



August 12, 2011

Memorandum

To: Members of the Board

From: Domenic N. Savini, Assistant Director

Through: Wendy M. Payne, Executive Director

Subj: **Draft Materials: Accounting and Financial Reporting for Impairment of General Property, Plant, and Equipment Remaining in Use. – Tab I¹**

MEETING OBJECTIVE

The objective for the August meeting is to review materials prepared based upon guidance received from members at the June meeting so that staff can obtain further direction for incorporation into the next revision of the draft Exposure Draft document. This memorandum includes (1) edits to the April version of the draft Exposure Draft document, (2) incorporation of a flowchart and decision table, and (3) various impairment loss illustrations.

BRIEFING MATERIALS

1. **Attachment 1-** draft Exposure Draft on *Accounting and Financial Reporting for Impairment of General Property, Plant, and Equipment Remaining in Use.*
2. **Attachment 2-** Summary of Impairment Loss Illustrations.
3. **Appendix A-** GASB 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries.*

NEXT STEPS

August 2011 – Asset Impairment

- Review draft Exposure Draft and identify changes

¹ The staff prepares board meeting materials to facilitate discussion of issues at the board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

October 2011 – Asset Impairment

- Revise Exposure Draft and identify changes

December 2011 – Asset Impairment

- Email pre-ballot draft (note: asset impairment will not be on the December 2011 agenda if approved before meeting and there are no outstanding issues)
- Email ballot draft early December with ballots due at December meeting
- Proceed with exposure draft for 90-day comment period upon receipt of five affirmative ballots

April 2012– Asset Impairment

- Report and analyze asset impairment comments
- Consider whether a public hearing is desired
- Finalize Board discussion

June 2012– Asset Impairment

- Provide draft SFFAS
- Email pre-ballot following the June meeting

August 2012– Asset Impairment

- Proceed with final Ballot

September 2012– Asset Impairment

- Issue Final SFFAS

BACKGROUND

BACKGROUND

At the June 22, 2011, meeting the Board discussed the preliminary draft Exposure Draft document entitled, *Accounting and Financial Reporting for Impairment of Capitalized Property, Plant, and Equipment Remaining in Use*. Members agreed that (1) impairment loss recognition should be limited to very rare instances and (2) impairment loss reversals should not be allowed. The Board made clear that entities are not expected to apply this proposed standard in a manner that would require them to survey their asset portfolios to search for potential impairments. The Board's intent is for the community to adopt the proposed standard only for significant events that are material to the financial statements. Concerning impairment loss reversals, some of the members noted that allowing reversals seems to be overly complex and unnecessary. They specifically noted that if events later change and assets are placed back into service, the costs incurred to place them back into service would become their new cost basis. In addition, the members provided the following direction regarding other aspects of the preliminary draft Exposure Draft:

1. Whether or not an impairment event can be expected does not seem to drive an impairment decision.
2. Management's intention not to restore lost service utility as a test for permanence appears reasonable.
3. Service utility losses can be both gradual and sudden.
4. Impairment loss calculations should not include improvements or betterments.
5. Distinguishing between replacement and restoration cost approaches appears to be both reasonable and consistent with expert Task Force (appraiser) advice.
6. Illustrations should be included with each proposed measurement method.
7. A process flowchart should be considered for incorporation into the draft ED.
8. Certain proposed methods may need to be carefully considered before adopting into proposed standards.
9. Additional measurement methods may need to be incorporated into proposed standards.
10. Given a choice among methods, entities should adopt the most efficient method available given the circumstances.

EFFECTIVE DATE

The proposed standards would be effective for periods beginning after September 30, 2014 (beginning in fiscal year 2015). Earlier implementation is encouraged.

If you require additional information or wish to suggest another alternative not considered in the staff paper, please contact me as soon as possible. If you have any questions or comments, please contact me by telephone at 202.512.6841 or by e-mail at savinid@fasab.gov.

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Questions for the Board

Questions for the Board

Questions 1 through 3 – As noted in the background section (items 6 and 7), members asked staff to prepare illustrations and a process flowchart for incorporation into the draft ED.

Question 1 –

**Question 1 - Refer to pages 28 and 29 of Attachment 1 -
*Flowchart depicting the General PP&E Impairment Decision
Process:***

Does the Board believe that the proposed flowchart (1) is consistent with the draft ED impairment methodology and (2) satisfactorily explains to users the PP&E impairment decision

Question 2 -

**Question 2 - Refer to page 30 of Attachment 1 – Decision Table
*Selecting a Measurement Method:***

Does the Board believe that the proposed table (1) is consistent with the draft ED measurement methodology and (2) satisfactorily explains to users the selection of a method that reasonably represents diminished service utility?

Question 3 -

Question 3 - Refer to Attachment 2 for a *Summary of Impairment Loss Illustrations* included within Attachment 1 and, Attachment 1 pages 31 through 63 for individual illustrations:

Does the Board believe that (1) the illustrations satisfactorily depict each of the 6 draft ED measurement methods located at paragraph 17, (2) the methods are sufficiently covered or explained, and (3) any of the proposed illustrations should be excluded?

Questions for the Board

Questions 4 and 5 – At the June 22 meeting, members made specific suggestions that are summarized in the Background paragraph. As previously noted, members agreed that impairment loss recognition should be limited to very rare instances and that entities are not expected to search for potential impairments. Members also noted that impairment loss reversals should not be allowed and that prominent or significant events without a material impact on the entities' financial statements should not be reported as impairment losses. Another important point and distinction from GASB 42 (refer to Appendix A) is that impairment decisions are not driven by whether or not an impairment event can be expected to occur. Lastly, it was noted that impairments can be a gradual or sudden decline in an asset's service utility.

Question 4 - Refer to Attachment 1 - *Draft Exposure Draft on Accounting and Financial Reporting for Impairment of General Property, Plant, and Equipment Remaining in Use*

Does the Board agree with the revised impairment definition found at paragraph 9?

“Impairment is a significant and permanent, gradual or sudden ~~often-unexpected~~ decline in the service utility of G-PP&E.”

Question 5 - Refer to Attachment 1 - *Draft Exposure Draft on Accounting and Financial Reporting for Impairment of General Property, Plant, and Equipment Remaining in Use*

Is the draft ED consistent with the Board's expectations? If not, please identify concerns and note that editorial concerns may be directed to staff prior to the meeting.

Questions for the Board

Question 6 – As discussed in June, the task force recommended that the undiscounted cash flow approach be applied to cash or revenue generating PP&E.

Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, requires recognition of an impairment loss only if the carrying amount (i.e. net book value) of a long-lived asset is not recoverable from its undiscounted cash flows and subsequently measures the impairment loss as the difference between the carrying amount and the fair value² of the asset.

For federal application this requirement can be problematic in several areas, (1) fair value and other current estimates may not always be readily or efficiently available (i.e., costs versus benefits) for the PP&E in question, (2) settlement amounts such as net realizable value³ may differ greatly from fair value due to the federal government’s policy objectives and process requirements in disposing of PP&E, and (3) for certain PP&E fair value estimates may not exist; e.g., no market exists. Because of these differences, staff believes adjusting the FASB guidance to allow either net realizable value or value-in-use is necessary. Each of these approaches allows the preparer to consider the unique circumstances of the federal government.

Staff looked to the International Public Sector Accounting Standard (IPSAS) 26, *Impairment of Cash-Generating Assets*, for a public sector alternative and found that it measures impairment as the difference between the asset’s carrying amount and its recoverable amount. Recoverable amount is the higher of fair value less costs to sell and value-in-use. IPSASB’s definition of value-in-use is equivalent to the FASAB definition.⁴ The effect of the IPSASB approach is that the loss is based on the most advantageous choice the asset owner has available – that is, either disposing of the asset or continuing to use it. Staff believes this is an appropriate approach.

² FASAB’s proposed Statement of Federal Financial Accounting Concepts (SFFAC) 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording*, paragraph 38. defines fair value as the amount at which an asset or liability could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

³ SFFAC 7 provides that “settlement amount” is the “amount at which an asset can be realized.” It allows consideration of the entity’s expectations regarding the circumstances of settlement. Net realizable value is a commonly used synonym for settlement amount. FASAB Glossary, Appendix E defines Net Realizable Value (NRV) as the estimated amount that can be recovered from selling, or any other method of disposing of an item less estimated costs of completion, holding, and disposal.

⁴ Statement of Federal Financial Accounting Concepts (SFFAC 7), *Measurement of the Elements of Accrual-Basis Financial Statements* at paragraph 50 defines value-in-use as “...the benefit to be obtained by an entity from the continuing use of an asset and from its disposal at the end of its useful life.” Paragraph 51 further states that , “Value in use is a remeasured amount for assets used to provide services. It can be measured at the present value of future cash flows that the entity expects to derive from the asset, including cash flows from use of the asset and eventual disposition. Value in use is entity specific and differs from fair value. Fair value is intended to be an objective estimate of the amount of an asset exchanged between willing parties that also is applicable to similar exchanges between other parties. Value in use is an entity’s subjective assessment of the value to the entity of an asset that it owns. Thus, value in use is useful in assessing the financial position and operating results of that entity, but because the amount is entity specific, it may not be comparable when making assessments of other entities.” (underscoring added for emphasis)

Questions for the Board

The proposed language follows:

“An impairment loss should be measured as the amount by which the net book value of the G-PP&E exceeds the higher of its net realizable value or value-in-use estimate. No impairment loss exists if the net book value is less than the higher of the G-PP&E’s net realizable value or value-in-use estimate.”

Question 6 - Does the Board agree that the impairment loss for cash/revenue generating G-PP&E that will continue to be used is the difference between the net book value and the higher of net realizable value and value-in-use estimate? If not, what would the Board propose as an alternative measure(s)?

Question 7 – Applicability of the standards to internal-use-software.

Staff clarified the applicability section of the exposure draft to indicate that existing requirements are not affected by the new standards. Presently, standards address recognition of a loss when G-PP&E is no longer used in service and impairment of internal use software. SFFAS 10, *Accounting for Internal Use Software*, provides the following impairment standards:

POST-IMPLEMENTATION/OPERATIONAL SOFTWARE

28. Impairment should be recognized and measured when one of the following occurs and is related to post-implementation/operational software and/or modules thereof:

- the software is no longer expected to provide substantive service potential and will be removed from service or
- a significant reduction occurs in the capabilities, functions, or uses of the software (or a module thereof).

29. If the impaired software is to remain in use, the loss due to impairment should be measured as the difference between the book value and either (1) the cost to acquire software that would perform similar remaining functions (i.e., the unimpaired functions) or, if that is not feasible, (2) the portion of book value attributable to the remaining functional elements of the software. The loss should be recognized upon impairment, and the book value of the asset reduced accordingly. If neither (1) nor (2) above can be determined, the book value should continue to be amortized over the remaining useful life of the software.

Questions for the Board

30. If the impaired software is to be removed from use, the loss due to impairment should be measured as the difference between the book value and the net realizable value (NRV), if any.⁸ The loss should be recognized upon impairment, and the book value of the asset reduced accordingly. The NRV, if any, should be transferred to an appropriate asset account until such time as the software is disposed of and the amount is realized.

DEVELOPMENTAL SOFTWARE

31. In instances where the managers of a federal entity conclude that it is no longer more likely than not that developmental software (or a module thereof) will be completed and placed in service, the related book value accumulated for the software (or the balance in a work in process account, if applicable) should be reduced to reflect the expected NRV, if any, and the loss recognized. The following are indications of this:

- Expenditures are neither budgeted nor incurred for the project.
- Programming difficulties cannot be resolved on a timely basis.
- Major cost overruns occur.
- Information has been obtained indicating that the cost of developing the software will significantly exceed the cost of COTS software available from third party vendors; hence, management intends to obtain the product from those vendors instead of completing the project.
- Technologies that supersede the developing software product are introduced.
- The responsibility unit for which the product was being created is being discontinued.

⁸ Presumably, NRV will be zero for software. However, in the rare case that it is not zero, NRV should be recognized.

Paragraph 29 addresses instances in which software will continue to be used. Key differences between SFFAS 10 provisions and the draft impairment standards are:

1. Impairments are not limited to those arising from significant events resulting in declines in service utility that are significant.
2. SFFAS 10 does not include the requirement that the impairment be considered permanent before a loss is recognized.
3. Options for measuring the loss are tailored to internal use software but are in principle similar to the certain proposed methods.
4. SFFAS 10 does not permit use of the loss measurement method applicable to cash generating assets (i.e., the undiscounted cash flow method).
5. SFFAS 10 does not address recoveries.

Questions for the Board

These differences may be significant. Staff plans to seek input from federal financial managers before the Board meeting and has no recommendation at this time.

Question 7. Does the Board wish to consider further whether to amend SFFAS 10 provisions for impairment of internal use software?

***Attachment 1- Draft ED: Accounting and Financial Reporting for
Impairment of General Property, Plant, and Equipment Remaining in Use.***

***Attachment 1- Draft ED: Accounting and Financial Reporting for
Impairment of General Property, Plant, and Equipment Remaining in Use.***

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Attachment 2 - Summary of Impairment Loss Illustrations.

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Attachment 2 - Summary of Impairment Loss Illustrations.

