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ACCOUNTING FOR ASSET IMPAIRMENTS IN THE WAKE OF HELENE

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It has been just over a year since Hurricane Helene struck western North Carolina. Many governments in North Carolina experienced damage to governmental capital assets and infrastructure. Repairs of governmental facilities are proceeding, but a great deal of work remains. If governmental facilities have been damaged, an economic loss may have occurred that needs to be recognized in a government's financial statements. The values of governmental assets also may be over-stated in a government's records. Some recognition of the impact of the damage to governmental facilities may be necessary so that a government's financial statements are fairly presented. Although some governmental audits have been completed, most governments are still in the process of preparing financial statements for the 2024 – 25 fiscal year.

This document is a follow up to our memo from earlier this year and will focus specifically on asset impairments and insurance recoveries. The primary guidance from the Governmental Accounting Standards Board (GASB) comes from GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. GASB 42 addresses five distinct categories of asset impairments; however, in this memo we are going to focus on the guidance relating to only one of the categories, physical damage. Most asset impairments from Helene are expected to fall into this category. In addition, we will discuss accounting for insurance recoveries.

DEFINITION

The GASB defines an asset impairment as "a significant, unexpected decline in the service utility of a capital asset". It is helpful to break down the definition.

1. Significant. The GASB uses this term similarly to material which means that it does not apply to small items. For our purposes we would compare the actual amount of damage to an asset's carrying value. For example, flooding from Helene might have totally destroyed a governmental storage building which could certainly be considered an impairment; however, if the building's net carrying value was only $25,000, it would usually not be considered to be significant. In this example, we would probably not record an impairment loss. We encourage governments not to apply the guidance on impairments to small or insignificant amounts.
2. Unexpected. A depreciable asset, such as a vehicle or building, declines in value over its useful life. If a school building is used for 50 years and then closed because of age, that is not unexpected. Unexpected is when a school building is damaged after 10 years of service by a flood. We plan for assets to gradually wear out and be replaced. Depreciation of assets is expected. An asset being damaged by a hurricane is unexpected.
3. Service Utility. This is nothing another than is an asset being used for the purpose for which it was originally intended. A school building which is being used as a school and not as a storage facility. It is connected to the original usable service capacity of an asset.
4. Capital Asset. Impairments of other types of assets are not covered under GASB Statement No. 42. Hurricane Helene did a tremendous amount of economic damage; however, we are only considering impairments in the specific context of damage to governmental capital assets. Governments classify capital assets in a variety of ways [e.g., a building could be recorded as a single asset (building) or as building subsystems (e.g., roof, HVAC systems, etc.)]. Capital assets also can be recorded as individual assets or groups of assets. The classification system is left up to the professional judgement of

government officials; however, the GASB specifically states that land, buildings, and depreciable improvements are different categories and should be separately evaluated for capital asset impairment.

ASSESSMENT OF IMPAIRMENT

Determining whether a government has an asset impairment is a two-step approach. The first step is to identify possible impairments. The GASB mentions that these are prominent events that are known to government officials. Hurricane Helene fulfills this requirement. The second step is to identify whether there are indicators of impairment. Capital assets affected by Helene most likely will have been impacted by physical damage, which is one of the five indicators of impairment identified in GASB Statement No. 42. Physical damage could have come from the effects of Helene itself but could also occur from mold that was not found until well after the initial event. Damage to capital assets from wind, flooding, and mold are all examples of physical damage and an indicator of impairment. With physical damage, a government usually must restore an asset to recover its service utility. Impairments from physical damage are usually considered to be permanent in nature. If a capital asset is evaluated with the two-step process and there is a significant and unexpected decline in the service utility of the asset, this is evidence of an asset impairment that will need to be recognized in the financial statements if the amount is material.

MEASUREMENT OF IMPAIRMENT (for capital assets that will continue to be used)

If there is an asset impairment, part of the value of an asset will be written off and recognized as a loss in the financial statements for assets that a government will continue to use. There are three measurement methods for asset impairments mentioned in the standards and the GASB directs governments to select the most appropriate method for the type of impairment. For physical damage, the GASB states that the most appropriate method for measuring the impairment is usually the restoration cost approach. The restoration cost approach calculates the impairment by estimating the costs needed to restore the service utility of the capital asset. The calculation involves using either an appropriate cost index to restate the estimated restoration cost to an estimated historical cost or by applying the ratio of the estimated restoration cost over the estimated replacement cost to the carrying value of the capital asset. That sounds horribly complex, but we have examples in the second part of this memo to illustrate the calculations. GASB Statement No. 42 defines restoration cost as the amount necessary to return a capital asset to its original condition. It should not include amounts that are additions or improvements. Particularly for older assets, amounts that are restoration costs may be difficult to separate from amounts that are additions or improvements. The GASB provides no practical guidance on how to separate these amounts. We believe that unless spending is clearly for an addition or improvement, it should be recorded as spending on restoration costs. We will cover the reporting of impairment losses later in this memo.

