Federal Accounting Standards Advisory Board

December 1, 2011

Memorandum

To: Members of the Board

From: Domenic N. Savini, Assistant Director

Through: Wendy M. Payne, Executive Director

Subj: **Draft Exposure Draft: *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use* – Tab H**[1]

MEETING OBJECTIVES

To **approve** the attached draft exposure draft (ED) entitled, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use* so that staff can prepare a pre-ballot draft ED for your consideration in January 2012. This draft ED proposes accounting and financial reporting standards for impairment of general property, plant, and equipment (G-PP&E) remaining in use, except for internal use software. The draft ED has been prepared based upon guidance received from members pursuant to the October meeting.

BRIEFING MATERIAL

1. **Attachment 1- Tracked Changes Version** of draft ED with revisions based on the October 2011 meeting.

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[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.

BACKGROUND

Members reviewed specific portions of the draft ED document that included the following topics: when provisions of this proposed statement would apply, not requiring entities to search solely for indications of impairment, how/when impairments can arise, and describing the magnitude of the decline in service utility.

In particular, members discussed the historical context of why the board decided to initiate an asset impairment project. Both auditors and practitioners have been raising this issue with members because, apart from internal use software, there is no FASAB impairment standard. In some cases, auditors are requiring management to use a cash flow approach which is not germane to the majority of G-PP&E. Although members believe that the benefits of issuing an asset impairment standard outweigh the costs, they would like to make clear that the board is asking the community to "look upward," keeping an eye on materiality and not process.

The board tentatively agreed to exempt internal use software from the provisions of this standard and address Statement of Federal Financial Accounting Standards (SFFAS) 10, *Accounting for Internal Use Software*, in a future project. Members asked staff to present a revised draft document for the next meeting.

Next Steps

January 2012

- ✓ Email pre-ballot draft in January and collect editorial comments

February 2012

- ✓ Proceed with final ballot draft
- ✓ Release ED for 90-day comment period upon receipt of five affirmative ballots

June 2012

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

August 2012

- ✓ Provide draft SFFAS
- ✓ Email pre-ballot following the August meeting
- ✓ Collect editorial comments

September 2012

- ✓ Proceed with final ballot draft
- ✓ Issue final SFFAS
- ✓ Transmit to Sponsors and Congress for review

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.

STAFF ANALYSIS AND RECOMMENDATIONS

1: Costs versus benefits. Refer to Attachment 1, page 8 and paragraph A21 on page 27.

Members asked staff to add an additional question for respondents that explicitly addressed the Board's belief that the benefits of implementing this proposed standard outweigh its costs. Perceived benefits include: specific impairment guidance for federal G-PP&E, reporting impairments when they occur rather than through depreciation expense or disposal, 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.

Staff suggests the following question:

> Q5. The Board believes that the benefits of implementing this Statement outweigh its costs. Benefits include: specific impairment guidance for federal G-PP&E, reporting impairments when they occur rather than through depreciation expense or disposal, 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.
>
> Do you agree or disagree that the benefits of implementing this Statement outweigh its costs? Please provide the rationale for your answer.

Question 1(a)

Does the Board believe that the suggested question (Q5) adequately frames the question that the Board perceives benefits to outweigh costs?

Question 1(b)

Does the Board agree with the perceived benefits listed within Q5 and paragraph A21 on page 28? Are there any that should be removed or changed? Are there others that should be added?

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2: Materiality. Refer to Attachment 1, page 31 for the flowchart and to each of the illustrations beginning on page 33.

Members asked staff to delete references to materiality in the flowchart and in the illustrations because it is a universally applied concept within the FASAB standards.

Question 2

Does the Board believe that the edits to Attachment 1 (page 31 for the flowchart and to each of the illustrations beginning on page 33) adequately address its concerns about materiality?

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3: Magnitude of the decline in service utility. Refer to Attachment 1, paragraph 16a on page 14 and paragraph A10 on page 24**.**

At the October meeting, staff suggested adopting Mr. Steinberg's language at Paragraph 16a dealing with the magnitude of the decline in service utility which reads as follows,

> "The costs associated with previous service utility are significantly greater than the costs that would otherwise be associated with the new expected service utility."

Question 3(a)

Does the Board agree with adopting the proposed language in par. 16a?

Question 3(b)

Is the language in par. A10 of the Basis for Conclusions sufficient?

****

Questions for the Board

Costs versus Benefits

1(a) Does the Board believe that the suggested question (Q5) adequately frames the question that the Board perceives benefits to outweigh costs?

1(b) Does the Board agree with the perceived benefits listed within Q5 and paragraph A21 on page 28? Are there any that should be removed or changed? Are there others that should be added?

Materiality

2 Does the Board believe that the edits to Attachment 1 (page 31 for the flowchart and to each of the illustrations beginning on page 33) adequately address its concerns about materiality?

Magnitude of the decline in service utility

3(a) Does the Board agree with adopting the proposed language in par. 16a?

3(b) Is the language in par. A10 of the Basis for Conclusions sufficient?