Attachment 2 – Summary of Impairment Loss Illustrations

Count	Illus. #	PP&E Category/Class	Potential Impairment Indicator	Affect on Asset	Par. 16 Measurement Method
1	1a	General / Building	Physical damage	Temporary declines in service utility	N/A
2	1b	General / Building	Physical damage	Complete Removal from Service	N/A - SFFAS 6, par. 38
3	1c	General / Building	Physical damage	Permanent declines in service utility	Replacement Approach
4	1d	General / Building	Physical damage	Permanent declines in service utility	Choosing among methods
5	2a	Multi-Use Heritage / Capitalized Alterations	Physical damage	Normal and ordinary declines in service utility	N/A
6	2b	Multi-Use Heritage / Building	Physical damage	Permanent declines in service utility	Restoration Approach
7	3a	General / Equipment	Change in technology / Obsolescence	Remaining service utility can be recovered	Service units approach
8	3b	General / Equipment	Change in technology / Obsolescence	Unable to recover remaining service utility	Service units approach
9	4a	General / Facility	Change in manner or duration of use	Permanent declines in service utility	Deflated depreciation current cost approach
10	4b	General / Facility	Change in manner or duration of use	Decline in service utility does not meet magnitude test.	N/A

Attachment 2 - Summary of Impairment Loss Illustrations.

Attachment 2 - Summary of Impairment Loss Illustrations

Count	Illus. #	PP&E Category/Class	Potential Impairment Indicator	Affect on Asset	Par. 16 Measurement Method
11	5	General / Equipment	Construction stoppage	Permanent declines in service utility	N/A Total Impairment SFFAS 6, Par. 38 application
12	6a	General / Equipment	Contract termination	Temporary declines in service utility	N/A
13	6b	General / Equipment	Contract termination	Permanent declines in service utility	Lower of NBV or recoverable value; higher of NRV or VIU
14	7a	General / Grouped Assets	Change in manner or duration of use	Carrying amount of asset is not recoverable	Undiscounted cash flow approach
15	7b	General / Equipment	Change in technology / Obsolescence	Carrying amount of the asset is not recoverable	Undiscounted cash flow approach
16	7c	General / Facility	Change in manner or duration of use	Using UCF, the carrying amount of the asset is recoverable	Undiscounted cash flow approach
17	7d	General / Facility	Change in manner or duration of use	The carrying amount of the asset is not recoverable & Value-in-Use illustrated	Undiscounted cash flow approach

Appendix A - GASB 42, Accounting and Financial Reporting for Impairment of Capital Assets and for insurance Recoveries.

Appendix A - GASB 42, Accounting and Financial Reporting for Impairment of Capital Assets and for insurance Recoveries.

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Federal Accounting Standards Advisory Board

**Accounting and Financial Reporting for Impairment of General
Property, Plant, and Equipment Remaining in Use**

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Statement of Federal Financial Accounting Standards

Exposure Draft

Written comments are requested by March **X**, 2012

December **X**, 2011

Working Draft – Comments Are Not Requested on This Draft

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General, established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the Federal Government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, Federal executives, Federal program managers, and other users of Federal financial information. The proposed standards are published in an Exposure Draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for Federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- "Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."
- "Mission Statement: Federal Accounting Standards Advisory Board", Exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at: www.fasab.gov.

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
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Washington, DC 20548
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www.fasab.gov

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1 December X, 2011

2 TO: ALL WHO USE, PREPARE, AND AUDIT FEDERAL FINANCIAL INFORMATION

3 The Federal Accounting Standards Advisory Board (FASAB or the Board) is requesting
4 comments on the exposure draft of a proposed Statement of Federal Financial
5 Accounting Standards entitled, *Accounting and Financial Reporting for Impairment of*
6 *General Property, Plant, and Equipment Remaining in Use*. Specific questions for your
7 consideration appear on page 7 but you are welcome to comment on any aspect of this
8 proposal. If you do not agree with the proposed approach, your response would be
9 more helpful to the Board if you explain the reasons for your position and any alternative
10 you propose. Responses are requested by March X, 2012.

11 All comments received by the FASAB are considered public information. Those
12 comments may be posted to the FASAB's website and will be included in the project's
13 public record.

14 We have experienced delays in mail delivery due to increased screening procedures.
15 Therefore, please provide your comments in electronic form. Responses in electronic
16 form should be sent by e-mail to fasab@fasab.gov. If you are unable to provide
17 electronic delivery, we urge you to fax the comments to (202) 512-7366. Please follow
18 up by mailing your comments to:

19 Wendy M. Payne, Executive Director
20 Federal Accounting Standards Advisory Board
21 Mailstop 6K17V
22 441 G Street, NW, Suite 6814
23 Washington, DC 20548
24

25 The Board's rules of procedure provide that it may hold one or more public hearings on
26 any exposure draft. **No hearing has yet been scheduled for this exposure draft.**

27 Notice of the date and location of any public hearing on this document will be published
28 in the *Federal Register* and in the FASAB's newsletter.

29 Tom L. Allen
30 Chairman

1 **Executive Summary**

2 **What is the Board proposing?**

3 This exposure draft proposes accounting and financial reporting standards for
4 impairment of general property, plant, and equipment (G-PP&E)¹ remaining in use. .
5 G-PP&E is considered impaired when its service utility has declined significantly,
6 whether gradual or sudden, and the decline is considered permanent.

7 **How would this proposal improve federal financial reporting and contribute**
8 **to meeting the federal financial reporting objectives?**

9 This Statement would improve financial reporting because it requires entities to
10 report the effects of G-PP&E impairments in their financial statements when they
11 occur rather than as a part of the ongoing depreciation expense for the G-PP&E or
12 upon disposal of the G-PP&E. This will enable users of financial statements to better
13 understand when impairments have occurred and what their financial impact is on
14 the federal entity and government. This Statement also enhances comparability of
15 financial statements between entities by requiring all entities to account for
16 impairments in the
17 same manner.

18 Of the four
19 objectives outlined
20 in Statement of
21 Federal Financial
22 Accounting
23 Concepts (SFFAC)
24 1, *Objectives of*
25 *Federal Financial*
26 *Reporting*, the
27 operating
28 performance
29 objective is identified as being most important for G-PP&E impairment accounting
30 and reporting.

Operating Performance Objective

Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities. Federal financial reporting should provide information that helps the reader to determine

- the costs of providing specific programs and activities and the composition of, and changes in, these costs;
- the efforts and accomplishments associated with federal programs and the changes over time and in relation to costs; and
- the efficiency and effectiveness of the government's management of its assets and liabilities.

Source: SFFAC 1

¹ Statement of Federal Financial Accounting Standards 6, *Accounting for Property, Plant, and Equipment* establishes three categories of Federal PP&E: (1) general PP&E are PP&E used to provide general government services or goods; (2) heritage assets are those assets possessing significant educational, cultural, or natural characteristics; and (3) stewardship land (i.e., land other than that included in general PP&E).

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Federal Accounting Standards Advisory Board
Accounting and Financial Reporting for Impairment of General Property,
Plant, and Equipment Remaining in Use
August X, 2011
Working Draft - August 12, 2011 DM 1479634

1 **Questions for Respondents**

2 The FASAB encourages you to become familiar with all proposals in the Statement
 3 before responding to the questions in this section. In addition to the questions below,
 4 the Board also would welcome your comments on other aspects of the proposed
 5 Statement.

6 The Board believes that this proposal would improve Federal financial reporting and
 7 contribute to meeting the Federal financial reporting objectives. The Board has
 8 considered the perceived costs associated with this proposal. In responding, please
 9 consider the expected benefits and perceived costs and communicate any concerns
 10 that you may have in regard to implementing this proposal.

11 Because the proposals may be modified before a final Statement is issued, it is
 12 important that you comment on proposals that you favor as well as any that you do not
 13 favor. Comments that include the reasons for your views will be especially appreciated.

14 The questions in this section are available in a Word file for your use at
 15 www.fasab.gov/exposure.html. Your responses should be sent by e-mail to
 16 fasab@fasab.gov. If you are unable to respond electronically, please fax your
 17 responses to (202) 512-7366 and follow up by mailing your responses to:

18 Wendy M. Payne, Executive Director
 19 Federal Accounting Standards Advisory Board
 20 Mailstop 6K17V
 21 441 G Street, NW, Suite 6814
 22 Washington, DC 20548

23 All responses are requested by March **X**, 2012.

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Accounting and Financial Reporting for Impairment of General Property,
Plant, and Equipment Remaining in Use
August X, 2011
Working Draft - August 12, 2011 DM 1479634

1 **Q1.** The Board proposes to establish a requirement to recognize impairment losses
 2 when there is a *significant and permanent* decline, whether gradual or sudden, in the
 3 service utility of G-PP&E. Refer to paragraphs 9 and 11 of the proposed standards and
 4 paragraphs [A3](#) and [A4](#) in Appendix A - Basis for Conclusions for a discussion and
 5 related explanation.

6 **Do you agree or disagree with the Board’s proposal to recognize impairment**
 7 **losses when there is a significant and permanent decline, whether gradual or**
 8 **sudden in the service utility of G-PP&E? Please provide the rationale for your**
 9 **answer.**

10 **Q2.** The Board proposes that this Statement (1) be used in limited and rare instances
 11 and (2) does not require entities to search their G-PP&E portfolios for potential
 12 impairments. Entities are not expected to alter existing surveillance methods as a direct
 13 consequence of the proposed standards. Refer to paragraphs 13 and 15 of the
 14 proposed standards and paragraphs [A4](#) and [A5](#) in Appendix A - Basis for Conclusions
 15 for a discussion and related explanation.

16 **Do you agree or disagree with the Board’s proposal that this statement (1) be**
 17 **used in limited and rare instances and (2) does not require entities to search their**
 18 **G-PP&E portfolios for potential impairments? Please provide the rationale for**
 19 **your answer.**

20 **Q3.** The Board has identified the following as conditions giving rise to G-PP&E
 21 impairments: evidence of physical damage, enactment or approval of laws or
 22 regulations, changes in environmental or economic factors, technological changes or
 23 evidence of obsolescence, changes in the manner or duration of use of G-PP&E, and
 24 construction stoppage or contract termination. Refer to paragraph 15 of the proposed
 25 standards and paragraphs [A6](#) through [A10](#) and [A14](#) through [A16](#) in Appendix A - Basis
 26 for Conclusions for a discussion and related explanation.

27 **Do you agree or disagree with each of the conditions identified as giving rise to**
 28 **impairments of G-PP&E? Please provide the rationale for your answer.**

29 **Q4.** The Board believes that impairment losses are estimated using a measurement
 30 method that reasonably reflects the diminished or lost service utility of the G-PP&E. The
 31 Board has identified the following methods used to measure diminished service utility:
 32 replacement approach, restoration approach, deflated depreciated current cost
 33 approach, service units approach, undiscounted cash flow approach and for
 34 construction stoppages/contract terminations a lower of net book value or recoverable
 35 amount approach. Refer to paragraph 17 of the proposed standards and paragraphs

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1 [A12](#), and [A13](#) through A19 in Appendix A - Basis for Conclusions for a discussion and
2 related explanation.

3 **Do you agree or disagree with each of the measurement methods identified used**
4 **to estimate diminished or lost service utility of G-PP&E? Please provide the**
5 **rationale for your answer.**

DRAFT

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1 Introduction

2 Purpose

- 3 1. The Federal Accounting Standards Advisory Board (FASAB) has not
4 previously established specific requirements for the accounting and financial
5 reporting of the impairment of general PP&E. Therefore, the objective of
6 this proposed Statement is to establish accounting requirements for the
7 impairment of general PP&E remaining in use.
- 8 2. Statement of Federal Financial Accounting Standards (SFFAS) 6,
9 *Accounting for Property, Plant, and Equipment*, contains principles-based
10 guidance concerning general PP&E that is removed from service due to
11 impairment or other reasons. SFFAS 6 requires that general PP&E be
12 removed from general PP&E accounts along with associated accumulated
13 depreciation/amortization, if prior to disposal, retirement or removal from
14 service it no longer provides service in the operations of the entity.
- 15 3. SFFAS 10, *Accounting for Internal Use Software*, provides guidance for the
16 impairment of internal use software.² According to SFFAS 10 criteria, in
17 order for software to be considered impaired, it would have to have lost its
18 service potential such that the federal entity would plan to remove it from
19 service or the software would have had its capabilities reduced. This
20 proposal would not alter existing requirements regarding internal use
21 software.
- 22 4. The proposed Statement is expected to provide accounting requirements for
23 all general PP&E impairment not yet addressed in SFFAS 6 and SFFAS 10.

24 Materiality

- 25 5. The provisions of this Statement need not be applied to immaterial items.
26 The determination of whether an item is material depends on the degree to
27 which omitting or misstating information about the item makes it probable

² SFFAS 10 at paragraphs 28 through 30 provide additional procedures for recognizing and measuring impairment related to internal use software. The provisions in SFFAS 10 and SFFAS 6 are the same regarding situations where the software or general PP&E is impaired and will be removed from service in its entirety. Both standards provide that the loss is measured as the difference between the book value and the net realizable value, if any. However, SFFAS 10 also provides for instances where (1) operational software is only partly impaired and (2) developmental software becomes impaired.

