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May 30, 2012

Ms. Wendy M. Payne
Executive Director
Federal Accounting Standards Advisory Board (FASAB)
441 G Street, NW, Suite 6814
Mailstop 6K17V
Washington, DC 20548

Dear Ms. Payne:

We appreciate the opportunity to respond to the proposed Statement of Federal Financial Accounting Standards, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use* – the exposure draft (ED). We support the Board's efforts to improve federal financial reporting of general property, plant, and equipment (G-PP&E) by establishing accounting and financial reporting standards for impairment of G-PP&E remaining in use and providing guidance on possible measurement methods.

In the remainder of this letter we provide our responses to the questions posed in the ED and other comments. Where applicable, proposed language revisions have been provided with added text <u>underscored</u> and deleted text ~~struck through~~.

1. The Board proposes to establish a requirement to recognize impairment losses when there is a significant and permanent decline, whether gradual or sudden, in the service utility of G-PP&E. Refer to paragraphs 8 and 10 of the proposed standards and paragraphs A3 through A5 in Appendix A - Basis for Conclusions for a discussion and related explanation. Do you agree or disagree with the Board's proposal to recognize impairment losses when there is a significant and permanent decline, whether gradual or sudden, in the service utility of G-PP&E? Please provide the rationale for your answer.

   <u>KPMG Response</u>: We agree with the Board's proposal to recognize impairment losses when there is a significant and permanent decline. However, the Board's inclusion in paragraph 8 of a significant and permanent gradual decline in the service utility of an asset as an impairment is not clear. We believe the term "gradual" means that service utility is declining in small degrees over a period of time and such a decline would be more appropriately accounted for through depreciation expense. If the event that caused the decline could not be reasonably expected at the time the asset's useful life was estimated, the federal entity would revise its estimate in accordance with Statement of Federal Financial Accounting Standards No. 6, *Accounting for Property, Plant, and Equipment* (SFFAS No. 6) rather than this ED. Paragraph 35 of SFFAS No. 6 states "Any changes in estimated useful life or salvage/residual value shall be treated prospectively. The change shall be accounted for in the period of the change and future periods. No adjustments shall be made to previously recorded depreciation or amortization". We recommend deleting the term "gradual" from the ED to avoid confusion with the depreciation concept.

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2. The Board proposes that this Statement should not require entities to review their G-PP&E portfolios solely for potential impairments. Entities are not expected to alter existing assessment methods as a direct consequence of the proposed standards. Refer to paragraphs 7, 13, and 14 of the proposed standards and paragraphs A3b, and A4 through A9 in Appendix A - Basis for Conclusions for a discussion and related explanation. Do you agree or disagree with the Board's proposal that this Statement should not require entities to review their G-PP&E portfolios solely for potential impairments? Please provide the rationale for your answer.

   KPMG Response: While we agree that entities do not need to review their G-PP&E portfolios solely for potential impairments, we believe it is not possible to determine the extent of additional procedures federal entities would need to comply with this ED, if any, without first understanding the controls and procedures that are currently in place. We believe that the discussion in paragraph 14 about possible existence of management processes provides appropriate guidance for federal entities' management as they assess and determine the sufficiency of controls over this aspect of financial reporting. We recommend deleting the proposed language in paragraphs 7, 13, and A4 from the ED.

3. The Board has identified the following as indicators of G-PP&E impairments: evidence of physical damage, enactment or approval of laws or regulations which limit or restrict G-PP&E usage, changes in environmental or economic factors, technological changes or evidence of obsolescence, changes in the manner or duration of use of G-PP&E, and construction stoppage or contract termination, and G-PP&E scheduled or awaiting disposal (i.e., idled or unserviceable), retirement, or removal for excessively long periods. Refer to paragraph 12 of the proposed standards and paragraphs A4 through A9 and A11 through A16 in Appendix A - Basis for Conclusions for a discussion and related explanation. Do you agree or disagree with each of the indicators of G-PP&E impairment? Please provide the rationale for your answer.

   KPMG Response: We generally agree with the indicators provided. However, paragraph 12.g states that "G-PP&E scheduled or awaiting disposal (i.e., idled or unserviceable), retirement, or removal for excessively long periods" would be an indicator of impairment. While we agree this would indicate a decline in service utility that could be significant and deemed permanent, this indicator implies that these assets no longer provide service to the entity's operation. We believe these instances would be accounted for and reported in accordance with SFFAS No. 6 and Federal Financial Accounting Technical Release No. 14, *Implementation Guidance on the Accounting for the Disposal of G-PP&E* (TR No.14). We recommend deleting item "g" from the list of indicators.