Federal Accounting Standards Advisory Board

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

Statement of Federal Financial Accounting Standards

Exposure Draft

Written comments are requested by March X, 2012

December X, 2011

Staff 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 Government Accountability 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
Mail stop 6K17V
Washington, DC 20548
Telephone 202-512-7350
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www.fasab.gov

Federal Accounting Standards Advisory Board

December X, 2011

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

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

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

The Board wishes to acknowledge and thank the Financial Accounting Foundation for giving us permission to cite Governmental Accounting Standards Board (GASB) Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. Specifically, paragraphs 8–21, 33, 44–46, and Illustrations 1, 4, 5, and 9, have been adapted for use in this document entitled, *"Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use."*

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

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

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

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

Tom L. Allen
Chairman

441 G Street NW, Mailstop 6K17V, Washington, DC 20548 ♦(202) 512-7350 ♦fax (202) 512-7366

Executive Summary

What is the Board proposing?

This exposure draft proposes accounting and financial reporting standards for impairment of general property, plant, and equipment (G-PP&E)[1] remaining in use, except for internal use software. G-PP&E is considered impaired when its service utility has declined significantly, whether gradual or sudden, and the decline is considered permanent. Recognition of impairment losses would involve a two-step process that entails (a) identifying potential impairments and (b) testing for impairment. The losses should be reasonably estimated by determining the portion of the decline in the net book value of the G-PP&E attributable to the lost service utility.

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

This Statement would improve financial reporting by requiring entities to report the effects of G-PP&E impairments in their financial statements when they occur rather than as a part of the ongoing depreciation expense for the G-PP&E or upon disposal of the G-PP&E. This will enable users of financial statements to discern the cost of impairments when they occur and what their financial impact is on the federal entity and government and the cost of services provided following the impairment. This Statement also enhances comparability of financial statements between entities by requiring all entities to account for impairments in a similar manner.

Of the four objectives outlined in Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, the operating performance objective is identified as being most important for G-PP&E impairment accounting 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

Comment: Per S. Showalter email dated 21 October. Suggest rewording added sentence to be active voice. "Impairment losses recognition is subject to a two-step process." Also, suggest changing "The loss.." to "Losses…"

Staff: Please see proposed language. This executive summary only appears in the ED and talks about what would be, not what is after it becomes a standard. Active voice should be in the standard but not in the executive summary; evidenced by language in second paragraph such as "would improve"

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Comment: Per H. Steinberg email dated 17 October. Once you say two-step process, I wonder what the two steps are. They should be identified in a sentence or two.

Staff: Please see proposed language.

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[1] Statement of Federal Financial Accounting Standards 6, *Accounting for Property, Plant, and Equipment* establishes three categories of 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). This proposal does not address impairment of internal use software which is discussed in SFFAS 10, *Accounting for Internal Use Software*.

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Questions for Respondents

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

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

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

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

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

All responses are requested by March X, 2012.

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Q1. 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.

Q2. The Board proposes that this Statement should not require entities to search their G-PP&E portfolios solely for potential impairments. Entities are not expected to alter existing surveillance methods as a direct consequence of the proposed standards. Refer to paragraphs 12 and 13 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 search their G-PP&E portfolios solely for potential impairments? Please provide the rationale for your answer.

Q3. The Board has identified the following as indicators of G-PP&E impairments: evidence of physical damage, enactment or approval of laws or regulations, 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 (i.e., idled or unserviceable) disposal, retirement, or removal for excessively long periods. Refer to paragraph 15 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.

Q4. 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 with the use of the measurement methods identified to estimate diminished or lost service utility of G-PP&E in the federal environment? Please provide the rationale for your answer.

Comment: Per T. Allen 26 October pre-brief. Respondents should be asked about the applicability of these methods in the federal environment.

Staff: Concur. Please see suggested edits.

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Q5. The Board believes that the benefits of implementing this Statement outweigh its costs. Benefits include: specific impairment guidance for federal G-PP&E, reporting impairments when they occur rather than through depreciation expense or disposal, 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.

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

Comment: As per A. Schumacher and B. Dacey at 27 October board meeting.

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Introduction

Purpose

1. Statement of Federal Financial Accounting Standards (SFFAS) 6, *Accounting for Property, Plant, and Equipment,* contains principles-based guidance concerning **general property, plant, and equipment (G-PP&E)**[2] that is removed from service due to total impairment of G-PP&E or other reasons. SFFAS 6 requires that G-PP&E be removed from G-PP&E accounts along with associated accumulated depreciation/amortization, if prior to disposal, retirement or removal from service it no longer provides service in the operations of the entity.

2. SFFAS 10, *Accounting for Internal Use Software,* provides guidance for the impairment of **internal use software**.[3] This proposal would not alter existing requirements regarding internal use software.

3. This proposed Statement would provide accounting requirements for all **partial impairments** of G-PP&E not addressed in SFFAS 6.

Materiality

4. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

[2] Terms defined in the Glossary are shown in **bold-face** the first time they appear.

[3] SFFAS 10, at paragraphs 28 through 30, provides 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 G-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.

Comment: Per S. Showalter email dated 21 October. Because impairment of internal use software was excluded from the Ed in footnote 1, is the paragraph necessary any longer?

Staff: Point-noted. Suggest we retain paragraph to be clear that IUS is exempt from this standard. Please see suggested edits.

Deleted: According to SFFAS 10 criteria, in order for software to be considered impaired, it would have to have lost its service potential such that the federal entity would plan to remove it from service or the software would have had its capabilities reduced.

Comment: Per A. Schumacher telecon 20 October. Change to plural.

Comment: Per H. Steinberg email dated 17 October. If the statement does not alter existing requirements regarding internal use software, then why add "or SFFAS 10" to paragraph 3. It suggests that this standard has some application.

