circumstances are defined as technological changes, laws and regulations being enacted or passed, and evidence of obsolescence. Materiality should be assessed at the Cabinet level, treating all asset types as one group. **If collectively all impairments total \$5,000,000 or more, your cabinet then has reportable asset impairments.**

The requirement of GASB 42 applies only to capital assets with material carrying values (e.g., this standard would not apply to fully depreciated capital assets.)

Definition of Impairment

GASB 42 defines asset impairment as unexpected decline in the service utility of a capital asset. The changes in circumstances that lead to impairments are not considered normal and/or ordinary. That is, at the time the capital asset was acquired, the change in circumstance would not have been expected to occur during the useful life of the capital asset.

Service utility, in turn, is defined as the usable capacity that a capital asset was expected to provide at its acquisition.

The most common indicators of potential impairment, as defined by GASB 42, are listed below.

- a. Enactment or approval of laws or regulations, or other changes in environmental factors, that limit or curtail the use of the capital asset because the asset does not meet and cannot be modified to meet the requirement of the new laws or regulations. GASB requires these impairments be reported when the change occurs not when the change goes into effect. Examples would include underground storage tanks or water treatment plants that cannot meet new EPA requirements.
- a. Technological development or evidence of obsolescence resulting in the capital asset being used much less frequently, or not at all. Examples would include magnetic resonance imaging (MRI) equipment of the enclosed type following the introduction of the more popular open models or other research equipment that is rarely used because newer equipment provides better service.

Should you have any questions, please call Jessica Pinkston at (502) 564-8769. Thank you for your prompt response to this request.

Please complete the attached questionnaire and return by August 4, 2023.

APPENDIX A

Checklist for Assessing Capital Asset Impairments

Name of Agency: _____ Fiscal Year: _____

Completed by: _____ Date: _____

GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries* (GASB 42) provides guidance on determining whether a capital asset has been impaired. **All paragraph references in this checklist are to GASB 42.**

Part 1 – Testing for Impairment

1. Has there been a change in the circumstances affecting the asset? (Paragraph 8)

YES _____ Go to Step 2.

NO _____ Go to Step 9.

- Paragraph 8 states that the change in circumstances affecting a capital asset should be “conspicuous or known to the government”. Further, those events or changes “are expected to have prompted discussion by the governing board, management, or the media.” Attach copies of any news articles, board minutes, memos, or other documentation related to the potential impairment of the capital asset.

2. Is the decline in the service utility of the asset unexpected? (Paragraph 11b)

YES _____ Go to Step 3.

NO _____ Go to Step 9.

- “Unexpected” means that the change in circumstance (see Step 1) was not expected to occur during the life of the asset. (Para. 5)
- GASB 42 establishes the presumption that capital asset impairment is permanent, unless evidence demonstrates that the impairment is only temporary. If the impairment is determined to be temporary, attach supporting evidence.

3. Will the institution continue to use the asset? (Paragraphs 12 and 16)

YES _____ Go to Step 5.

NO _____ Go to Step 8.

CHECK LIST CONTINUED

Part 2 – Measuring the Impairment Loss

4. Is the impairment the result of enactment or approval of new laws or regulations or other environmental factors that govern the asset's use? (Paragraph 9b)

YES _____ Stop here.

NO _____ Go to Step 5.

5. Is the impairment the result of change in technology or obsolescence? (Paragraph 9c)

YES _____ Stop here.

NO _____ Go to Step 6.

6. Is the impairment the result of a change in the manner or duration of use of the asset? (Paragraph 9d)

YES _____ Stop here.

NO _____ Go to Step 7.

- Paragraph 10 discusses changes in demand for services and contrast these to situations that are impairment indicators. A change in demand for the services of a capital asset is not an indicator of impairment by its self. The following are examples of assets impaired by changes in demand or duration of use.
 1. Technological developments, which render as asset obsolete.
 2. Enactment of laws or regulations or other changes in environmental factors. For example, new water quality standards are such that a water treatment plant does not meet and cannot be modified to meet.

7. Is the impairment the result of a permanent construction stoppage? (Paragraph 9e)

YES _____ Stop here.

NO _____ Go to Step 8.

8. The asset will no longer be used by the institution (Indicate with an "X" below).

TRUE _____ Stop here.

FALSE _____ Go to Step 9.

9. The asset is not impaired (Indicate with an "X" below)

_____ Stop here.