MEASUREMENT OF IMPAIRMENT (for capital assets that will no longer be used)

A government may decide that it no longer needs an impaired asset. If an impaired asset will no longer be used by a government, the historical cost of the asset is much less important and for that reason the restoration cost will not be calculated. Capital assets that will no longer be used should be reported at the lower of carrying value or fair value. If the fair value is more than the carrying value (as it often will be on land that has appreciated in value), the capital asset will continue to be reported at the carrying value and no impairment will be recorded. If the carrying value exceeds the fair value, the capital asset will be written down to the fair value, and an impairment loss will be recognized for the decline in the capital asset's value. Capital assets that fall into this category continue to be shown as capital assets. They are not reported as capital assets held for resale even if a government intends to sell them.

REPORTING IMPAIRMENT LOSSES

Because governmental funds use the current financial resources measurement focus and the modified accrual basis of accounting, capital assets are not typically reported in the funds which means that impairment losses are **NOT** reported in a governmental fund. Impairments are reported under the economic resources measurement focus and the accrual basis of accounting which means that impairments would be reported in the government-wide financial statements and in the proprietary funds.

The GASB requires that permanent impairments be recorded as losses in the operating statements utilizing accrual accounting (statements of activities, statements of revenues, expenses, and changes in fund net position). GASB Statement No. 42 indicates that losses may be reported as program or operating expenses, special items, or extraordinary items. Because Hurricane Helene was unusual, infrequent, and a natural event, we believe that an impairment loss from Helene would be reported as an extraordinary item on the accrual basis (the final item in an operating statement before the change in net position). In terms of debits and credits, the impairments (which are losses) are debits. The offsetting credits are reductions in the carrying values of the impaired assets. This can be handled in one of two ways. Either accumulated depreciation may be increased by the amount of the impairment or the carrying values of both the asset and the accumulated depreciation may be reduced proportionately. Calculating and recording the impairment losses is a complicated part of the process.

RESTORATION OF ASSETS

Restoration costs are not part of the normal maintenance of an asset and are necessary to restore the service potential of the capital asset. These costs come from unplanned damage and not from normal usage. Disbursements to restore an asset would follow a government's normal capitalization policies just as if a new capital asset were being acquired or constructed. This typically would mean that immaterial amounts below a government's capitalization threshold would not be capitalized while amounts above a government's capitalization threshold would be capitalized as part of an asset. Regardless of whether funds are being spent on restoration, additions, or improvements, the amounts will be capitalized and included in the cost of the capital asset if they exceed the capitalization threshold. In governmental funds, capital outlay expenditures will be recorded. For financial statements using the economic resources measurement focus and the accrual basis of accounting, restoration and replacement of capital assets are reported separately from impairments. They should NOT be netted with impairment losses.

INSURANCE RECOVERIES

Governments with damaged capital assets usually receive payments from both FEMA and from insurance recoveries. **BE VERY CAREFUL – THE ACCOUNTING FOR EACH OF THESE IS VERY DIFFERENT.** The first memo on Helene focused on budgeting and accounting for FEMA reimbursements. We will not repeat that discussion here, but it would be worthwhile for finance officials to review the earlier memo. As a reminder, the GASB considers FEMA grants to be nonexchange transactions. This means that the damage from Helene and any FEMA reimbursements are reported as two separate events.

The accounting is different for insurance recoveries. In governmental funds, an insurance recovery and the restoration or replacement of a capital asset are reported separately. Restoration and replacement will be reported as capital outlay expenditures and insurance recoveries will be reported as other financing sources or as an extraordinary item. Illustration 2 in GASB Statement No. 42 reports an insurance recovery as an other financing source even though the event in the illustration is noted to be an extraordinary item. Possibly, this is because insurance recoveries themselves are common events.

For the government-wide and proprietary fund financial statements, the restorage and replacement of impaired capital assets is reported separately from the impairment loss and the related insurance recovery. Transactions are not normally netted; however, insurance recoveries are netted with impairment losses if both occur in the same fiscal year. This means that any insurance recoveries from Helene during the 2024 – 25 fiscal year should be netted against the impairment loss if the accrual basis of accounting is being used. Insurance recoveries in future fiscal years obviously could not be netted with the impairment losses from previous years and will be reported separately. GASB requires an insurance recovery in future years to be reported as a program revenue, a nonoperating revenue, or as an extraordinary item. We suggest recording insurance recoveries in the years following the event as program revenues or nonoperating revenues and not as extraordinary items. The reason for this suggestion is to avoid reporting extraordinary items for multiple years for a single event. Insurance recoveries should be recorded when realizable (the insurer has acknowledged coverage) even if the amount of the recovery has not been finalized.