Staff: Concur. Please see deletion.

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Effective Date

5. The proposed standards would be effective for reporting periods beginning after September 30, 2014. Earlier implementation is encouraged.

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Proposed Standards

Scope and Applicability

6. This Statement applies to federal entities that present general purpose federal financial reports, including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles, as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

7. This Statement applies to general property, plant, and equipment (G-PP&E) except internal use software.[4] This Statement establishes guidance on accounting for the impairment of G-PP&E remaining in use. The provisions of this Statement are to be applied when indicators of impairment, as specified in this Statement, are identified by the entity. The entity is not required to conduct an annual or other periodic survey solely for the purpose of applying these standards. Existing processes may result in routine assessments regarding the continued operational and functional capacity of G-PP&E, entity mission requirements, impacts of prominent events or changes in circumstances, and deferred maintenance and repairs. The results of such processes may serve as the basis for applying these standards.

Comment: Per M. Granof 17 November email.

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Definition of Impairment

8. **Impairment** is a significant[5] and permanent, gradual or sudden decline in the **service utility** of G-PP&E. Entities generally hold G-PP&E because of the services they provide; consequently, impairments affect the service utility of the G-PP&E. The events or changes in circumstances that lead to impairments are not considered normal and ordinary.[6] That is, at the time the G-PP&E was acquired, the event or change in circumstance would not

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

[5] The determination of whether or not an item is significant is a matter of professional judgment. Determining if a decline in service utility 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.

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

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have been (a) expected to occur during the useful life of the G-PP&E or, (b) if expected, sufficiently predictable to be considered in estimating the useful life.

9. The service utility of G-PP&E is the usable capacity that at acquisition was expected to be used to provide service, as distinguished from the **level of utilization**, which is the portion of the usable capacity currently being used. The current usable capacity of 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. G-PP&E that experience 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

10. 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.

11. The determination of whether G-PP&E is impaired, as defined in paragraph 8 above, includes (a) identifying potential impairments and (b) testing for impairment. G-PP&E that is potentially impaired is identified as a result of the occurrence of prominent events or changes in circumstances, or routine asset management processes. When these processes suggest that G-PP&E is potentially impaired, the initial step – identifying the presence of indicators of impairment – would be taken.

G-PP&E Identified From Prominent Events or Changes in Circumstances

12. Events or changes in circumstances affecting G-PP&E that may indicate impairment are sometimes prominent. Prominent events or changes in circumstances are conspicuous or known to the entity's management or oversight entities. Entities are not required to perform procedures solely to identify potential impairment of G-PP&E. Events or circumstances that may indicate impairment generally are expected to have prompted

Comment: As per B. Dacey at 27 October board meeting. Collapse two-step process.

Staff: See suggested edit which replaces reference to 2 step process with "includes".

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Comment: Per A. Schumacher telecon 20 October. Change "are" to "is" in 2 places and specify processes.

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Comment: Per H. Steinberg email dated 17 October. Change "is taken" to "has been taken" or "would have been taken" to improve clarity.

Staff: Please see suggested edit on line 27.

Comment: Per H. Steinberg email dated 17 October. The placement of this sentence here is a little confusing. The paragraph by stating there is a two-step process; then provides the guidance for the first step—identifying potential impairments, and concludes by saying the second step should be taken. However, there is then two sections containing three paragraphs (paragraphs 12-14) that further describe the identification of potential impairments. This is exacerbated by a further discussion of the two step process with the first step outlined in detail (paragraph 15). Perhaps ... [1]

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Comment: Per A. Schumacher telecon 20 October. Clarify an ... [3]

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Comment: Per A. Schumacher telecon 20 October. Consider ... [4]

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consideration[7] by oversight entities, management, or others (e.g., the media).

G-PP&E Identified From Asset Management Reviews (e.g., portfolio surveys)

13. Existing asset management processes may include portfolio surveys that consider matters such as the continued operational and functional capacity of G-PP&E, entity mission requirements, or deferred maintenance and repairs assessments. Potentially impaired G-PP&E may be identified from such surveys and further evaluated through the two-step process.

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.

Identifying Potential Impairments – Two-step process

Step 1 – Identify Indicators of Potential Impairment

15. Some common indicators of impairment include those listed below:

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,[8]

Comment: Per M. Granof 17 November email. I objected to the term “prompted discussion” and asked to offer alternative wording. I would replace the word “discussion” with “consideration.” A corresponding change would then be made in the footnote. “Consideration” seems to have a more professional tone.

Staff: Please see suggested edits here and in footnote below.

Comment: Per W. Jackson 27 board meeting. Media is limiting; expand to “or others (e.g. the media).”

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[7] Consideration might include but is not limited to management discussions, internal managerial analyses or reviews, conferences or consultations with experts, media or public relations interviews, or external industry scrutiny.

[8] 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 expected, PP&E that is 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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e. changes in the manner or duration of use of G-PP&E,

f. construction stoppage or contract termination, and

g. G-PP&E scheduled or awaiting (i.e., idled or unserviceable) disposal, retirement, or removal for excessively long periods.[9]

Step 2 - Impairment Test

16. G-PP&E identified through the processes described in paragraphs 10 through 14 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. 9) is significant**. 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 include operational, maintenance, and depreciation. 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.

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. That is, management expects that the G-PP&E will remain in service so that its remaining service utility will be utilized. Reasonable expectation may exist when management has (1) specific plans to replace or restore the lost service utility, (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.