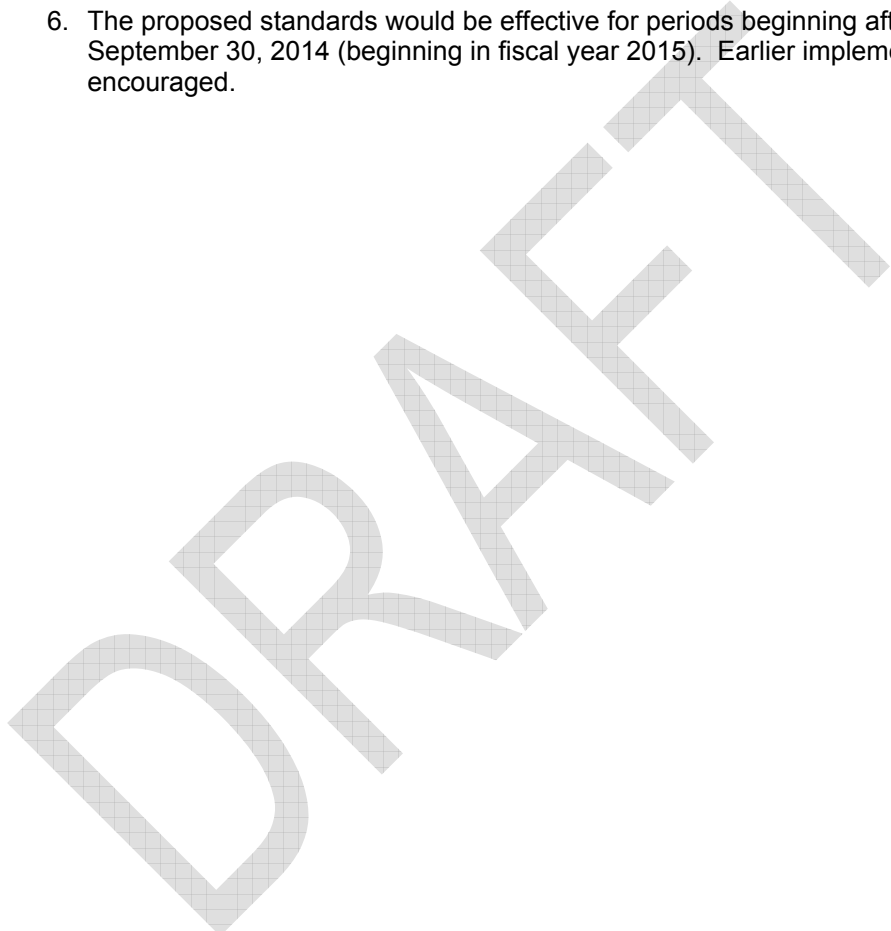
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1 that the judgment of a reasonable person relying on the information would
2 have been changed or influenced by the omission or the misstatement.

3 **Effective Date**

4 6. The proposed standards would be effective for periods beginning after
5 September 30, 2014 (beginning in fiscal year 2015). Earlier implementation is
6 encouraged.



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1 Proposed Standard

2 **Applicability**

- 3 7. This Statement applies to federal entities that prepare general purpose
- 4 federal financial reports, including the consolidated financial report of the
- 5 U.S. Government (CFR), in conformance with SFFAS 34, *The Hierarchy of*
- 6 *Generally Accepted Accounting Principles, Including the Application of*
- 7 *Standards Issued by the Financial Accounting Standards Board.*

Deleted: Scope

Comment: Per team review on 10 August. Add new language.

- 8 8. This Statement applies to general property, plant, and & equipment (G-
- 9 PP&E) except internal use software.³ This Statement establishes guidance
- 10 for the accounting for and financial reporting of the impairment of G-PP&E.
- 11 This Statement is intended to be applied in limited and rare instances and
- 12 does not require that entities search their G-PP&E portfolios for potential
- 13 impairments.

Comment: As per 22 June Board meeting. M. Granof, M. Reger, W. Jackson and T. Allen.

Edit made to address (1) when an entity would need to follow this guidance (MG & MR) and (2) the concern that the proposed standard could be misinterpreted or construed to mean that the Board is creating an expectation that management should have processes in place that would divert attention from material to immaterial issues; e.g., F/A 18's vs. M16 rifles (WJ).

14 **Definition of Impairment**

- 15 9. Impairment is a significant⁴ and permanent, gradual or sudden decline in the
- 16 service utility of G-PP&E. Entities generally hold G-PP&E because of the
- 17 services they provide; consequently, impairments affect the service utility of
- 18 the G-PP&E. The events or changes in circumstances that lead to
- 19 impairments are not considered normal and ordinary.⁵ That is, at the time
- 20 the G-PP&E was acquired, the event or change in circumstance would not
- 21 have been (a) expected to occur during the useful life of the G-PP&E or, (b)
- 22 if expected, sufficiently predictable to be considered in estimating the useful
- 23 life.
- 24 10. The service utility of G-PP&E is the usable capacity that at acquisition was
- 25 expected to be used to provide service, as distinguished from the level of
- 26 utilization, which is the portion of the usable capacity currently being used.

Comment: As per 22 June Board meeting. R. Dacey.

Edit made to specify that whether or not an impairment event can be expected does not drive an impairment decision. That is, impairments (1) may or may not be expected and (2) are limited to being both significant and permanent declines to service utility.

Comment: As per 22 June Board meeting. H. Steinberg and R. Dacey.

Edit made to specify that declines to service utility can be both gradual or sudden.

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³ G-PP&E includes, among other types of PP&E, multi-use heritage assets, capitalized improvements to stewardship land and internal use software.

⁴ The determination of whether or not an item, such as an impairment event is significant is a matter of professional judgment. Determining if an item is significant is separate and distinct from materiality considerations that include considering the likely influence that such disclosure could have on judgments or decisions of financial statement users.

⁵ Normal and ordinary are defined as events or circumstances that fall within the expected life cycle of the PP&E such as standard maintenance and repair requirements.

The current usable capacity of G-PP&E may be less than its original usable capacity due to the normal or expected decline in useful life or to impairing events or changes in circumstances, such as physical damage, obsolescence, enactment or approval of laws or regulations or other changes in environmental or economic factors, or change in the manner or duration of use. Usable capacity may be different from maximum capacity in circumstances in which surplus capacity is needed for safety, economic, operational readiness or other reasons. Decreases in utilization and the simultaneous existence of or increases in surplus capacity not associated with a decline in service utility are not considered impaired.

Recognition of Impairment

- 11. Generally, G-PP&E is impaired if the decline, whether gradual or sudden in the service utility of the G-PP&E is significant and deemed permanent. Impairments to G-PP&E that are recognized should arise from significant events and those without a material impact to the financial statements need not be recognized.
- 12. The determination of whether G-PP&E is impaired, as defined in paragraph 9 above, is a two-step process of (a) identifying potential impairments and (b) testing for impairment. G-PP&E that have potential for meeting the definition of impairment are identified through events or changes in circumstances that are prominent and denote the presence of indicators of impairment, such as those described in paragraphs 13 and 15 below. For G-PP&E so identified, a test of impairment, as described in paragraph 16, should be performed to determine whether the circumstance or change in condition results in an impairment as defined in paragraph 9 and explained in paragraphs 10 through 14.

Identification of Events or Changes in Circumstances That May Indicate Impairment

- 13. Events or changes in circumstances affecting G-PP&E that may indicate impairment are prominent—that is, conspicuous or known to the entity. Absent any such events or changes in circumstances, entities are not required to perform additional procedures to identify potential impairment of G-PP&E. Events or circumstances that may indicate impairment generally are expected to have prompted discussion by oversight entities, senior management, or the media. Prominent or significant events with a

Comment: As per 22 June Board meeting. R. Dacey.

Edit made to specify that whether or not an impairment event can be expected does not drive an impairment decision. That is, impairments (1) may or may not be expected and (2) are limited to being both significant and permanent declines to service utility.

Deleted: (c) the event or change in circumstance was unexpected or not sufficiently predictable to have been considered in estimating useful life (e.g., outside of standard maintenance and repair requirements of the PP&E).

Comment: As per 22 June Board meeting. T. Allen

Staff Notes: Generally, the Board avoids discussing materiality within the standards. However, staff proposes that we add the last sentence and include such a reference so that we are clear as to Board intent.

Comment: As per 22 June Board meeting. W. Jackson.

Edit made to address the concern that the proposed standard could be misinterpreted or construed to mean that the Board is creating an expectation that management should have processes in place that would divert attention from material to immaterial issues; e.g., F/A 18's vs. M16 rifles.

Staff Notes: Generally, the Board avoids discussing materiality within the standards. However, staff proposes that we add the last sentence and include such a reference so that we are clear as to Board intent. ... [1]

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permanent loss in service utility but without a material impact on the financial statements, need not be reported as an impairment loss.

Reduced demand should not be considered a discrete or sole indicator of impairment

14. Reduced demand for the services of G-PP&E should not be considered a discrete or sole indicator of impairment. Instead, there should also be evidence of an underlying potential impairment resulting in the reduced demand. The causes behind such changes in demand should be evaluated in light of the indicators listed in paragraph 15 and G-PP&E in these circumstances should be tested for impairment.

Comment: Per Team Review on 10 August. Make consistent with BFC A-13
Deleted: unless there is
Deleted: reduced

Identifying Potential Impairments – 2 step process

Step 1 – Identify Indicators of Potential Impairment

15. Common indicators of impairment include those listed below. As entities evaluate prominent events or changes in circumstances affecting G-PP&E to determine whether impairment of G-PP&E has occurred, they occasionally come across conditions giving rise to impairments. Such events or changes in circumstances that may be indicative of impairment include:

- a. evidence of physical damage,
- b. enactment or approval of laws or regulations,
- c. changes in environmental or economic factors,
- d. technological changes or evidence of obsolescence,⁶
- e. changes in the manner or duration of use of G-PP&E,
- f. construction stoppage or contract termination, and

Comment: As per 22 June Board meeting. W. Jackson.

Edit made to address the concern that the proposed standard could be misinterpreted or construed to mean that the Board is creating an expectation that management should have processes in place that would divert attention from material to immaterial issues; e.g., F/A 18's vs. M16 rifles.
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⁶ Technological changes or evidence of obsolescence should be considered along with other factors when assessing impairment. For example, if obsolete PP&E continues to be used the usable capacity expected at acquisition may not be diminished. Further, when obsolescence is not unexpected, PP&E that are subject to obsolescence can be addressed through depreciation, particularly by using accelerated methods that yield a lower capital cost per year as the asset's utility diminishes when compared to that of later versions of the same asset.

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g. other indicators such as G-PP&E scheduled or awaiting (i.e., idled or unserviceable) disposal, retirement, or removal for excessively long periods⁷.

Step 2 - Impairment Test

16. G-PP&E identified through the processes described in paragraphs 11 through 15 should be tested for impairment by determining whether the following two factors are present:

a. The magnitude of the decline in service utility (as defined in par. 10) is significant. The expenses associated with continued operation and maintenance (including depreciation) or costs associated with replacement or restoration of the G-PP&E are significant in relationship to the currently expected service utility.

b. The decline in service utility is expected to be permanent. The decline is considered permanent when management has no reasonable expectation that the lost service utility will be replaced or restored. Management expects that the G-PP&E's remaining service utility can continue providing value.

Measurement

17. Impairment losses on G-PP&E that will continue to be used by the entity should be estimated using the measurement method that reasonably reflects the diminished service utility of the G-PP&E. Some acceptable methods which are widely recognized include the following:

⁷ Refer to Technical Release #14, Implementation Guidance on the Accounting for the Disposal of General Property Plant, & Equipment for guidance related to when an asset is other than permanently removed from service.

⁹ See SFFAS 6, Accounting for Property, Plant, and Equipment, par. 38 and 39 for guidance regarding PP&E that will not continue to be used by the entity.

¹⁰ Given a choice among comparable methods, entities should adopt the most efficient and practical method available given the circumstances.

Comment: Per Team Review on 10 August. Modify the GASB language so that it is clear that a decline may be significant whether or not management takes action. Also, to avoid confusion regarding permanent impairment since management's decision to remedy any decline is also an action but one that means there is no impairment recognition.

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Inserted: (refer to paragraph 9 for related comments)

Deleted: In circumstances other than health and safety, management's action to address the decline in service utility is an indication that the operation and maintenance expenses are too high in relation to the benefits received.

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Comment: As per 22 June Board meeting. R. Dacey.

Edit made to specify that whether or not an impairment event can be expected does not drive an impairment decision. That is, impairments (1) may or may not be expected and (2) are limited to being both significant and permanent declines to service utility.