4. The Board believes that impairment losses should be estimated using a measurement method that reasonably reflects the diminished or lost service utility of the G-PP&E. The Board has identified the following methods for use in the federal environment to measure diminished service utility: replacement approach; restoration approach; service units approach; deflated depreciated current cost approach; cash flow approach; and for construction stoppages/contract terminations the lower of (1) net book value or (2) the higher of its net realizable value or value-in-use estimate approach. Refer to paragraph 17 of the proposed standards and paragraphs A11 through A19 in Appendix A - Basis for Conclusions for a discussion and related explanation. Do you agree or disagree that the measurement method selected should reasonably reflect the diminished service utility of the G-PP&E? Do you

agree or disagree with the use of the measurement methods identified? Please provide the rationale for your answer.

KPMG Response: We generally agree with the ED. However, we have the following comments:

- We recommend the following change to the second sentence of paragraph 17 to be consistent with the remainder of the paragraph and with Statement of Federal Financial Accounting Concepts No. 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording*:

  "Impairment losses on G-PP&E that will continue to be used by the entity should be estimated using a measurement method that reasonably reflects the diminished service utility of the G-PP&E. The goal of the measurement ~~approaches~~methods….."

- The measurement method described in paragraph 17.f does not appear to be different from the measurement method described in paragraph 17.e. Both methods consider the recoverability of the net book value of the asset and recognize that the recorded value of the asset should ultimately be the lower of the net book value or, the net realizable value or value-in-estimate, whichever is higher. We recommend the following changes to paragraphs 17.e and 17.f, taking into consideration the need to make similar changes to the remainder of the ED, as appropriate:

  "**e. Cash flow approach**. Impairment of cash or revenue generating G-PP&E, such as those used for business or proprietary-type activities, may be assessed using a cash flow approach. Under this approach, an impairment loss should be recognized only if the net book value of the GPP&E (1) is not recoverable and (2) exceeds the higher of its net realizable value or value-in-use estimate. 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. If the net book value is not recoverable, the impairment loss is 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. This measurement method can also be used when PP&E that is expected to provide service in the future is impaired from either construction stoppages or contract terminations.

  ~~**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 (1) the G-PP&E's net book value or (2) 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.~~"

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5. The Board believes that the benefits of implementing this Statement outweigh its administrative costs of implementation. Benefits include: specific impairment guidance for federal G-PP&E, eliminating the need to rely on other accounting literature to determine appropriate treatment, reporting impairments when they occur rather than through depreciation expense or disposal, providing management with information useful for decisions regarding G-PP&E investments, discerning the cost of impairments and impact on the entity and the cost of services provided following the impairment, and lastly, enhancing comparability between entities. Refer to paragraph A21 in Appendix A - Basis for Conclusions for a discussion and related explanation.

   (a) Are there other costs or benefits in addition to those identified by the Board that should be considered in determining whether benefits outweigh costs? Please provide the rationale for your answer.

   KPMG Response: We are not aware of other costs or benefits beside those listed above or in the ED.

   (b) Are there G-PP&E categories, classes, or base units to which provisions of this proposed Statement should not apply? Please provide the rationale for your answer.

   KPMG Response: We are not aware of G-PP&E categories, classes, or base units to which provisions of this proposed Statement should not apply.

   (c) Do you agree or disagree that the benefits of implementing this Statement outweigh its costs? Please provide the rationale for your answer.

   KPMG Response: We agree.

Other Comments:

Construction Work in Process:

– Paragraph 3 of the ED indicates that the purpose of this ED is to provide accounting requirements for partial impairment of G-PP&E *remaining in use* (emphasis added). This asserts that the assets within the scope of this ED have already been placed in service. However, the ED's discussion of the impairment caused by construction stoppage implies that the ED is also applicable to construction work in process. There is also an inconsistency between the ED and SFFAS No. 6's definition of G-PP&E. Paragraph 34 of SFFAS No. 6 states "In the case of constructed PP&E, the PP&E shall be recorded as construction work in process until it is placed in service, at which time the balance shall be transferred to general PP&E". We recommend that these inconsistencies in the scope of the ED be clarified.

  If the Board believes construction work in process should be within the scope of this ED, we suggest the following revisions to clarify its applicability to construction work in process, taking into consideration other recommended changes presented in other parts of this letter:

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- Changing the title of the proposed standard as follow:

  "Accounting for Impairment of General Property, Plant, and Equipment <u>and Construction Work in Process</u>~~Remaining in Use~~"

- Adding the following to paragraph 3 to clarify the scope of the ED:

  "This proposed Statement would provide accounting requirements for all **partial impairments** of G-PP&E remaining in use <u>and construction work in process expected to provide service in the future</u>."

- Adding the following to paragraph 8 to clarify the scope of the ED:

  "**Impairment** is a significant and permanent decline, whether gradual or sudden, in the **service utility** of G-PP&E <u>or expected service utility for construction work in process</u>. Entities generally hold G-PP&E because of the services they provide <u>or will provide in the future</u>; consequently, impairments affect the service utility of the G-PP&E <u>and construction in process</u>."