Comment: Per S. Showalter email dated 21 October. Does a reference to a Technical Release in a SFFAS elevate its status in the GAAP hierarchy?

Staff: SFFAS 34 identifies the GAAP hierarchy and TR's are categorized in descending order as Level C GAAP. Unless SFFAS 34 changes the order of precedence, mere reference to a lower tier source of GAAP should not elevate its classification.

Comment: Per A. Schumacher telecon 20 October. Judgment should be required and lost service utility is not always tied to an event; can be gradual.

Staff: Concur. Please see suggested edits.

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Comment: As per W. Jackson and J. Hamilton at 27 October board meeting. "Set-aside" is not an appropriate action that can be taken consider using "committed".

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[9] 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.

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Measurement

17. Impairment losses on G-PP&E that will continue to be used by the entity[10] should be estimated using the measurement method that reasonably[11] reflects the diminished service utility of the G-PP&E. The goal of the measurement approaches discussed below is to reasonably estimate the portion of the net book value associated with the diminished service utility of the G-PP&E. However, there should not be a presumption of reasonableness attached to a method for which the resultant calculations reflect an unreasonable amount of the remaining service utility of the G-PP&E. Some acceptable methods which are widely recognized include the following:

    a. **Replacement approach.** Impairment of G-PP&E with physical damage generally may be measured using a replacement approach. This approach uses the estimated cost to replace the lost service utility of the G-PP&E at today's standards to identify the portion of the historical cost of the G-PP&E that should be written off. For federal real property purposes, this cost can be derived from the plant replacement value (PRV). This estimate can be converted to historical cost by restating (i.e., deflating) the estimated cost to replace the diminished service utility using an appropriate cost index. Alternatively, it may be appropriate to apply the ratio of the estimated cost to replace the diminished service utility over total estimated cost to replace the G-PP&E, to the net book value of the G-PP&E.

    b. **Restoration approach.** Impairment of improvements made to stewardship land and multi-use heritage assets with physical damage generally may be measured using a restoration approach. This approach uses the estimated cost to restore the diminished service utility of the G-PP&E to identify the portion of the historical cost of the G-PP&E that should be written off. This approach does not include any amounts attributable to improvements and additions to meet today's standards. The estimated restoration cost can be converted to historical cost by restating (i.e., deflating) the estimated restoration cost using an appropriate cost index. Alternatively, it may be appropriate to apply the ratio of estimated

Comment: Per S. Showalter email dated 21 October. The added sentence contains a double negative, which makes it hard to understand. Can it be rewritten?

Staff: Please see suggested edits.

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

[11] Given a choice among comparable methods, entities should adopt the most efficient and practical method available under the circumstances.

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restoration cost to restore the diminished service utility over total estimated restoration cost to the net book value of the G-PP&E.

c. **Service units approach.** Impairment of G-PP&E that are affected by enactment or approval of laws or regulations or other changes in environmental/economic factors or are subject to technological changes or obsolescence generally may be measured using a service units approach. This approach compares the service units provided by the G-PP&E before and after the impairment event or change in circumstance to isolate the historical cost of the service utility of the G-PP&E that cannot be used due to the impairment event or change in circumstances. The amount of impairment is determined by evaluating the service provided by the G-PP&E—either maximum estimated service units or total estimated service units throughout the life of the G-PP&E—before and after the event or change in circumstance.

d. **Deflated depreciated current cost approach.** Impairment of G-PP&E that are subject to a change in manner or duration of use generally may 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 (i.e., deflated depreciated current cost).

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 G-PP&E (1) is not recoverable and (2) exceeds the higher of its net realizable value[12] or value-in-use estimate.[13] The net book value of the G-

[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.

[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*

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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.

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.

Reporting Impairment Losses

18. The loss from impairment should be recognized in the statement of net cost. The impairment loss should be recognized regardless of whether the G-PP&E is being depreciated individually or as part of a composite group. A general description of the impaired G-PP&E, the nature (e.g., 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. Events, changes in circumstances, or asset management reviews might indicate that the future service utility of G-PP&E has been adversely affected. If future service utility has been adversely affected but the impairment test determines that a loss need not be recognized, the estimates used in depreciation calculations such as estimated useful life and salvage value, should be reevaluated and changed, if necessary.

Comment: Per A. Schumacher telecon 20 October. "If so" is ambiguous, please specify meaning by referring to Step 2.

Staff: Concur: Please see suggested edits.

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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)

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 in accordance with SFFAS 6, paragraphs 38 and 39.

Reversing Previously Reported Impairments

21. Subject to the entity's capitalization policies, if an entity later remediates the previously impaired G-PP&E, the costs incurred to replace or restore the lost service utility 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*.

Recoveries

22. 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.

Consolidated Financial Report of the U.S. Government

23. The U. S. government-wide financial statements need not disclose the measurement methods used in recognizing impairment losses. However, if an impairment of G-PP&E is reported, the following information should be disclosed:

    a. a general description of what constitutes G-PP&E impairment,

    b. the consolidated G-PP&E impairment losses reported by component entities, and

    c. reference(s) to component entity report(s) for additional information.

Effective Date

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

Comment: Per S. Showalter email dated 21 October. The phrase "If G-PP&E impairment is reported.." should be added at the end of line 17 (after the word However) as it applies to a, b and c.

Staff: Concur.