DISCLOSURES

Since governments are in the process of reporting on the fiscal year in which Hurricane Helene took place, there will be disclosures for an extraordinary item in the financial statements. We are not going to illustrate an extraordinary item disclosure in this memo; however, we are going to discuss some of the disclosure requirements from GASB Statement No. 42 which may be a part of the extraordinary item disclosure. GASB Statement No. 42 requires the following specific disclosures:

1. The carrying value of impaired capital assets that are idle at the end of the fiscal year regardless of whether the impairment is permanent or temporary.
2. A general description of the loss, the amount, and the classification of impairment losses if this information is not already apparent in the financial statements.
3. The amount and classification of insurance recoveries if the information is not otherwise apparent from the financial statements.

ILLUSTRATIVE EXAMPLES

The following illustrative examples for Hurricane Helene are intended to show the accounting and financial reporting treatments for specific situations with capital asset impairments. In each situation the amount of the possible impairment is considered to be material and the physical damage in all the examples is assumed to be caused by Helene. This means that in each of these cases the reader may assume that there has been a significant, unexpected decline in the service utility of a capital asset.

EXAMPLE 1

Cardinal Creek Recreation Area (governmental fund): This Carolina County property has a playground, outdoor tennis and basketball courts, picnic pavilion, paved walking trail, and youth soccer sports fields. The original carrying value was $1 million. It is near a creek and was wiped out by flood waters. It is in a flood zone for insurance purposes and has a $500,000 deductible. Carolina County has received $31,000 in an insurance settlement after the deductible was subtracted. This property will be restored but only emergency repairs have been made so far. The County currently estimates that the restoration cost will be $1.5 million. The County will file a claim with FEMA for the $500,000 deductible plus it expects to receive an additional insurance recovery settlement after actual costs are incurred. There will also be stream restoration done on this property that will be funded by grants.

- The assumption is that the property, including all the amenities mentioned above, would only be reported at the government-wide level. The carrying value of the property, not including the land, should be written off as an extraordinary loss (the inference above is that everything but the land was destroyed, thus no write-off for the land would be reported) in the government-wide financial statements. The $31,000 insurance recovery received in the fiscal year of the disaster should be netted against the extraordinary loss in the financial statements reported using the accrual basis of accounting.
- The $31,000 received should be reported in the general fund as an other financing source (this is our recommended alternative) or as an extraordinary item. The insurance recovery should not be netted against the restoration costs, and no impairment loss is reported in the governmental funds.
- As restoration is made to capitalizable items, the general fund will reflect capital outlay expenditures (or a capital project fund could be used for the project). With either option, a construction-in-progress capital asset would be reported in the government-wide financial statements and then converted to specific capital assets when completed. Any costs associated with repairing land damage would be reported as a capital outlay expenditure in the general fund (or capital project fund, if applicable) and added to the capitalized land value in the government-wide financial statements.
- The $500,000 deductible that will be filed with FEMA should be reported as a FEMA receivable and a deferred inflow of resources in the general fund once all the eligibility requirements have been met. (The complete write-off of the assets in the government-wide financial statements effectively recorded the loss.) Once the FEMA reimbursement occurs, the receivable and the deferred inflow will be reversed, and cash and grant revenue will be reported.
- Assuming the stream is not an asset of the government, those repairs, funded by grant monies, would simply be expenditures in the general fund and grant revenue as eligibility requirements are met and amounts become available.

EXAMPLE 2

Carolina County School Building (governmental fund): This is a historical property that is leased to a preservation entity and does not house any county departments. As of the date of the hurricane, the net book value of the school building was $550,000. It had a $25,000 deductible for insurance purposes. The County has received approximately $250,000 in insurance settlements but not all the repairs have been made. The County has not yet spent the insurance settlement amounts. It will qualify for a FEMA claim when costs exceed the insurance settlements. The County is waiting on estimates from contractors as to the restoration repair costs.

- The assumption is the historical property is still listed as an active asset of the county, and it was not completely destroyed. To calculate the impairment, you will need to know the net book value of the building, the estimated replacement cost of the building, repairs to date, and the estimate of future repairs. The estimate of total repairs divided by the replacement costs of the entire building provides a

restoration cost ratio. That ratio, applied against the net book value at the time of the disaster, would be the impairment loss.
- The insurance settlements received in the year of the disaster, netted against the impairment loss would result in an extraordinary loss in the government-wide financial statements. The insurance settlements received in the year of the disaster would be reported as an other financing source (our suggested method) or as an extraordinary gain in the general fund. Restoration costs would be reported as expenditures. The impairment loss would not be reflected in the general fund as the impaired capital asset is not reported in a governmental fund.
- As the building is being rebuilt, the costs incurred would become part of the capitalizable amount of the restored asset. Repairs after the year of the disaster will be capital outlay expenditures in the general fund (assuming the repairs are capitalizable repairs) and additions to the capitalizable asset in the government-wide financial statements.