Deleted: c. The decline in service utility is often unexpected.⁹ The replacement or restoration cost ... [2]

Comment: As per 22 June Board meeting. D. Bond and T. Allen. ... [3]

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Comment: As per 22 June Board meeting. S. Showalter and T. Allen. ... [4]

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- 1 a. **Replacement approach.** Impairment of G-PP&E with physical damage
 2 generally may be measured using a replacement approach. This approach
 3 uses the estimated cost to replace the lost service utility of the G-PP&E at
 4 today's standards to identify the portion of the historical cost of the G-
 5 PP&E that should be written off. For Federal Real Property purposes, this
 6 cost can be derived from the Plant Replacement Value (PRV). This
 7 estimate can be converted to historical cost either by restating (i.e.,
 8 deflating) the estimated cost to replace the diminished service utility using
 9 an appropriate cost index. Alternatively, it may be appropriate to apply the
 10 ratio of the estimated cost to replace the diminished service utility over
 11 total estimated cost to replace the G-PP&E, to the net book value of the
 12 G-PP&E.
- 13 b. **Restoration approach.** Impairment of improvements made to
 14 stewardship land and multi-use heritage assets with physical damage
 15 generally may be measured using a restoration approach. This approach
 16 uses the estimated cost to restore the diminished service utility of the G-
 17 PP&E to identify the portion of the historical cost of the G-PP&E that
 18 should be written off. This approach does not include any amounts
 19 attributable to improvements and additions to meet today's standards. The
 20 estimated restoration cost can be converted to historical cost either by
 21 restating (i.e., deflating) the estimated restoration cost using an
 22 appropriate cost index or by applying a ratio of estimated restoration cost
 23 to restore the diminished service utility over total estimated restoration
 24 cost to the net book value of the G-PP&E.
- 25 c. **Service units approach.** Impairment of G-PP&E that are affected by
 26 enactment or approval of laws or regulations or other changes in
 27 environmental/economic factors or are subject to technological changes or
 28 obsolescence generally may be measured using a service units approach.
 29 This approach compares the service units provided by the G-PP&E before
 30 and after the impairment event or change in circumstance to isolate the
 31 historical cost of the service utility of the G-PP&E that cannot be used due
 32 to the impairment event or change in circumstances. The amount of
 33 impairment is determined by evaluating the service provided by the G-
 34 PP&E—either maximum estimated service units or total estimated service
 35 units throughout the life of the G-PP&E—before and after the event or
 36 change in circumstance.
- 37 d. **Deflated depreciated current cost approach.** Impairment of G-PP&E
 38 that are subject to a change in manner or duration of use generally may

Comment: As per 22 June Board meeting. S. Showalter and T. Allen.

Edit made to recognize that "other acceptable methods" may exist for management's use and FASAB lists those which it believes to be widely recognized.

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Comment: As per 22 June Board meeting. W. Payne and S. Showalter.

Edit made to avoid potential conflict with FASAB's measurement attributes.

Comment: As per 22 June Board meeting. S. Showalter and T. Allen.

Edit made to recognize that "other acceptable methods" may exist for management's use and FASAB lists those which it believes to be widely recognized.

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Comment: As per 22 June Board meeting. S. Showalter and T. Allen.

Edit made to recognize that "other acceptable methods" may exist for management's use and FASAB lists those which it believes to be widely recognized.

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Comment: As per 22 June Board meeting. S. Showalter and T. Allen.

Edit made to recognize that "other acceptable methods" may exist for management's use and FASAB lists those which it believes to be widely recognized.

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be measured using a deflated depreciated current cost. This approach quantifies the cost of the service currently being provided by the G-PP&E and converts that cost to historical cost. A current cost for a G-PP&E to replace the current level of service is estimated. This estimated current cost is then depreciated to reflect the fact that the G-PP&E is not new, and then is subsequently deflated to convert it to historical cost dollars. A potential impairment loss results if the net book value of the G-PP&E exceeds the estimated historical cost of the current service utility (e.g., deflated depreciated current cost).

Comment: Per Team Review on 10 August. There is no need to refer to the service units approach because the Standards provide for management flexibility among all of the proposed methods.

Deleted: the service units approach or using

Deleted: replacement

e. **Undiscounted cash flow approach.** Impairment of cash or revenue generating G-PP&E, such as those used for business or proprietary type activities, may be measured using an undiscounted cash flow approach. Under this approach, an impairment loss should be recognized only if the net book value of the G-PP&E (1) is not recoverable and (2) exceeds the higher of its net realizable value¹² or value-in-use estimate¹³. The net book value of the G-PP&E is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the G-PP&E. That assessment should be based on the net book value of the G-PP&E at the date it is tested for recoverability, whether in use or under development. An impairment loss should be measured as the amount by which the net book value of the G-PP&E

Comment: As per 22 June Board meeting. S. Showalter and T. Allen.

Edit made to recognize that "other acceptable methods" may exist for management's use and FASAB lists those which it believes to be widely recognized.

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Deleted: This approach recognizes impairment if the carrying amount of the PP&E is not recoverable (undiscounted cash flows) and exceeds its net realizable value.¹¹ This approach can be applied to cash generating PP&E such as those used for business or proprietary type activities

Inserted: (undiscounted cash flows)

Deleted: carrying amount

¹² Net realizable value is the estimated amount that can be recovered from selling, or any other method of disposing of an item less estimated costs of completion, holding and disposal. Source: FASAB Glossary, Appendix E.

¹³ Statement of Federal Financial Accounting Concepts (SFFAC 7), *Measurement of the Elements of Accrual-Basis Financial Statements* at paragraph 50 defines value-in-use as "...the benefit to be obtained by an entity from the continuing use of an asset and from its disposal at the end of its useful life." Paragraph 51 further states that, "Value in use is a remeasured amount for assets used to provide services. It can be measured at the present value of future cash flows that the entity expects to derive from the asset, including cash flows from use of the asset and eventual disposition. Value in use is entity specific and differs from fair value. Fair value is intended to be an objective estimate of the amount of an asset exchanged between willing parties that also is applicable to similar exchanges between other parties. Value in use is an entity's subjective assessment of the value to the entity of an asset that it owns. Thus, value in use is useful in assessing the financial position and operating results of that entity, but because the amount is entity specific, it may not be comparable when making assessments of other entities." (underscoring added for emphasis)

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exceeds the higher of its net realizable value or value-in-use estimate. No impairment loss exists if the net book value is less than the higher of the G-PP&E's net realizable value or value-in-use estimate.

f. **Construction stoppage / contract termination.** G-PP&E impaired from either construction stoppages or contract terminations which are expected to provide service, should be reported at their recoverable amount; the lower of the G-PP&E's net book value or the higher of its net realizable value or value-in-use estimate. Impaired G-PP&E which are not expected to provide service should be accounted for and reported in accordance with SFFAS 6.

Reporting Impairment Losses

18. The loss from impairment should be reported in the statement of net cost. The impairment loss should be reported regardless of whether the G-PP&E 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 of the impaired G-PP&E, the nature (i.e., damage or obsolescence) and amount of the impairment, and the financial statement classification of the impairment loss should be disclosed in the notes to the financial statements.

G-PP&E That Do Not Meet the Impairment Test

19. If an event or circumstance indicates that G-PP&E may be impaired, but the test of impairment determines that the impairment need not be reported, yet future service utility has been adversely affected, the estimates used in depreciation calculations such as remaining estimated useful life and salvage value, should be reevaluated and changed, if necessary.

G-PP&E That Is No Longer Being Used

20. G-PP&E that is no longer being used by the entity should be accounted for and reported in accordance with SFFAS 6, paragraphs 38 and 39.

Recoveries

21. The impairment loss should be reported net of any associated recovery when the recovery and loss occur in the same year. Recoveries reported in subsequent years should be reported as revenue, a gain, or extraordinary

Comment: As per 22 June Board meeting. Majority disagreed with this notion.

Deleted: Reversals of Partial Impairment Losses ¶ Impairment losses recognized in accordance with this Statement can be reversed in future years, if the events or circumstances causing the partial impairment or its remediation have changed.

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Deleted: In such cases, SFFAS 6 requires that (1) general G-PP&E be removed from the accounts along with associated accumulated depreciation/amortization and (2) the recognition of gains or losses.

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1 item, as appropriate. Recoveries should be recognized only when realized
 2 or realizable. For example, if ~~a manufacturer or contract operator has~~
 3 admitted or acknowledged ~~warranty or contract liability, respectively, a~~
 4 recovery would be realizable. If the ~~manufacturer or contract operator~~ has
 5 denied ~~liability~~, the ~~recovery~~ generally would not be realizable. If not
 6 otherwise apparent in the financial statements, the amount and financial
 7 statement classification of ~~recoveries~~ should be disclosed.

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Consolidated Financial Report of the US Government

9 22. The U. S. government-wide financial statements need not disclose the
 10 nature or measurement methods used in recognizing impairment losses.
 11 The U. S. government-wide financial statements should include the
 12 following information:

- 13 a. general description of what constitutes G-PP&E impairment,
- 14 b. consolidated amount of G-PP&E impairment reported by component
 15 entities,
- 16 c. reference to component entity reports for additional information.

Effective Date

18 23. The requirements of this Statement are effective for periods beginning after
 19 September 30, 2014. Earlier implementation is encouraged.

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

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1 Appendix A: Basis for Conclusions

2 This appendix discusses some factors considered significant by Board members in
3 reaching the conclusions in this Statement. It includes the reasons for accepting certain
4 approaches and rejecting others. Individual members gave greater weight to some
5 factors than to others. The standards enunciated in this Statement—not the material in
6 this appendix—should govern the accounting for specific transactions, events, or
7 conditions.

8 Project History

9 A1. In Statement of Federal Financial Accounting Standards (SFFAS) 23,
10 *Eliminating the Category National Defense Property, Plant, and Equipment*,
11 issued in May 2003, the Board identified impairment as one of three areas (the
12 other two being depreciation and deferred maintenance) that it desired to
13 consider integrating into a comprehensive project. Complete impairment was
14 addressed in SFFAS 6, *Accounting for Property, Plant, and Equipment*, through
15 the requirements that general PP&E "...be removed from general PP&E
16 accounts along with associated accumulated depreciation/amortization, if prior
17 to disposal, retirement or removal from service, it no longer provides service in
18 the operations of the entity. This could be either because it has suffered
19 damage, becomes obsolete in advance of expectations, or is identified as
20 excess." However, SFFAS 6 does not address partial impairment, although, it is
21 feasible that the effects of partial impairment are material in some cases. The
22 Board believed that addressing asset impairment in connection with deferred
23 maintenance might lead to potential enhancements which could be made to
24 existing FASAB guidance.

25 A2. In evaluating an approach applicable to federal G-PP&E, the Board considered
26 the approaches used in the following documents:

- 27 • Financial Accounting Standards Board (FASB) Statement No. 144,
28 *Accounting for the Impairment or Disposal of Long-Lived Assets*
- 29
- 30 • Governmental Accounting Standards Board Statement (GASB) No. 42,
31 *Accounting and Financial Reporting for Impairment of Capital Assets and*
32 *for Insurance Recoveries*
- 33
- 34 • International Public Sector Accounting Standard (IPSAS) No. 21,
35 *Impairment of Non-Cash Generating Assets*
36

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- International Public Sector Accounting Standard (IPSAS) No. 26,
Impairment of Cash-Generating Assets

A working group was organized to assist the Board in analyzing the impairment standards promulgated by the FASB, GASB, and IPSASB. The subgroup's analysis was initially screened by the Deferred Maintenance and Asset Impairment (DM-AI) Task Force and subsequently tested with the broader community beyond the task force to get other points of view. The consensus recommendation was to use the GASB 42 approach as a baseline for the development of a federal asset impairment standard.

Significant and Permanent Decline in Service Utility

A3. This proposed Statement requires recognizing a potential impairment loss only when there is a significant and permanent decline (gradual or sudden) in the G-PP&E's service utility. In reaching this decision, the Board considered and weighed (a) the need for relevant, reliable, and consistent financial reporting and (b) entity burden.

a. For financial reporting to be:

(i) relevant - a logical relationship must exist between the information provided and the purpose for which it is needed. G-PP&E impairment information is relevant because it is capable of making a difference in a user's assessment of how well the entity is meeting its federal asset stewardship responsibilities.

(ii) reliable - information needs to be comprehensive and nothing material should be omitted nor should anything be included that would likely cause the information to be misleading. The reporting of G-PP&E impairments significantly adds to the informational value and reliability of asset amounts presented in the entity's balance sheet and statement of net cost.

(iii) consistent over time - an accounting principle or reporting method should be used for all similar transactions and events unless there is good cause to change. Establishing G-PP&E impairment standards significantly adds to consistent financial reporting.

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Federal Accounting Standards Advisory Board
Accounting and Financial Reporting for Impairment of General Property,
Plant, and Equipment Remaining in Use

August X, 2011

Working Draft - August 12, 2011 DM 1479634

1 b. The Board is aware of the increased demands that entities confront due to
 2 initiatives that attempt to better align and integrate entity mission, budget, and
 3 performance objectives. As such, the Board desires to issue a G-PP&E
 4 impairment standard that entities can effectively adopt without undue
 5 administrative burden.
 6

7 **Impairments are Limited and/or Rare Instances**

8 A4. The Board views impairments of G-PP&E as prominent or significant events
 9 known by the entity because they are conspicuous or readily identifiable. Such
 10 events are generally unusual and significant in nature. That is, the events or
 11 changes in circumstances that lead to impairments are not considered normal
 12 and/or ordinary. One or more parties such as the entity's oversight bodies,
 13 senior management, and the media will usually identify such prominent or
 14 significant events. As a result, this proposed Statement does not require entities
 15 to alter existing surveillance methods.
 16

17 **Significant Events Are Not Always Material Events**

18 A5. The Board notes that not all prominent or significant events and/or changes in
 19 circumstances discussed by oversight bodies, senior management, or the media
 20 would necessarily be considered material to an entity's financial statements.
 21 Consequently, an entity must exercise judgment in this regard considering
 22 whether omitting or misstating information about the prominent or significant
 23 event and/or changes in circumstances makes it probable that the judgment of a
 24 reasonable person relying on the information would be changed or influenced by
 25 the omission or the misstatement. However, in cases where an entity decides
 26 that a prominent or significant event or changed circumstance is immaterial, it
 27 should consider adjustments to the G-PP&E's depreciation methods, useful life
 28 or salvage value estimates.
 29

30 **Common Indicators of Potential Impairment**

31 A6. The Board considered the general approaches used by other standards setters
 32 regarding the issues of impairment identification and testing. The DM-AI Task
 33 Force identified the GASB approach as being the most germane for federal
 34 application and recommended adopting its use with appropriate modifications.