Comment: Per A. Schumacher telecon 20 October. Correct sentence structure.

Staff: Concur: Please see suggested edits.

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

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Appendix A: Basis for Conclusions

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

Project History

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

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

- Financial Accounting Standards Board (FASB) Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*

- Governmental Accounting Standards Board (GASB) Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*[14]

[14] © Financial Accounting Foundation, Governmental Accounting Standards Board, 401 Merrit 7, Norwalk, CT. All Rights Reserved. GASB 42, November 2003.

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- International Public Sector Accounting Standard (IPSAS) No. 21, *Impairment of Non-Cash Generating Assets*

- 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 the International Public Sector Accounting Standards Board (IPSASB). The working group'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

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change. Establishing G-PP&E impairment standards significantly adds to consistent financial reporting.

b. The Board is aware of the increased demands that entities confront due to initiatives that attempt to better align and integrate entity mission, budget, and performance objectives. As such, the Board desires to issue a G-PP&E impairment standard that entities can effectively adopt without undue administrative burden while still satisfying the objectives of federal financial reporting.

Recognizing Impairments

A4. As discussed in paragraphs 12 and 13, impairments can be identified and brought to management's attention in a variety of ways. Although a presumption exists that there are existing processes and internal controls in place to ensure such identification and communication, this standard does not require entities to alter existing surveillance methods solely for the purpose of applying these standards.

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

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The Board also notes that common indicators of potential impairment can be discovered during different types of asset management reviews that include the following types of G-PP&E assessments:

a. Condition assessments revealing evidence of physical damage, deterioration, and/or distresses such as for a building (1) damaged by fire or flood, (2) not adequately maintained or repaired, (3) associated with significant amounts of deferred maintenance and repairs and/or (4) exhibiting signs of advanced degradation that might adversely impact

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expected duration of use, each requiring remedial or replacement/restoration efforts to restore service utility.

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

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

Common Indicators of Potential Impairment

A6. The Board considered the general approaches used by other standards-setters regarding the issues of impairment identification and testing. The DM-AI Task Force identified the GASB approach as being the most germane for federal application and recommended adopting its use with appropriate modifications. As a result, this proposed Statement consists of a two-step process of (a) identifying potentially impaired G-PP&E through indictors of impairment and (b) testing to determine whether a potential impairment exists by comparing the net book value of the G-PP&E to a valuation reflecting the current state of the G-PP&E.

A7. Recognizing the administrative burden and costs involved in applying a test of potential impairment, the Board desires to make clear that the indicators identified at paragraph 15 in and of themselves are not conclusive evidence that a measurable or reportable impairment exists. Entities should carefully consider the surrounding circumstances to determine if a test of potential impairment may be unnecessary given the circumstances.

A8. In order to limit the universe of G-PP&E tested for potential impairment because of cost-benefit considerations, the Board proposes two modifiers to the indicators: (a) the magnitude of the gradual or sudden decline in service utility is significant and (b) the decline in service utility is permanent. The first modifier would limit testing for potential impairment to only G-PP&E that have experienced a significant decline, gradual or sudden, of the asset's service utility. The second modifier would limit testing to only those G-PP&E where the

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decline in lost 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 and that the G-PP&E's remaining service utility can continue providing value.

A9. Only when both of these two modifiers are present, is G-PP&E to be considered impaired. When either of these conditions is not present, the decline in the service utility of the G-PP&E may be recognized through other methods such as changing useful life or salvage value estimates.

Determining if Magnitude of Decline in Service Utility is Significant

A10. Because measurement of a potential impairment is not required unless a significant decline in service utility occurs, management should assess the magnitude of the service decline. In cases where there is physical damage to G-PP&E, the significance can often be objectively assessed because the costs of remediation (i.e., replacement or restoration) may be relatively easy to determine, at least within a range of estimates. In circumstances other than those involving physical damage, significance may be discerned by less objective assessments such as whether management acts to address the situation. Management action may be an indication that the expenses are too high in relation to the benefit following a service decline. Management inaction, absent other facts, may be an indication that the decline is not significant and that the test of impairment should not be required.

Selecting a Measurement Approach

A11. Professional judgment should be used when selecting a method to measure the decline in service utility of G-PP&E. Generally, potential impairments:

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

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

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

Comment: Per S. Showalter email dated 21 October. What does this sentence mean or why it is necessary?

Staff: If lost service declines other than those brought about by damage are followed by management interest, the presumption is that we have passed the magnitude test. Members asked that staff clarify this issue and as a result of coordinating with GASB, staff suggests use of this language.

Comment:
Per A. Schumacher telecon 20 October. Consider clarifying the use of management versus senior management. Asset custody to include assessments will typically be a mid-level management function. The draft ED is unclear concerning this distinction.

Staff: Concur: Staff suggests eliminating references to "senior management" and use the more generic "management". Trying to determine what duties/functions belong to mid-level versus senior management is problematic.

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

e. arising from 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.

A12. The Board emphasizes that in estimating the diminished service utility of the G-PP&E, the measurement approach chosen should yield a reasonable estimate. That is, there should not be a presumption of reasonableness attached to the use of any of these methods; instead if the resultant calculations reflect an unreasonable estimate of the remaining service utility of the G-PP&E the method should be questioned. For example, if using the replacement approach, cost estimates to remediate the damage to an asset are equal to or greater than the asset's total replacement cost, the resultant calculation would lead to a full write-down of the carrying value. However, if the asset is to remain in use, the full write-down would be inappropriate because some service potential remains. In such a case, management should look to another method such as the deflated depreciation current cost approach to estimate the historical cost of the asset's residual service capacity that will continue to be used.