EXAMPLE 3

Pine Tree Greenway (governmental fund): This is a walking trail that is being built by a third party. Carolina County is given ownership of these sections of greenway by the third party as the sections are completed. Several county-owned sections were damaged by the hurricane. Some were repaired prior to June 30, 2025, but there are two damaged sections that are not fully repaired. Insurance and FEMA settlements have not yet been spent because contractors are not yet available.

- The assumption is being made that the trails are being capitalized by the county as they are received (affecting only the government-wide statements at that time). Also, assuming the repairs are considered impairments, you will need the net book value of the trails, the estimated restoration costs, the replacement cost, and the incurred expenses to date. Dividing the restoration costs by the replacement cost provides a restoration cost ratio. Multiplying that ratio against the carrying value of the trails renders the impairment loss that will be reported only in the government-wide financial statements.
- The insurance recoveries that have been received by year end would be reported as an other financing source (our suggested method) or an extraordinary item in the general fund. Capital outlay expenditures are reported in the fiscal year for restoration expenditures for the trails in the general fund. In the government-wide financial statements, the impairment loss would be netted against insurance recoveries received during the fiscal year and an extraordinary item would most likely be reported.

EXAMPLE 4

City of Dogwood Wastewater System Treatment Plant (enterprise fund): The City's wastewater treatment plant was severely damaged by Helene's floodwater and is completely inoperable until repairs are made. The total net book value of the plant at the time of the storm was $14,500,000. Contractors have determined that it will cost approximately $9,000,000 to restore the damaged elements of the treatment plant to an operable condition. Total replacement costs of the entire plant are estimated to be $27,000,000. Insurance proceeds have been received in the year of the flood in the amount of $1,500,000. Additional insurance claims of $5,000,000 have been approved but not yet received as of the fiscal year end. FEMA claims have been filed and approved but have not yet been received for the insurance deductible of $750,000. More FEMA claims are planned when the restoration is completed.

- Total estimated restoration costs of $9,000,000 divided by the total estimated replacement costs of $27,000,000 provides the restoration cost ratio of 33%. This ratio multiplied by the net book value of the plant at the time of the storm renders the impairment loss of $4,785,000 ($14,500,000 X 33%). No repair costs have been incurred at the end of the fiscal year.

- Insurance proceeds have been received in the amount of $1,500,000 during the fiscal year of the disaster. The additional insurance claims of $5,000,000 that have been approved but not yet received are considered realizable and therefore would also be reported in the fiscal year of the loss.
- The impairment loss of $4,785,000 is netted against insurance proceeds received ($1,500,000) plus the amount that is realizable ($5,000,000) in the year of the loss to render an extraordinary ***gain*** of $1,715,000 in the enterprise fund and the government-wide statements.
- The FEMA claims that have been filed and approved should be reported as a receivable and grant revenue.

EXAMPLE 5

Town of Longleaf Water Filtration Plant (enterprise fund): The Town's water filtration plant was significantly damaged during Hurricane Helene. The plant is only five years old and the net book value at the time of the storm was $22,500,000. The estimated cost for complete replacement of the plant is $30,000,000. The final estimate for complete repairs totals $6,450,000. Initial insurance proceeds received within the same fiscal year as the storm total $750,000. The Town will file more insurance claims in the next fiscal year as repairs proceed. FEMA has reimbursed the Town for an initial $300,000 with the Town planning on filing additional reimbursement claims in the next fiscal year.

- The restoration cost ratio is calculated by dividing the estimated repair/restoration cost of $6,450,000 by the estimated total replacement cost of $30,000,000. The ratio is 21.5%.
- The restoration cost ratio of 21.5% is then multiplied by the net book value at the time of the loss ($22,500,000). This renders the impairment loss of $4,837,500 ($22,500,000 X 21.5%).
- Insurance claims that have been received during the year of the disaster total $750,000. This will be netted against the impairment loss and reported as an extraordinary loss in the enterprise fund and the government-wide financial statements ($4,087,500). Insurance proceeds received in future years related to this loss will be reported as nonoperating revenue in the enterprise funds and program revenue in the government-wide financial statements.
- The FEMA reimbursement of $300,000 received in the year of the loss will be reported as grant revenue, as FEMA reimbursements would be in future years.
- As restoration to the capitalizable assets proceeds, the costs incurred would become part of the capitalizable amount of the restored asset. Costs incurred that do not meet the normal capitalization rules would be reported as expenses.