- Adding the following in a new paragraph after paragraph 16:

  "<u>For construction work in process, the testing of impairment discussed in paragraph 16 should be performed over the expected future service utility rather than current service utility.</u>"

Illustrative Examples:

Overall, we found the examples useful. However, to be of most use, the examples should clearly demonstrate the application of the two step processes of impairment identification. To that end, we have the following recommendations in addition to minor editorial suggestions:

- Example 1c. We recommend including the $320,000 accumulated depreciation for the capital improvements in the "Assumptions" section or provide information to support the calculation of this amount.

- Example 2a. We recommend the following change to the second sentence in the second paragraph:

  "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

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brought about by administrative and visitor use of one ~~the~~or more prominent multi-use heritage assets has drawn management's attention."

- Example 2b. We recommend the following change to the first sentence in the first paragraph:

  "A fire recently destroyed a 3-story wing addition of a~~n~~ historic building."

- Example 2b. The last paragraph in the "Assumptions" section implies that the service utility of the other levels could be restored in the future; however, the conclusion is that the wing met the second impairment test that the decline in service utility is expected to be permanent. We recognize that the example indicates that there are no plans to restore these levels and no funds were committed but the facts in the example may be interpreted that the decline could still be temporary because funds could be committed in the future. We recommend adding to the facts the example provided in paragraph 16.b that in similar past instances, management did not restore or replace the decline in service utility.

- Example 3a. It is not clear how the assessment of costs related to the "closed" MRI by the hospital administrator in the last sentence of the third paragraph meets the requirements in paragraph 16.a. We recommend that the cost considerations in illustrative example 3a are clarified consistent with the requirement in paragraph 16.a.

- Example 3a. We recommend the following change in the "Evaluation of potential estimated impairment loss" section to clarify that the asset did not meet the second step in testing impairment:

  "However, the MRI system did not meet Step 2- impairment test ~~management has concluded that there is no potential estimated impairment loss~~ because the asset can achieve its expected service output by being kept in service 3 years longer than originally planned."

- Example 3b. We recommend moving the last sentence in the paragraph under the header "Evaluation of potential estimated impairment loss" that states "Potential estimated impairment loss using the service units approach would be determined as follows:" to be under the header "Measurement of potential estimated impairment loss".

- Examples 4a, 7a, and 7c. It is not clear in the "Evaluation of potential impairment loss" section whether or not the assets met the second step of in testing impairment. We recommend that this is clarified in the examples.

- Examples 5, 6a, and 6b. We recommend aligning the examples based on previous discussion of construction work in process.

- Example 6b. It is not clear if the system technology was a single asset or multiple assets. If multiple assets, we believe that the assets comprising the 30% that will not provide future service would be subject to SFFAS No. 6. If intended as a grouped assets example, please clarify.

- Example 7a. We recommend making the following changes to the first paragraph in the "Evaluation of potential estimated impairment loss" section:

  "~~If an impairment indicator exists an impairment analysis should be performed. In this case, t~~The entity's public-private initiative includes a significant change in the manner or duration ~~extent in which~~ the assets will be used."

- Example 7b. If management decided to sell the asset, how will the asset remain in service? Wouldn't the asset be subject to SFFAS No. 6? We recommend adding clarification or changing the conclusion.

- Example 7d. We recommend removing the header in the table titled "Calculated undiscounted cash flows" because it does not relate to the information below it. We also recommend identifying the source for the present value factor information.

Other Technical and Editorial Comments:

- We recommend that the ED provides guidance on the recognition of asset impairment when the asset is a component of an asset group. This is only mentioned in paragraph 18 and covered by illustrative example 6b but not addressed in detail in the proposed standards.

- The concept introduced in paragraph 8 that the events or changes in circumstances that lead to impairments are not considered normal and ordinary is not included in the two step process discussed later in the ED as a consideration. We recommend the following revision to paragraph 12.a to address such consideration:

  "a. evidence of physical damage~~,~~ that is not considered normal and ordinary,"

- We recommend the following revision to footnote 8 for clarity:

  "Normal and ordinary are defined as events or circumstances that are expected to occur or ordinarily occur within the ~~fall within the expected~~ useful life of the PP&E such as standard maintenance and repair requirements."

- The last two sentences in paragraph 9 provide considerations related to surplus and maximum capacity but because these two terms are not defined, the intended meaning of the two sentences is not clear. We recommend the following:
  - Clarifying the intention of the last two sentences and defining surplus and maximum capacity.
  - Moving paragraph 15 to the end of paragraph 9 because it includes related guidance on the decrease in service utilization.