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- 1 As a result, this proposed Statement consists of a two-step process of (a)
 2 identifying potentially impaired G-PP&E through indicators of impairment and (b)
 3 testing to determine whether potential impairment exists by comparing the net
 4 book value of the G-PP&E to a valuation reflecting the current state of the G-
 5 PP&E.
- 6 A7. Recognizing the administrative burden and costs involved in applying a test of
 7 potential impairment, the Board desires to make clear that the indicators
 8 identified at paragraph 15 in and of themselves are not conclusive evidence that
 9 a measurable or reportable impairment exists. Entities should carefully consider
 10 the surrounding circumstances to determine if they are significant or prominent
 11 before requiring a test of potential impairment, as it may be unnecessary given
 12 the circumstances.
- 13 A8. In order to limit the universe of G-PP&E tested for potential impairment because
 14 of cost-benefit considerations, the Board proposes two modifiers to the
 15 indicators: (a) the magnitude of the gradual or sudden decline in service utility is
 16 significant and (b) the decline in service utility is permanent. The first modifier
 17 would limit testing for potential impairment to only G-PP&E that have
 18 experienced significant events or changes in circumstances that cause a related
 19 significant decline, gradual or sudden, of the asset's service utility. The second
 20 modifier would limit testing to only those G-PP&E where the decline in lost
 21 service utility is expected to be permanent. The decline is considered
 22 permanent when management has no reasonable expectation that the lost
 23 service utility will be replaced or restored and that the G-PP&E's remaining
 24 service utility can continue providing value.
- 25 A9. Only when both of these two modifiers are present, is G-PP&E to be considered
 26 potentially impaired. When either of these conditions is not present, the decline
 27 in the service utility of the G-PP&E should be recognized through more
 28 traditional methods such as changing useful life or salvage value estimates.

29

30 **G-PP&E Impairments Can Also Be Identified From Asset Management Reviews**

- 31 A10. Common indicators of potential impairment can be discovered during different
 32 types of asset management reviews which include the following types of G-
 33 PP&E assessments:
- 34 a. Condition assessments revealing evidence of physical damage,
 35 deterioration, and/or distresses such as for a building (1) damaged by fire

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1 or flood, (2) not adequately maintained or repaired, (3) significant amounts
 2 of deferred maintenance and repairs and/or (4) exhibiting signs of
 3 advanced degradation that might adversely impact expected duration of
 4 use, each requiring remedial or replacement/restoration efforts to restore
 5 service utility.

6 b. Functionality assessments revealing evidence of reduced capacity,
 7 inadequate configuration, change in entity mission, change in the manner
 8 or expected use, and enactment or approval of laws, regulations, codes or
 9 other changes in environmental factors, such as new water quality
 10 standards that a water treatment plant does not meet (and cannot be
 11 modified to meet).

12 c. Obsolescence assessments revealing evidence of technological
 13 development or obsolescence, such as that related to a major piece of
 14 diagnostic or research equipment (for example, a magnetic resonance
 15 imaging machine or a scanning electron microscope) that is rarely or
 16 never used because newly acquired equipment provides better service.

17 A11. Potential impairments identified from such assessments as discussed above in
 18 items a. through c. are eligible for recognition if they meet the requirements set
 19 forth in paragraphs 15 and 16 of the Standard.

20 **Selecting a Measurement Approach**

21 A12. Professional judgment should be used when selecting a method to measure the
 22 decline in service utility of G-PP&E. Generally, potential impairments:

23 a. reflecting degradation or physical damage may be measured using a
 24 replacement cost approach or for multi-use heritage assets a restoration cost
 25 approach.

26 b. reflecting a change resulting from enactment or approval of laws or
 27 regulations or other changes in environmental/economic factors or from
 28 technological development or obsolescence generally may be measured
 29 using a service units approach.

30 c. reflecting a change in manner or duration of use or change in mission
 31 generally may be measured using deflated depreciated current cost
 32 approach.

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1 d. for cash or revenue generating assets may be measured using the
2 undiscounted cash flow approach.

3 e. arising from construction stoppages or contract terminations which are
4 expected to provide service, should be reported at their recoverable amount;
5 the lower of the G-PP&E's net book value or the higher of its net realizable
6 value or value-in-use estimate.

7 8 **Among Comparable Methods – Choose the Most Efficient**

9
10 A13. The Board recognizes that there may be cases where more than one
11 comparable method could be used to measure the decline in an assets'
12 service utility. In such cases, the entity should use whichever method
13 reasonably reflects the diminished service utility. In cases where the methods
14 under consideration are expected to yield similar results, management should
15 adopt the most efficient method available given the circumstances.

16 17 **Reduced Demand**

18 A14. The Board notes that reduced demand for the services of G-PP&E should not
19 be considered as a discrete or sole indicator of potential impairment. That is,
20 reduced demand absent evidence of an underlying potential impairment
21 resulting in that reduced demand is not an indicator of impairment. For
22 example, decreased demand for the processing services of a mainframe
23 computer because former users of the mainframe have transitioned to PC and
24 server-based systems should be considered a change in demand not requiring
25 impairment testing. However, if associated with an indicator of potential
26 impairment such as evidence of obsolescence, then the mainframe should be
27 tested for potential impairment.

28 A15. In addition, a decrease in demand solely resulting from the conclusion of a
29 special project requiring large amounts of processing time on a mainframe
30 computer that runs other applications should not be considered for impairment
31 testing.

32 A16. A decrease in occupancy is another example of a change in demand. If a
33 decrease in the occupancy of hospital beds prompts management to close a
34 hospital, a change in manner or duration of use has also resulted and a test for

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1 impairment should be performed. However, a test for impairment is not
 2 required if the decrease in hospital beds results solely because the hospital is
 3 changing from an overcrowded condition to one in which occupancy rates are
 4 now below the required maximum. However, care should be taken to ensure
 5 that there is not a potential indicator of impairment that could require testing.

6 **Estimating Potential Impairment Losses**

7 A17. Measuring the amount of the cost to replace the lost service utility generally
 8 requires the use of estimates or approximations. According to Statement of
 9 Federal Financial Accounting Concepts (SFFAC) 5, *Definitions of Elements*
 10 *and Basic Recognition Criteria for Accrual-Basis Financial Statements*, an item
 11 must be measurable, meaning that a monetary amount can be determined
 12 with reasonable certainty or is reasonably estimable (underscoring added for
 13 emphasis).

14 A18. Nonetheless, the Board notes that care should be taken when estimating
 15 potential impairments losses. For example, if a multi-use heritage asset
 16 requires testing for potential impairment, the restoration cost and not the
 17 replacement approach should be used. Although these approaches may
 18 appear to be identical, they are not. The replacement approach estimates the
 19 cost to replace the lost service utility of the G-PP&E at today's standards
 20 whereas the restoration cost approach does not. In either case, the required
 21 estimates used for the calculation inputs are different and can significantly
 22 affect the potential impairment loss measurement. Differences will arise
 23 because the replacement approach uses estimates reflecting today's current
 24 labor and material options and costs, modern standards, and installation
 25 methods whereas the restoration cost approach uses estimates that generally
 26 require using curatorial-approved (e.g., aesthetic or historic) materials and
 27 conservation/preservation methods to preserve the historic nature and value of
 28 the multi-use heritage asset.

29 A19. Entities should also ensure that impairment loss calculations exclude
 30 improvements or betterments. For example, assume that a portion of an old
 31 warehouse not being currently used suffers roof damage due to heavy
 32 snowfall. The entity decides not to repair the roof and to contain the damage
 33 by securing the adjoining area ensuring that there are no safety hazards. In
 34 this case, estimates for the construction of a new warehouse, including its roof
 35 should not include amounts for new types of roof ventilation systems, solar
 36 panel features, or green energy improvements, etc. Including such

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1 improvements or betterments might significantly affect the potential impairment
2 loss measurement.

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Federal Accounting Standards Advisory Board
Accounting and Financial Reporting for Impairment of General Property,
Plant, and Equipment Remaining in Use
August X, 2011
Working Draft - August 12, 2011 DM 1479634

1 Appendix B: Flowcharts, Decision Table and Illustrations

2

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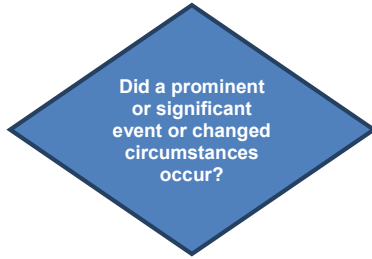
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Federal Accounting Standards Advisory Board
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August X, 2011
Working Draft - August 12, 2011 DM 1479634

Refer to – Par. 12

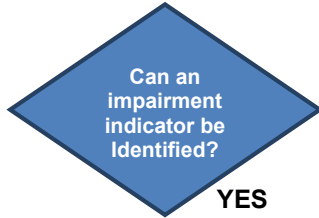


NO

Step1 – Identify indicators

YES

Refer to – Par. 13 and Par. 14, items a-g.

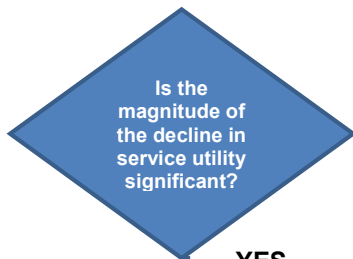


NO

YES

Step2 – Impairment Test

Refer to – Par. 15 a



NO

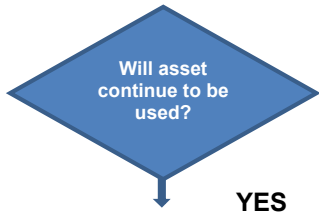
YES

Refer to – Par. 15 b



NO

YES



NO

YES

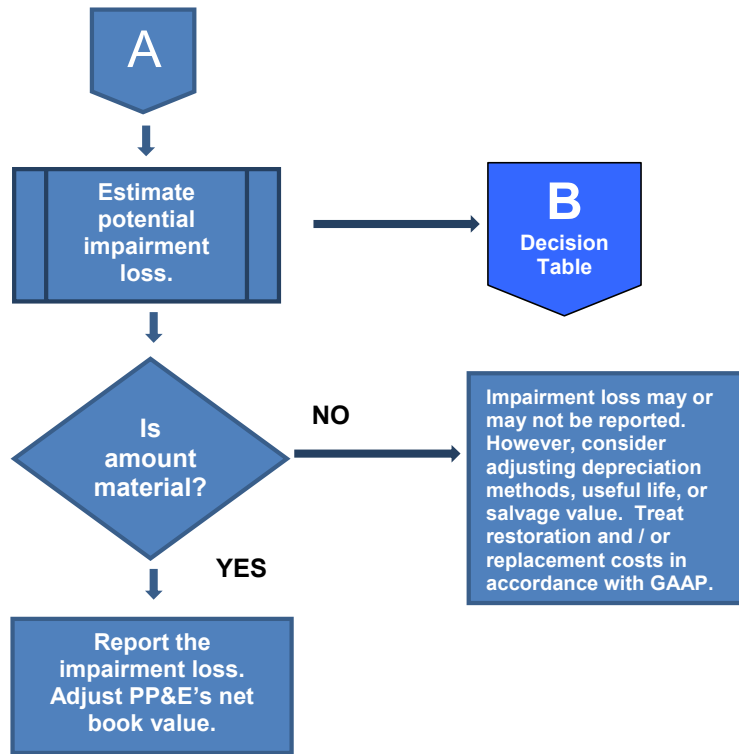
Total impairment. Write down asset in accordance with SFFAS 6, paragraph 38.

Go to A

No impairment. Consider adjusting depreciation methods, useful life, or salvage value. Treat restoration and / or replacement costs in accordance with GAAP.

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Refer to – Par. 16



Refer to – Par. 17

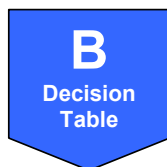
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General PP&E Impairment Decision Table

Selecting a Measurement Method

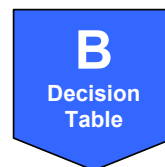
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Select a method that reasonably represents diminished service utility by considering potential indicators and type of PP&E.

If more than one method is reasonable, select the most



Measurement Method	Potential Indicators	Type of PP&E	Reference	Illustration Reference
Replacement Approach	<ul style="list-style-type: none"> Physical Damage 	All G-PP&E	Par. 16 a	1c
Restoration Approach	<ul style="list-style-type: none"> Physical Damage 	Multi-use Heritage PP&E	Par. 16 b	2b
Service Units Approach	<ul style="list-style-type: none"> Enactment or approval of laws/regulations Changes in environmental or economic factors Technological changes or obsolescence 	All G-PP&E	Par. 16 c	1d, 3a, 3b
Deflated Depreciation Current Cost Approach	<ul style="list-style-type: none"> Change in manner or duration of use. 	All G-PP&E	Par. 16 d	4a, 4b
Undiscounted Cash Flow approach	<ul style="list-style-type: none"> Cash or revenue generating assets 	All G-PP&E	Par. 16 e	7a, 7b, 7c, 7d
Lower of Net Book value or Net Realizable Value Approach	<ul style="list-style-type: none"> Construction stoppage Contract termination 	All G-PP&E	Par. 16 f	5, 6a, 6b

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ILLUSTRATIONS

This appendix illustrates the application of the provisions of this Statement to assist in clarifying their meaning. 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. 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 and require reference to other applicable Standards.