Among Comparable Methods – Choose the Most Efficient

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

Reduced Demand

A14. The Board notes that reduced demand for the services of G-PP&E should not be considered as a discrete or sole indicator of potential impairment. That is, reduced demand absent evidence of an underlying potential impairment resulting in that reduced demand is not an indicator of impairment. For example, decreased demand for the processing services of a mainframe computer because former users of the mainframe have transitioned to PC and

Comment: Per A. Schumacher telecon 20 October. Housekeeping edits.

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Comment: Per S. Showalter email dated 21 October. The added sentence contains a double negative, which makes it hard to understand. Can it be rewritten?

Staff: Please see suggested edits.

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Comment: Staff edit for redundancy of "existing" and "remains."

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server-based systems should be considered a change in demand not requiring impairment testing. However, if associated with an indicator of potential impairment such as evidence of obsolescence, then the mainframe should be tested for potential impairment.

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

A16. A decrease in occupancy is another example of a change in demand. If a decrease in the occupancy of hospital beds prompts management to close a hospital, a change in manner or duration of use has also resulted and a test for impairment should be performed. However, a test for impairment is not required if the decrease in hospital beds results solely because the hospital is changing from an overcrowded condition to one in which occupancy rates are now below the maximum allowed. However, care should be taken to ensure that there is not a potential indicator of impairment that could require testing.

Estimating Potential Impairment Losses

A17. Measuring the cost of the lost service utility generally requires the use of estimates or approximations. According to Statement of Federal Financial Accounting Concepts (SFFAC) 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*, to be recognized an item must be measurable, meaning that a monetary amount can be determined with reasonable certainty or is reasonably estimable (underscoring added for emphasis). For this reason, the Board notes that it (1) does not seek exact precision in determining the lost service utility of the asset and (2) does not intend to direct or prescribe the use of any particular method listed in paragraph 17.

Comment: Per A. Schumacher telecon 20 October. Housekeeping edits.

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A18. However, the Board notes that care should be taken when estimating potential impairment losses. For example, if a multi-use heritage asset requires testing for potential impairment, the restoration cost and not the replacement approach should be used. Although these approaches may appear to be identical, they are not. The replacement approach estimates the cost to replace the lost service utility of the G-PP&E at today's standards whereas the restoration cost approach does not. In either case, the required estimates used for the calculation inputs are different and can significantly affect the potential impairment loss measurement. Differences will arise because the

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replacement approach uses estimates reflecting today's current labor and material options and costs, modern standards, and installation methods whereas the restoration cost approach uses estimates that generally require using historically accurate (e.g., aesthetic or historic) materials and construction methods approved by an historic architect or historic preservationist to preserve the historic nature and value of the multi-use heritage asset.

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

G-PP&E Impairment Loss Reversals

A20. In reaching the decision not to allow for reversals of G-PP&E impairment losses, the Board concluded that because reversal events are expected to be rare occurrences, there is no compelling need for complexity or increased burden as benefits do not appear to justify costs. Further, the Board concluded it is not a reversal of a previously reported impairment loss, but rather a change in facts resulting in an addition to the cost basis. Specifically, should events later change and an asset's lost service utility is replaced or restored, the resultant incurred costs to place the replaced or restored lost service utility into service becomes part of the G-PP&E's new cost basis. It is the Board's opinion that such a practice is consistent with the operating performance objective of federal financial reporting; users will be able to evaluate the service efforts, costs, and accomplishments of the reporting entity based on the revised cost basis.

Perceived costs versus benefits

A21. The Board believes that the benefits of implementing this Statement outweigh its costs. The Board has attempted to carefully word the Statement so that users understand that they are not required to search out impairments or to apply the Statement to immaterial items. Entities should consider G-PP&E

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impairments in the context of their existing practices and to apply this Statement only when there is an indicator of significant impairment present. The Board believes that a federal alternative to existing generally accepted accounting principles, such as GASB, IPSASB, and FASB, provides federal preparers with specific guidance relative to federal G-PP&E Other perceived benefits include: reporting impairments when they occur rather than through depreciation expense or disposal, 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.

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Appendix B: Flowcharts, Decision Table and Illustrations