- The terms "previous service utility" and "the new expected service utility" used in paragraph 16.a need to be defined to clarify the intended meaning of the first sentence. We also suggest clarifying in this paragraph whether the term "cost" refers to cost of operations or cost of remediating the lost service utility. In addition, we recommend the following change:

> "Judgment is required to determine whether the decline is significant. Such judgments may be based on: (1) the relative costs of providing the service before and after the decline, (2) the percentage decline in service utility, or (3) other considerations. The costs associated with previous service utility are significantly greater than the costs that would otherwise be associated with the new expected service utility. Such costs should include operational and maintenance costs. ~~Judgment is required to determine whether the decline is significant. Such judgments may be based on: (1) the relative costs of providing the service before and after the decline, (2) the percentage decline in service utility, or (3) other considerations.~~"

- We recommend the following revision to the third sentence in paragraph 16.b for clarity:

> "In contrast, reasonable expectation may exist when management has (1) specific plans to replace or restore the lost service utility of this G-PP&E, not the function, (2) committed or obligated funding for remediation efforts, or (3) a history of remediating lost service utility in similar cases or for similar G-PP&E."

- We recommend changing the word "capacity" in the title of paragraph 20 to "utility".

- We recommend the following change to paragraph 21 to be consistent with SFFAS No. 6:

> "**G-PP&E That ~~Is~~ No Longer ~~Being Used~~ Provides Service**
> 21. G-PP&E or construction work in process that ~~is~~ no longer ~~being used~~ provides service in the operations of ~~by~~ the entity should be accounted for in accordance with SFFAS 6, paragraphs 38 and 39."

- We recommend referencing TR No.14 in paragraphs 1 and 21.

- The header of paragraph 22 is "Reversing Previously Reported Impairments", however, the discussion in the paragraph addresses subsequent costs incurred to replace or restore the lost service utility and not the reversal of the impairment loss. We recommend the following change for clarity:

> "**Subsequent Replacement or Restoration of Lost Service Utility~~Reversing Previously Reported Impairments~~**
> 22. Subject to the entity's capitalization policies, if an entity later incurs ~~remediates the previously impaired G-PP&E remaining in use~~, ~~the~~ costs ~~incurred~~ to replace or restore the lost service utility of an impaired G-PP&E or construction work in process, such costs should be accounted for in accordance with applicable standards. For example, costs to prepare the site and install replacement facilities would be recognized in accordance with SFFAS 6, *Accounting for Property, Plant, and Equipment*."

- Although we generally agree with providing guidance on accounting and reporting for recoveries, we have the following comments on paragraph 23:

  - Paragraph 23 states that recoveries reported in subsequent years should be reported as revenue or other financing source. It is not clear why the ED is providing the option of reporting the recoveries as revenue or other financing source and if a federal entity elects to report recoveries as revenue, whether the recoveries should be reported as exchange or nonexchange revenue. We recommend selecting one method to report recoveries, given that revenue and other financing sources are presented differently in the financial statements and if the Board's view that recoveries should be reported as revenue, we recommend that the ED clarify what type of revenue should be used based on the criteria in Statement of Federal Financial Accounting Standards No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting* (SFFAS No. 7).

  - Paragraph 23 also states that recoveries should be recognized only when realized or realizable. Does this mean entities have the option to recognize recoveries on either cash or accrual basis? We believe that once the ED is clarified to specify the type of revenue or other financing source that should be used to recognize recoveries, this sentence will no longer be needed and users would refer to SFFAS No. 7 for guidance on revenue recognition.

    We recommend removing the language on when recoveries are realized or realizable from paragraph 23, as demonstrated below, taking into consideration our proposition above on specifying the type of revenue and not providing options:

    > "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 or other financing source as appropriate. ~~Recoveries should be recognized only when realized or realizable. For example, if a manufacturer or contract operator has admitted or acknowledged warranty or contract liability, respectively, a recovery would be realizable. If the manufacturer or contract operator has denied liability, the recovery generally would not be realizable.~~ If not otherwise apparent in the financial statements, the amount and financial statement classification of recoveries should be disclosed in the notes."

- Including the first sentence in paragraph 24 implies that disclosing the measurement method might be required for component entities because the same sentence is not in paragraph 19. We recommend either deleting the first sentence in paragraph 24 or adding it in paragraph 19 as well.

- We recommend the following related to the table in page 31:

  - Adding "Physical damage" as a potential indicator for the Service Units Approach, as demonstrated in example 1d.
  - Considering whether the bottom row titled "Lower of (1) Net Book value or (2) Higher of Net Realizable Value or Value-in-Use Approach" need to be merged with the cash flow approach row

based on the comment provided in question 4 in this letter related to construction stoppage/contract termination.

- We recommend the following edit to the first item in Appendix C: Abbreviations:

  "CFR Consolidated financial report of the U.S. government"

If you have questions about our response, please contact Ms. Amanda Nelson at 202-533-5560 or aenelson@kpmg.com.

Very truly yours,

KPMG LLP