Illustration 1a

Temporary Declines in Service Utility: *Physical Damage to an Office Building with Mold Contamination*¹⁴

Assumptions

In 2012 senior entity officials became aware of extensive mold contamination at one of its office buildings. Facilities management personnel advised that the building be closed due to health and safety concerns. Shortly afterwards, the office building was vacated and closed. The mold remediation involves removing and rebuilding the interior walls and improving site drainage at a total cost of \$4 million.

Senior management plans to begin remediation efforts as soon as possible and replace the lost service utility.

Evaluation of potential impairment

The mold contamination is evidence of physical damage – an impairment indicator. Also, the magnitude of the event (i.e., closure of the building) is a significant decline in service utility. However, because senior management plans to replace the lost service utility of the building, the damage is temporary and no impairment loss is recognized.

¹⁴ FASAB Illustrations 1a through 1d have been adapted from GASB 42, Illustration 1, *Physical Damage – School with Mold Contamination*.

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Illustration 1b**Complete Removal from Service: *Physical Damage to an Office Building with Mold Contamination*****Assumptions**

In 2012 senior entity officials became aware of extensive mold contamination at one of its office buildings. Facilities management personnel advised that the building be closed due to health and safety concerns. Shortly afterwards, the office building was vacated and closed.

Due to the extent of the damage, senior management does not believe that remediation efforts will begin and that the lost service utility of the building is not temporary. As a result, senior management has decided to remove this building from service and prepare it for disposal.

Evaluation of potential impairment

The mold contamination is evidence of physical damage – an impairment indicator. Also, the magnitude of the event (i.e., closure of the building) is a significant decline in service utility. Because senior management does not believe that remediation efforts will begin, the lost service utility of the building is permanent. However, because the entire office building will be taken out of service and prepared for disposal purposes, no impairment loss is recognized. Instead, the provisions of SFFAS 6, *Accounting for Property, Plant, and Equipment* paragraph 38 are applicable.

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Illustration 1c**Replacement Approach - Permanent Declines in Service Utility: *Physical Damage to an Office Building with Mold Contamination*****Assumptions**

In 2012 senior entity officials became aware of extensive mold contamination at one of its office buildings. The mold contamination in the walls of the building was limited to the top two floors of the five story building and could be safely contained and encapsulated. Facilities management personnel advised that the first three floors of the building could continue to be safely used.

Senior management does not believe that the loss of service utility will impede their operations and consequently, do not plan to remediate the mold contamination. Senior management has decided to discontinue the use of the top two floors and commence containment and encapsulation efforts. The remainder of the building will be kept in service.

The office building was constructed in 1982 at a cost of \$1.3 million, including \$100,000 for acquisition of the building site. The building had an expected useful life of sixty years. During its life, the entity made improvements to the building totaling \$1.235 million.

Evaluation of potential impairment

The mold contamination is evidence of physical damage – an impairment indicator. Also, the magnitude of the event (i.e., contamination of two of the five floors of the building) is a significant decline in service utility. Because senior management does not plan to replace the lost service utility of these floors, the lost service utility of the building is permanent. Because the loss of service utility is permanent, any impairment loss, if material, is recognized.

Measurement of potential impairment

Facilities managers have estimated that mold remediation (involving removal and rebuilding of the interior walls and improving site drainage) would cost \$4 million. In accordance with the entity's capitalization policies, 40 percent of the remediation cost would be allocable to demolition and mold removal, and 60 percent would be allocable to rebuilding the interior building walls. As recorded in the entity's asset management system, the estimated plant replacement value (PRV) of the office building is \$6.2 million.

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Calculate Net Book Value:

	Historical Cost	Accumulated Depreciation, 2003	Net Book Value, 2003
Land	<u>\$100,000</u>		<u>\$100,000</u>
Building acquisition, 1982	\$1,200,000	\$600,000	\$600,000
Improvements	1,235,000	320,000	915,000
Total - Building & Improvements	<u>\$2,435,000</u>	<u>\$920,000</u>	<u>\$1,515,000</u>

Calculate estimated cost to replace lost service utility:

Total mold remediation cost	\$4,000,000
Percentage wall rebuilding cost	<u>60%</u>
Wall Remediation cost	<u>\$2,400,000</u>

Calculate percentage of lost service utility in current dollars:

Wall Remediation (estimate of lost service utility in current dollars)	\$2,400,000
Plant Replacement Value (estimate to replace building in current dollars)	<u>6,200,000</u>
Wall Remediation cost percentage	38.71%

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Calculate potential impairment loss:

Net book value (historical cost)	\$1,515,000
Multiplied by: Wall Remediation cost percentage	<u>38.71%</u>
Potential impairment loss	<u>\$586,452</u>

Reporting

If material, the potential impairment loss of \$586,452 and corresponding reduction of the book value of the building would be reported.

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Illustration 1d

Choice Among Methods - Permanent Declines in Lost Service Utility: *Physical Damage to an Office Building with Mold Contamination*

Assumptions

Same as Illustration 1c except that facilities managers advise senior management that the service units approach should be adopted to measure the potential impairment loss because it is the most efficient method available for use given the circumstances.

Evaluation of potential impairment

Same as Illustration 1c.

Measurement of potential impairment

Calculate percentage of lost service utility in terms of units:

Lost service utility in terms of floor units	2 floors
Total service utility prior to damage in terms of floor units	<u>5 floors</u>
Percentage of lost service utility in terms of units	40.00%

Calculate potential impairment loss:

Net Book Value (historical cost)	\$1,515,000
Multiplied by: percentage of lost service utility - units	<u>40.00%</u>
Potential impairment loss	<u>\$606,000</u>

Reporting

If material, the potential impairment loss of \$606,00 and corresponding reduction of the book value of the building would be reported..

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Illustration 2a**Normal and Ordinary Lost Service Utility: *Physical Damage to a Multi-use Heritage Asset***¹⁵**Assumptions**

Recent media reports have noted that acid precipitation (often called acid rain) is of increasing concern in the metropolitan area and, in particular to many of the area's historic and national landmarks including multi-use heritage assets. The entity's conservation scientists confirm the media reports and note that although normally rain is slightly acid, current rainfall has an average pH of more than 10 times normal levels.

Limestone and marble, the stones that form many of the buildings and monuments in the metropolitan area are especially vulnerable to acid precipitation because they are predominantly made of the mineral calcite (calcium carbonate), which dissolves (i.e., erosion) easily in acid. Capitalized alterations made over the years to accommodate the heavy traffic brought about by administrative and visitor use of one the more prominent multi-use heritage assets has drawn senior management's attention. The entity's Inspector General (IG) has begun a review and in an interim draft report has noted the following,

"The marble balustrade on the south side, main entrance of the administrative building shows damage from acid rain posing a serious threat to the hundreds of visitors and employees who walk by this concourse daily. Management must take immediate corrective action in order to avoid potential bodily harm and liability."

Senior management in consultation with the conservation scientists and facilities managers determines that (1) erosion (deterioration caused by exposure to the environment) is a natural part of the normal geologic cycle and was reasonably expected to occur, and (2) temporary braces and steel under-girding currently in-place are sufficient for the current year. Senior management plans to restore the balustrade during the next fiscal year.

Evaluation of potential impairment

The erosion is evidence of gradual physical damage – an impairment indicator. Also, the prominence of the event (i.e., coverage by the media and the IG's recommendation) would be evaluated as a potential impairment indicator of significant loss in service utility. However, no impairment loss is recognized because (1) the decline in lost service utility is "normal and ordinary" as it arises from a cyclical act of nature and (2) restoration efforts to cure the damage are planned to begin next fiscal year. Senior management should consider evaluating its depreciation policies and methods to reflect the adverse effect of the acid rain on buildings and monuments made of limestone and marble.

¹⁵ FASAB Illustration 2a adapted from: Department of the Interior, *Acid Rain in Washington*, <http://pubs.usgs.gov/gip/stones/acid-rain.html>.

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Illustration 2b**Restoration Approach - Permanent Declines in Service Utility: *Physical Damage to a Multi-use Heritage Asset*****Assumptions**

A fire recently destroyed a 3-story wing addition of an historic building. The building addition housed a visitor welcome center and housed senior administrative offices. The administrative offices comprised approximately 25% of the building's total 80,000 square feet and 100.0% of the 3-story wing.

The Secretary's proposal to the Board of Regents (Regents) requested a minimum of \$4.5 million to restore the 3-story administrative wing. The Regents questioned the reasonableness of the cost estimate noting that typical office building construction in the metropolitan area costs about \$160.00 per square foot (psf). The Secretary advised that the \$160.00 psf estimate was not appropriate to use because it represented a "replacement" estimate using today's current labor, materials, standards and methods and not a "restoration" estimate that required using curatorial and conservation methods to preserve the historic nature and value of the multi-use heritage asset.

As an example, the Secretary noted the limited supply of the red Seneca sandstone used to construct the building in the 19th century and the added wing in the 20th century. The local quarry could only supply sufficient quantities to restore one level. As a result, complete restoration could not begin until a second quarry could be located to supply the additional quantities. Furthermore, experienced masons would have to be used for the restoration effort.

As a result of this information, the Board of Regents modified the Secretary's request to restore one level of the wing noting that subsequent levels may or may not be restored in the future. Displaced staff were moved to nearby vacant office space.

Evaluation of potential impairment

The destruction of the 3-story wing is evidence of physical damage – an impairment indicator. Also, the magnitude of the event (i.e., loss of senior administrative office space) would be evaluated as a significant decline in service utility. Because the Board of Regents provided for partial restoration (one level) of the multi-use heritage asset, the lost service utility of the other two levels of the administrative wing is deemed permanent. As a result, because the lost service utility from these two levels will not be restored, any resultant impairment loss, if material, is recognized.

Measurement of potential impairment

Facilities managers and reconstruction specialists have estimated that (1) the total remediation of the 3 story wing would cost \$4.5 million and (2) restoring the first level

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would cost \$2.0 million. As recorded in the entity’s asset management system, the estimated plant replacement value (PRV) of the wing is \$20 million. The net book value of the administrative portion of the building prior to the fire damage was \$1.75 million. In accordance with the Restoration Approach, the following estimates and calculations were presented to senior management:

Calculate estimated cost to restore lost service utility:

Total restoration cost (all 3 levels)	\$4,500,000
Less: portion to be restored (first level)	2,000,000
Cost to restore lost service utility (2nd and 3rd levels)	<u>\$2,500,000</u>

Calculate percentage of restored lost service utility in current dollars:

Cost to restore lost service utility of the 2nd and 3rd levels of the wing (estimate of lost service utility in current dollars)	\$2,500,000
Plant Replacement Value of wing (estimate to restore entire wing in current dollars)	<u>20,000,000</u>
Restoration cost percentage	12.5%

Calculate potential impairment loss:

Net Book Value (historical cost of wing)	\$1,750,000
Multiplied by: Restoration cost percentage	<u>12.5%</u>
Potential impairment loss	<u>\$218,750</u>

Reporting

If material, the potential impairment loss of \$218,750 and corresponding reduction of the book value of the building would be reported.

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Illustration 3a**Service Units Approach - Recoverable Service Utility: Technological Development or Evidence of Obsolescence -Underutilized Magnetic Resonance Imaging Machine¹⁶****Assumptions**

In 2010, a 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 2013, an affiliated entity transferred an “open” MRI system to the hospital. The transferred 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 six images per day; a decrease to 60 percent of prior levels. Furthermore, the expenses associated with the continued operation and maintenance (O&M) of the “closed” MRI system continue to be incurred and senior management is evaluating the asset’s continued service use and whether or not to book an impairment loss.

Upon inspection of the “closed” MRI system and closer examination of the related O&M costs, hospital administrators have determined that it is cost beneficial to keep the system operational and that there is no impairment loss. They estimate that the system can be expected to last at least 3 years longer than originally estimated and achieve its expected service output. Furthermore, hospital administrators contend that a significant portion of the costs are (1) considered “sunk” due to the fixed-price nature of the long-term maintenance contracts and (2) fixed inasmuch as they will be incurred regardless of the closed MRI system’s operating levels.

Evaluation of potential impairment

Senior management initially identified that the change in technology was an indicator of potential impairment because it had resulted in a permanent reduction in the usage of the “closed” MRI system. Also, they believed that the magnitude test (i.e., decline in service utility relative to operating costs) had also 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 60 percent of prior levels. However, senior management has concluded that there is no potential impairment loss because the asset can achieve its

¹⁶ Illustrations 3a and 3b adapted from: GASB 42, Illustration 4, *Technological Development or Evidence of Obsolescence -Underutilized Magnetic Resonance Imaging Machine*.