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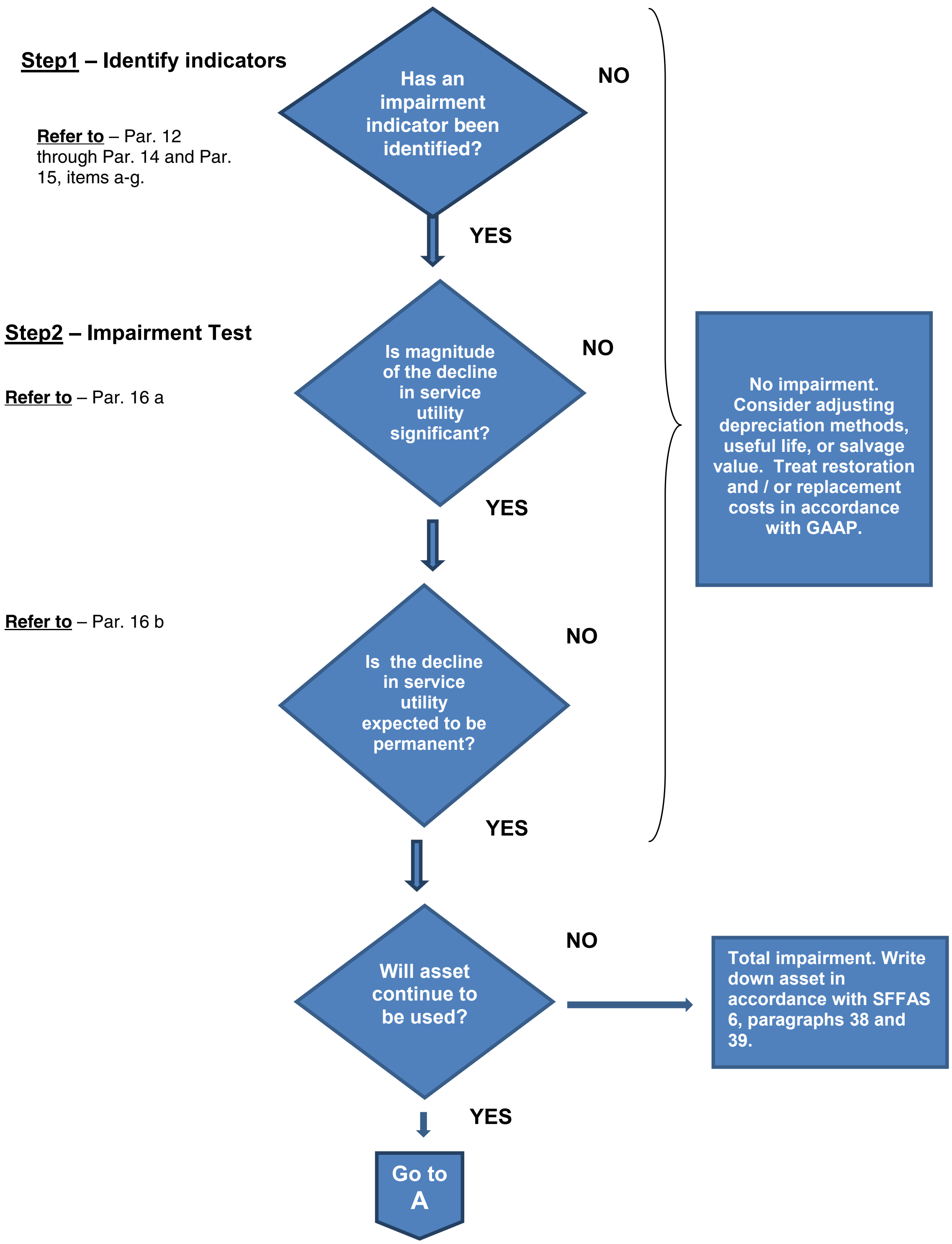
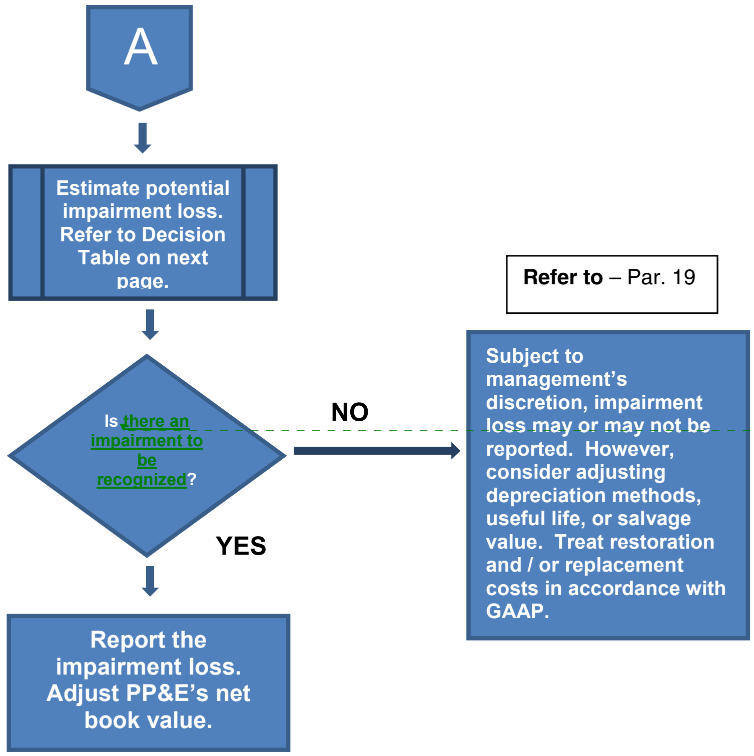

Step1 – Identify indicators
Refer to – Par. 12 through Par. 14 and Par. 15, items a-g.
Has an impairment indicator been identified?
NO
YES
Step2 – Impairment Test
Refer to – Par. 16 a
Is magnitude of the decline in service utility significant?
NO
YES
No impairment. Consider adjusting depreciation methods, useful life, or salvage value. Treat restoration and / or replacement costs in accordance with GAAP.
Refer to – Par. 16 b
Is the decline in service utility expected to be permanent?
NO
YES
Will asset continue to be used?
NO
Total impairment. Write down asset in accordance with SFFAS 6, paragraphs 38 and 39.
YES
Go to A

Refer to – Par. 17



Refer to – Par. 18 and Par. 23.