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expected service output by being kept in service 3 years longer than originally planned. Using the service units approach, senior management determines the followings:

Measurement of potential impairment

Calculate Net Book Value:

a Acquisition cost, 2010	\$2,250,000
Accumulated depreciation, 2013 (3 / 7 years)	<u>964,286</u>
b Net Book Value, 2013	<u>\$1,285,714</u>

Calculate Acquisition cost per service unit:

a Acquisition cost, 2010	\$2,250,000
Originally expected service units (7 years × 52 weeks c per year × 5 days per week × 10 uses per day)	<u>18,200</u>
d Acquisition cost per service unit (a divided by c)	\$124.00

Calculate Remaining Number of Service Units & Related Costs to be recovered:

d Acquisition cost per service unit (a divided by c)	\$124.00
Remaining number of service units = (4 years plus 3 e extended years × 52 weeks per year × 5 days per week × 6 uses per day)	<u>10,920</u>
f Remaining service costs to be recovered (d multiplied by e)	<u>\$1,354,080</u>

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Calculate Potential Impairment Loss:

Net Book Value, 2013 (b)	<u>\$1,285,714</u>
Remaining service costs to be recovered (f)	<u>\$1,354,080</u>
Potential impairment loss (b minus f)	<u>N/A</u>

Reporting

Although there is no potential impairment loss to consider or report because the remaining service costs to be recovered is greater than the PP&E's net book value, management should consider re-evaluating its depreciation policies and methods to reflect the additional 3 years of extended service.

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Illustration 3b

Service Units Approach - Non-recoverable Service Utility: Technological Development or Evidence of Obsolescence -*Underutilized Magnetic Resonance Imaging Machine*

Assumptions

In 2010, a 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 2013, an affiliated entity transferred an “open” MRI system to the hospital. The transferred 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; decrease to 10 percent of prior levels. Furthermore, the expenses associated with the continued operation and maintenance of the “closed” MRI system continue to be incurred and has drawn senior management’s attention to evaluate the asset’s continued service use.

Evaluation of potential impairment

The indicator of potential impairment is the change in technology, which has resulted in a permanent reduction in the usage of the “closed” MRI system. The magnitude test (i.e., decline in service utility relative to operating costs) has also 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. Potential impairment loss using the service units approach would be determined as follows:

Measurement of potential impairment

Calculate Net Book Value:

a Acquisition cost, 2010	\$2,250,000
Accumulated depreciation, 2013 (3 / 7 years)	<u>964,286</u>
b Net Book Value, 2013	<u>\$1,285,714</u>

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Calculate Acquisition cost per service unit:

a Acquisition cost, 2010	\$2,250,000
Originally expected service units (7 years × 52 weeks c per year × 5 days per week × 10 uses per day)	<u>18,200</u>
d Acquisition cost per service unit (a divided by c)	\$124.00

Calculate Remaining Number of Service Units & Related Costs to be recovered:

d Acquisition cost per service unit (a divided by c)	\$124.00
Remaining service number of units = (4 years × 52 weeks e per year × 5 days per week × 1 use per day)	<u>1,040</u>
f Remaining service costs to be recovered (d multiplied by e)	<u>\$128,960</u>

Calculate Potential Impairment Loss:

Net Book Value, 2013 (b)	<u>\$1,285,714</u>
Remaining service costs to be recovered (f)	<u>\$128,960</u>
Potential Impairment loss (b minus f)	<u>\$1,156,754</u>

Reporting

If material, the potential impairment loss of \$1,156,754 and corresponding reduction of the book value of the equipment would be reported.

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Illustration 4a**Deflated Depreciated Current Cost Approach: Change in Manner or Duration of Use – Training Facility Used for Storage¹⁷****Assumptions**

In 2013, senior management decided to close a training facility because enrollments declined due to outsourcing initiatives brought about as a result of Office of Management and Budget (OMB) Circular No. A-76, "Performance of Commercial Activities." The closed training facility has been converted to use as a storage warehouse.

This training facility was constructed in 2001 at a cost of \$10 million. The estimated useful life of the facility is fifty years. Entity senior management has (1) no evidence that enrollments will increase in the future such that the building would be reopened for use as a training facility and (2) concerns with the significantly high operating costs – maintenance and repair, depreciation, insurance, utilities, security, etc.

Because no physical damage occurred that would require detailed cost repair estimates, senior management decides to use the deflated-depreciated replacement cost approach to measure the potential impairment loss. Facilities managers have been able to readily identify current plant replacement value for a comparable warehouse of the same size as \$4.2 million and commercial construction indices of 100 and 150 for years 2001 and 2013, respectively.

Evaluation of potential impairment

Impairment is indicated because the manner of use of the training facility has changed from training students to storage. The situation passes the magnitude test (i.e., decline in service utility relative to operating costs) because the ongoing costs of the training facility would likely be considered high in relation to the benefit it is providing - storage.

¹⁷ Illustrations 4a and 4b adapted from: GASB 42, Illustration 5, *Change in Manner or Duration of Use – School Used for Storage*.

Measurement of potential impairment

Calculate Net Book Value:

Potential impairment loss using the deflated depreciated replacement cost approach would be determined as follows:

Historical cost, 2001	\$10,000,000
Accumulated depreciation (12 / 50 years)	<u>2,400,000</u>
a Net Book Value, 2013	<u>\$7,600,000</u>

Calculate Depreciated replacement cost (current dollars):

Replacement cost of warehouse, 2013	\$4,200,000
Accumulated depreciation (12 / 50 years)	<u>1,008,000</u>
b Depreciated replacement cost (current dollars)	<u>\$3,192,000</u>

Calculate Deflation factor:

c Commercial construction index, 2001	100
d Commercial construction index, 2013	<u>150</u>
e Deflation factor (c divided by d)	<u>0.67</u>

Apply deflation factor to depreciated replacement cost (current dollars):

b Depreciated replacement cost (current dollars)	\$3,192,000
e Deflation factor (c divided by d)	<u>0.67</u>
f Deflated depreciated replacement cost (b × e)	<u>\$2,128,640</u>

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Calculate Potential impairment loss:

a Net Book Value, 2013	\$7,600,000
f Deflated depreciated replacement cost (b × e)	<u>2,128,640</u>
Potential impairment loss (a - f)	<u>\$5,471,360</u>

Reporting

If material, the potential impairment loss of \$5,471,360 and corresponding reduction of the book value of the facility would be reported.

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Illustration 4b**Deflated Depreciated Replacement Cost Approach: Change in Manner or Duration of Use – *Training Facility Used for Storage*****Assumptions**

Same as illustration 4a except that senior management is not concerned with the facility's operating costs – maintenance and repair, depreciation, insurance, utilities, security, etc., because they are considered to be low relative to the storage benefits received.

Evaluation of potential impairment

Although impairment is indicated because the manner of use of the training facility has changed from training students to storage, because the situation does not pass the magnitude test, no test for potential impairment is required. However, senior management should consider adjusting the facility's depreciation method, useful life and/or salvage value estimates.

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Illustration 5**Construction Stoppage—Special Purpose Test Equipment ¹⁸****Assumptions**

In 2012, in response to a Congressional order canceling a major program, senior management stopped all construction activities related to the fabrication of program-related special purpose test equipment. The entity conducts numerous design and build projects for military and scientific all of which have potential commercial application. The entity's program manager advised senior management that the special purpose test equipment was substantially complete at the time of stoppage and could be considered available for commercial use. The entity had accumulated costs totaling \$10 million and was approximately 75 percent complete with the project.

Upon further inquiry, senior management determined that despite initial interest from two commercial firms, early in 2012, one of them filed for bankruptcy and the other withdrew its interest citing that the costs-to-complete are too high. There is no evidence to demonstrate that the construction stoppage is temporary or that other potential commercial interests can be found. Also, the program manager advises that there is no potential government use for this asset and that it should be disposed.

Evaluation of potential impairment

The indicator of impairment is the construction stoppage. It appears to meet the test of impairment in that senior management would not have initiated the project if it had expected either program cancellation or lack of any potential commercial use. The situation passes the magnitude test because the costs-to-date (75% or \$7.5 million) are significant in both percentage and monetary terms. However, there is no potential impairment loss to report because the asset is totally impaired as it has no commercial or government use and cannot provide service,. As such, the requirements in SFFAS 6 at paragraph 38 should be followed. Specifically, in the period of disposal accumulated costs should be removed from the asset accounts and any difference between the book value of the equipment and amounts realized shall be recognized as a gain or a loss.

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¹⁸ Illustrations 5 adapted from: GASB 42, Illustration 9, *Construction Stoppage—Airport Pavements*.

Illustration 6a**Contract Termination - *Transferable Equipment Technology*****Assumptions**

In 2012 the entity's chief contracting officer pursuant to the Federal Acquisition Regulations terminated a contract for convenience. The entity experienced substantial cost increases, schedule delays, and performance shortfalls. The terminated contract was to build the entity's next-generation surveillance equipment capable of covertly operating in adverse weather conditions. Despite several cure notices, the entity terminated the contract for default. The contractor has stated that it will not protest the termination. At the time of termination, the entity incurred over \$150 million in contract costs.

In the meantime, the program manager determined that the operating environment had changed and that remaining funds would be better spent on other priorities and was able to transfer the system technology to other entity projects. The manner and use of the systems are not expected to change.

Evaluation of potential impairment

The indicator of impairment is the contract termination. It appears to meet the test of potential impairment because the event is significant and the termination decision will not be protested; i.e., permanent. However, because the entity was able to transfer the system technology to other entity projects, no impairment loss exists.

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Illustration 6b**Contract Termination - *Partially-Transferable Equipment Technology*****Assumptions**

Same as Illustration 6a except that the program manager was unable to transfer the entire system technology to other entity projects. After an inspection and engineering review, it was determined that 70.0% of hardware and software could be transferred to existing projects. There is no potential use or application for the remaining 30.0% of equipment technology.

Evaluation of potential impairment

The indicator of impairment is the contract termination. It appears to meet the test of potential impairment because the termination decision is a significant event and is considered permanent because the decision will not be protested. As a result of the entity being unable to transfer the entire system technology to other entity projects, an impairment loss exists.

Measurement of potential impairment

Because 30.0 of the system technology cannot be transferred to other entity projects a potential impairment loss of \$45 million exists (30.0% X \$150 million).

Reporting

If material, the potential impairment loss of \$45 million and corresponding reduction of the book value of the equipment would be reported.

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Illustration 7a**Undiscounted Cash flow approach – Grouped Assets****Assumptions**

An entity manages and operates a shared-services center on a post-wide basis. The entity groups the individual services separately into two distinct categories rather than on an individual basis.

In December 20X1, the entity's senior management decided to implement a public-private strategic initiative that could eventually over several years transition these shared-services operations to private ownership. Both national and local private interests have asked their respective political representatives to accelerate the entity's implementation time-table and influence a favorable outcome. As a result, senior management was directed to (1) immediately estimate the amount that could be recovered from selling the operations and (2) identify to the lowest level identifiable, operating information to include cash flows for each category.

As a result of complying with this directive and evaluating the resultant financial information and appraisal analysis, senior management became concerned that its assets might be impaired and adversely impact its public-private strategic initiative.

Evaluation of potential impairment

If an impairment indicator exists an impairment analysis should be performed. In this case, the entity's public-private initiative includes a significant change in the manner or extent in which the assets will be used. This represents an impairment indicator that would trigger an impairment analysis.

Senior management is concerned that the presence of an impairment indicator might affect its plan regarding the future use of the shared-services if the analysis indicates that the net book value of the assets are not recoverable. According to the undiscounted cash flow approach, the entity will need to estimate the future undiscounted cash flows expected to result from the use of the assets and their eventual disposition. The future cash flows are the expected cash inflows to be generated by the asset net of any expected future cash outflows that are needed to produce the inflows.

Measurement of potential impairment

This approach requires that an entity recognize an impairment loss if (1) the undiscounted cash flows are less than the net book value of the assets (the net book value is not recoverable) and (2) the net book value exceeds the higher of the assets

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1 net realizable value¹⁹ or value-in-use estimate²⁰. A potential impairment loss would be
 2 measured as the amount by which the net book value of the grouped assets exceed the
 3 higher of their net realizable value or value-in-use estimate(s).

4
 5 When identifying cash flows, assets should be grouped at the lowest level for which
 6 there are identifiable cash flows that are largely independent of the cash flows of other
 7 groups of assets.

8
 9 **Calculate Net book value:**

Net book value:	<u>Asset Group:</u> <u>Administrative</u>	<u>Asset Group:</u> <u>Information</u> <u>Technology</u>
Assets' net book values at 12/31/X1	<u>\$12,000,000</u>	<u>\$11,000,000</u>
(a)	(a)	(a)

11

¹⁹ Net realizable value is the estimated amount that can be recovered from selling, or any other method of disposing of an item less estimated costs of completion, holding and disposal. Source: FASAB Glossary, Appendix E.

²⁰ Statement of Federal Financial Accounting Concepts (SFFAC 7), *Measurement of the Elements of Accrual-Basis Financial Statements* at paragraph 50 defines value-in-use as "...the benefit to be obtained by an entity from the continuing use of an asset and from its disposal at the end of its useful life." Paragraph 51 further states that, "Value in use is a remeasured amount for assets used to provide services. It can be measured at the present value of future cash flows that the entity expects to derive from the asset, including cash flows from use of the asset and eventual disposition. Value in use is entity specific and differs from fair value. Fair value is intended to be an objective estimate of the amount of an asset exchanged between willing parties that also is applicable to similar exchanges between other parties. Value in use is an entity's subjective assessment of the value to the entity of an asset that it owns. Thus, value in use is useful in assessing the financial position and operating results of that entity, but because the amount is entity specific, it may not be comparable when making assessments of other entities." (underscoring added for emphasis)

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1 Calculate undiscounted cash flows:

Undiscounted cash flows:	Asset Group: <u>Administrative</u>	Asset Group: <u>Information Technology</u>
Undiscounted cash flows from future operations	\$12,000,000	\$9,000,000
Undiscounted cash flows from disposal of assets	2,000,000	1,000,000
Total - undiscounted cash flows (b)	\$14,000,000 (b)	\$10,000,000 (b)

2

3 Calculate Recoverability:

Recoverability: (b minus a)	Asset Group: <u>Administrative</u>	Asset Group: <u>Information Technology</u>
Total - undiscounted cash flows (b)	\$14,000,000	\$10,000,000
Assets' net book values at 12/31/X1 (a)	<u>12,000,000</u>	<u>11,000,000</u>
Recoverability (b minus a)	\$2,000,000	\$(1,000,000)
Is Net book value Recoverable?	Yes	No
Is asset subject to potential impairment?	No	Yes

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1 Calculate potential impairment:

Potential impairment:	<u>Asset Group: Administrative</u>	<u>Asset Group: Information Technology</u>
Net Realizable Value of assets at 12/31/X1	N/A	\$ 8,000,000
Less: Assets' net book values at 12/31/X1	N/A	<u>\$11,000,000</u>
Excess of net book value over Net Realizable Value	N/A	\$3,000,000
Potential impairment loss	N/A	<u>\$3,000,000</u>

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Reporting

The potential impairment loss of \$3.0 million would be reported if the amount is material to the reporting entity's financial statement. The asset group's new cost basis becomes \$8,000,000.

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Illustration 7b**Undiscounted Cash flow approach – Equipment: Technological Development or Evidence of Obsolescence - *Underutilized Magnetic Resonance Imaging Machine*²¹****Assumptions**

In 2009, a hospital operating in a major metropolitan area purchased a magnetic resonance imaging (MRI) system at a cost of \$2.25 million to be used exclusively for non-service connected procedures. The hospital, which charges fees for non-service connected care 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 2012, the manufacturer introduced an “open” MRI system that was advertised as being more comfortable for patients and provided a superior image. Furthermore, the expenses associated with the continued operation and maintenance of the “closed” MRI system continue to be incurred and has drawn senior management’s attention to evaluate the asset’s continued service use. Because similar used MRI machines in the open market can be purchased from authorized dealers for \$750,000 (their mark-up percentages are unknown), senior management is considering the possibility of selling the old machine and using its proceeds to help purchase the “open” MRI system.

Hospital administrators and technicians believe that the “closed” system can continue being used for at least 3 years beyond the originally estimated service life. Also, they believe that the “open” system provides for only marginal benefits that do not exceed their cost. However, senior management decides to sell the “closed” system and use the proceeds for much needed research equipment. They believe that the \$750,000 open market price is a reasonable estimate for the asset’s net realizable value.

Evaluation of potential impairment

The indicator of potential impairment is the change in technology. The magnitude test has also been met due to the fact that the cost of operating the “closed” MRI system has drawn senior management’s attention to evaluate the asset’s continued service use. Potential impairment loss using the undiscounted cash flow approach would be determined as follows:

²¹ Illustration 7b adapted from: GASB 42, Illustration 4, *Technological Development or Evidence of Obsolescence -Underutilized Magnetic Resonance Imaging Machine*.

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Measurement of potential impairment

Calculate Net Book Value:

a	Acquisition cost, 2009	\$2,250,000
	Accumulated depreciation, 2012 (3 / 7 years)	<u>964,286</u>
b	Net Book Value, 2012	<u>\$1,285,714</u>

Calculate undiscounted cash flows:

c	Average service fee per use	\$20.00
	Remaining service units (4 years plus 3 extra years × 52 weeks per year × 5 days per week × 10 use per day)	<u>18,200</u>
e	Undiscounted cash flows (c multiplied by d)	<u>\$364,000</u>

Calculate Recoverability: (b minus a)

	<u>MRI</u>
Total - undiscounted cash flows (e)	\$364,000
Assets' net book values at 9/30/12 (b)	<u>\$1,285,714</u>
Recoverability (e minus b)	\$(921,714)
Is Net book value Recoverable?	No
Is asset subject to potential impairment?	Yes

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1 **Calculate Potential Impairment Loss:**

2 An impairment loss should be recognized only if the net book value of the G-PP&E (1) is
 3 not recoverable and (2) exceeds the higher of its net realizable value or value-in-use
 4 estimate. Because management believes that the open market price of \$750,000 is a
 5 reasonable estimate of the asset's net realizable value, it is compared to the asset's
 6 value-in-use estimate to determine which amount is higher. However, because the
 7 \$364,000 undiscounted cash flows amount (prior to calculating the net present value to
 8 determine a value-in-use estimate) is lower than net realizable value amount of
 9 \$750,000, there is no need to present value the cash flows to calculate a value-in-use
 10 estimate.

11
 12 Because senior management has decided to sell the "closed" system, the net realizable
 13 value estimate is used as the "recoverable basis". Had the net realizable value estimate
 14 been unavailable to management, a value-in-use estimate (net present value of the
 15 future cash flows) could have been used as the "recoverable basis".
 16

	<u>MRI</u>
Net Realizable value of asset	\$750,000
Less: Assets' net book value	<u>\$1,285,714</u>
Excess of net book value over fair value	\$ (535,714)
Potential impairment loss	\$ (535,714)

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19 **Reporting**

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21 If material, the potential impairment loss of \$535,714 and corresponding reduction of the
 22 book value of the equipment would be reported.
 23

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Illustration 7c**Undiscounted Cash flow approach – Facility: Changes in manner or duration of use - Government owned-contractor operated (GOCO) manufacturing facility²²****Assumptions**

An entity operates a Government owned-contractor operated (GOCO) manufacturing facility in an economically depressed area fabricating various commodities with commercial applicability. The facility's current net book value is \$22,500,000 with an estimated salvage value of \$5,000,000 and has a 25 year remaining useful life. Under the terms of the contract, the government provides the contractor with exclusive use of the facility in exchange for negotiated lease payments in the amount of \$150,000 per year. The contractor is responsible for all maintenance and operating costs.

Recently this unique partnership has come under federal and state scrutiny as many legislators and environmentalists have expressed concerns that the contractor whose operations have caused contamination found in and around the facility is not being held financially responsible for the cleanup costs.

Outrage which has surfaced during congressional hearings on environmental cleanups has become the focus of print and cable-news outlets.

Further complicating senior management's "crisis response" is that (1) the contract effectively prohibits modifying the facility to achieve greater environmental compliance without legislative relief and (2) the contracting officer has initiated debarment procedures that effectively would shut down the facility in 90-days for an indeterminable amount of time.

Facilities managers and engineers believe that a prospective buyer can be found but that it will take significant time to pass all necessary sale requirements. Until then, they advise that the facility can be quickly reconfigured and partitioned into commercially viable long-term storage space. The required modifications would cost \$500,000 and lease agreements are estimated to generate approximately \$35,000 in annual revenues. A fairly recent analysis completed 9 months ago reveals that the property's net realizable value (NRV) was at that time, \$30,000,000; 20% of which is attributable to land.

Senior management has approved the reconfiguration and partition plan and believes that it will take a minimum of 5 years before all approvals are in place and disposal efforts can begin and an additional 2 years to ultimately dispose of the property.

²² Illustration 7c adapted from: Military law Review, Volume 131 Winter 1991 - Government Owned – Contractor Operated Munitions Facilities: Are they appropriate in the age of strict environmental compliance and liability? Major Mark J. Connor

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1 Because senior management is concerned with the proper financial reporting of this
 2 event, it has asked its comptroller for advice.

3

4 **Evaluation of potential impairment**

5

6 The indicator of potential impairment is the change in manner of use. The magnitude
 7 test has also been met due to (1) federal and state scrutiny, (2) media coverage, and (3)
 8 the fact that the cost of operating the facility has drawn senior management's attention
 9 to evaluate the asset's continued service use and seek the comptroller's advice.

10 Because the entity is seeking appropriate approvals to commence disposal efforts and
 11 does not know when such permission will be granted, senior management intends to
 12 convert a portion of the facility for public storage; a change in the manner of use.

13

14 **Measurement of potential impairment**

15

16 **Calculate Net book value:**

17

Calculate Net book value:	<u>Facility</u>
Assets' net book value at 12/31/X1 (a) (excluding land)	\$22,500,000 (a)

18

19

20

Calculate undiscounted cash flows:

Calculate undiscounted cash flows:	<u>Facility</u>
Required modifications (outflow)	(\$500,000)
Undiscounted cash in-flows from future rental lease payments (7 x \$35K)	\$245,000
Undiscounted cash in-flows from disposal of assets (1.0 -0.2 X \$30Mil)	24,000,000
Total - undiscounted cash flows (b)	\$23,745,000 (b)

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Calculate Recoverability: (b minus a)

Calculate Recoverability: (b minus a)	<u>Facility</u>
Total - undiscounted cash flows (b)	\$23,745,000
Assets' net book values at 12/31/X1 (a)	<u>22,500,000</u>
Recoverability (b minus a)	\$1,245,000
Is Net book value Recoverable?	Yes
Is asset subject to potential impairment?	No

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Illustration 7d

Undiscounted Cash flow approach – Facility: Changes in manner or duration of use - Government owned-contractor operated (GOCO) manufacturing facility²³

Assumptions

Same facts as Illustration 7c above except that (1) senior management has decided to reconfigure the facility and lease available storage space for the remaining life of the facility, and (2) the net realizable value estimate is \$2 million. Furthermore, because senior management does not believe that a prospective buyer can be found it decides not to seek disposal authority. The entity’s comptroller advises senior management that to assess whether or not a potential impairment exists a value-in-use estimate would be appropriate to use because it is higher than the net realizable value estimate. A risk-free discount rate of 3.00% is used.

Evaluation of potential impairment

In this case the entity should use the undiscounted cash flows to estimate its recoverable value and not the NRV estimate. In so doing, a potential impairment loss is realized. Calculations follow:

Calculate cash flows:

Calculate undiscounted cash flows:	<u>Undiscounted</u>	<u>PV Factor</u>	<u>Discounted</u>
Required modifications (outflow)	(\$500,000)	1.00	(\$500,000)
Undiscounted cash inflows from future rental lease payments (25 x \$35K)	\$875,000	17.41315	\$609,460
Undiscounted cash inflows from disposal of assets)	5,000,000	0.47761	\$2,388,050
Total - cash flows (b)	\$5,375,000 (b)		\$2,497,510

²³ Adapted from: Military law Review, Volume 131 Winter 1991 - Government Owned – Contractor Operated Munitions Facilities: Are they appropriate in the age of strict environmental compliance and liability? Major Mark J. Connor

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Calculate Recoverability: (b minus a)

Recoverability: (b minus a)	<u>Facility</u>
Total - undiscounted cash flows (b)	\$5,375,000
Assets' net book values at 12/31/X1 (a)	<u>22,500,000</u>
Recoverability (b minus a)	(\$17,125,000)
Is Net book value Recoverable?	No
Is asset subject to potential impairment?	Yes

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Calculate potential impairment:

Potential impairment:	<u>Facility</u>
Value in Use - Discounted cash flows	\$2,497,510
Less: Assets' net book value at 12/31/X1	<u>\$22,500,000</u>
Excess of recoverable value over net book value	\$20,002,490
Potential impairment loss	\$20,002,490

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Reporting

If material, the potential impairment loss of \$20,002,490 and corresponding reduction of the book value of the facility would be reported.

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1 Appendix C: Abbreviations

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1 Appendix D: Glossary

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Page 12: [1] Comment **Domenic Savini** **8/10/2011 6:52 PM**

As per 22 June Board meeting. W. Jackson.

Edit made to address the concern that the proposed standard could be misinterpreted or construed to mean that the Board is creating an expectation that management should have processes in place that would divert attention from material to immaterial issues; e.g., F/A 18's vs. M16 rifles.

Staff Notes: Generally, the Board avoids discussing materiality within the standards. However, staff proposes that we add the last sentence and include such a reference so that we are clear as to Board intent.

Page 14: [2] Deleted **Domenic Nicholas Savini** **8/10/2011 2:05 PM**

c. **The decline in service utility is often unexpected.**¹ The replacement or restoration cost or other impairment circumstance is not a part of the normal life cycle (e.g., outside of standard maintenance and repair requirements) of the PP&E. In some cases, management may not be able to foresee with precision the useful life of a PP&E or the service utility throughout its useful life. However, in such cases there may be a reasonable range of expectations about the service utility and useful life at the time of acquisition. In other instances, management may possess service life estimates that when adjusted for actual PP&E assessment results reveal that service life has been unexpectedly reduced.

Page 14: [3] Comment **Domenic Savini** **8/10/2011 1:44 PM**

As per 22 June Board meeting. D. Bond and T. Allen.

Edit made to address concern that when competing methods are in-play, management should exercise judgment in selecting the one method that is most efficient and practical to use given the circumstances.

Page 14: [4] Comment **Domenic Savini** **8/10/2011 1:44 PM**

As per 22 June Board meeting. S. Showalter and T. Allen.

Edit made to recognize that “other acceptable methods” may exist for management’s use and FASAB lists those which it believes to be widely recognized.

Page 5: [5] Deleted **Domenic Nicholas Savini** **7/20/2011 2:32 PM**

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¹ Technological changes or obsolescence is not always unexpected and as previously noted, when obsolescence is not unexpected, PP&E that are subject to obsolescence can be addressed through depreciation.