As per B. Dacey 27 October board meeting: edit decision diamond.

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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 efficient and practicable method.

Measurement Methods[15]	Potential Indicators	Type of PP&E *	Reference	Illustrations that may be appropriate
Replacement Approach	• Physical Damage	All G-PP&E	Par. 17 a	1c
Restoration Approach	• Physical Damage	Multi-use Heritage PP&E	Par. 17 b	2b
Service Units Approach	• Enactment or approval of laws/regulations • Changes in environmental or economic factors • Technological changes or obsolescence	All G-PP&E	Par. 17 c	1d, 3a, 3b
Deflated Depreciated Current Cost Approach	• Change in manner or duration of use.	All G-PP&E	Par. 17 d	4a
Cash Flow Approach	• Any of the indicators as listed at Paragraph 15 (a through g)	All G-PP&E	Par. 17 e	7a, 7b, 7c, 7d
Lower of (1) Net Book value or (2) Higher of Net Realizable Value or Value-in-Use Approach	• Construction stoppage / Contract terminations	All G-PP&E	Par. 17 f	5, 6a, 6b

Comment: As per W. Jackson and B. Dacey at 27 October board meeting. No need because footnote is clear in this regard.

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* = excluding internal use software

[15] Other industry-accepted methods may be appropriate.

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* [16]

Assumptions

In 2012 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.

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Management develops specific plans to begin remediation efforts as soon as possible and replace the lost service utility. In addition, funding has been identified and set-aside.

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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 management has specific plans to replace the lost service utility of the building and has identified and set-aside funding, there is reasonable expectation that the damage is temporary and no impairment loss is recognized.

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

Illustration 1b

Complete Removal from Service: *Physical Damage to an Office Building with Mold Contamination*

Assumptions

In 2012 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.

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

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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 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* paragraphs 38 and 39 are applicable.

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Illustration 1c

Replacement Approach - Permanent Declines in Service Utility: *Physical Damage to an Office Building due to an Earthquake*

Assumptions

In 2012 entity officials became aware of extensive masonry wall and building foundation damage at one of its office buildings as a result of a recent earthquake. The damage to the masonry walls was spread throughout the five-story building and the building foundation was damaged at non-critical vertical-load points. Facilities management personnel and engineers advised that despite a decline in service utility, the damaged building would still be capable of meeting reasonable, but reduced performance objectives in its damaged state, making major repairs and costly upgrading unnecessary. Limited and minor repairs, both cosmetic and structural, could be made to improve visual appearance and component damage at nominal cost. Facilities managers and engineers have estimated that the major repairs and upgrades (involving removal and rebuilding of the interior walls and improving site drainage) would cost $2 million.

After a detailed review, management decides to accept the reduced performance objectives of the building and not make the major repairs and costly upgrades.

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.

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Comment: As per B. Dacey at 27 October meeting. Explicitly state that there is a decline in service utility.

Staff: See suggested edits.

Comment: As per B. Dacey at 27 October meeting. The term “mold remediation” should be deleted.

Deleted: mold remediation

Comment: Per H. Steinberg email dated 17 October. Page 32, 1st paragraph, last line states major repairs and upgrades would cost $24 million. Last paragraph, 2nd line and calculations on page 33say major repairs and upgrades would cost $2 million. I assume it is the latter.

Staff: Concur.

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Evaluation of potential impairment

The masonry wall and building foundation damage is evidence of physical damage – an impairment indicator. Also, the magnitude of the decline in the lost service utility is significant because its remediation would involve major repairs and costly upgrades. Because management decides to accept the reduced performance objectives of the building and not make the major repairs and costly upgrades, the lost service utility of the building is permanent. Because the loss of service utility is permanent, any impairment loss, if material, is recognized.

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Measurement of potential impairment

Facilities managers and engineers estimated that the major repairs and upgrades would have cost if incurred, $2 million. In accordance with the entity’s capitalization policies, 10 percent of the remediation cost would be allocable to site clean-up and treated as a period expense, and 90 percent would be allocable to remediating the masonry wall and building foundation damage. As recorded in the entity’s asset management system, the estimated plant replacement value (PRV) of the office building is $8.5 million.

Calculate Net Book Value:

	Historical Cost	Accumulated Depreciation, 2012	Net Book Value, 2012
Land	**$100,000**		**$100,000**
Building acquisition, 1982	$1,200,000	$600,000	$600,000
Improvements	1,235,000	320,000	915,000
Total - Building & Improvements	**$2,435,000**	**$920,000**	**$1,515,000**

Calculate estimated cost to replace lost service utility:

Total remediation cost	$2,000,000
Percentage wall & foundation cost	90%
Wall & Foundation Remediation cost	**$1,800,000**

Calculate percentage of lost service utility in current dollars:

Wall & Foundation Remediation (estimate of lost service utility in current dollars)	$1,800,000
Plant Replacement Value (estimate to replace building in current dollars)	8,500,000
Wall & Foundation Remediation cost percentage	**21.18%**

Calculate potential impairment loss:

Net book value (historical cost)	**$1,515,000**
Multiplied by: Wall & Foundation Remediation cost percentage	**21.18%**
Potential impairment loss	**$320,877**

Reporting Considerations

The potential impairment loss and corresponding reduction of the book value of the building is $320,877.

Comment: Per M. Granof at 27 October board meeting. Delete references to “material” in the illustrations.

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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

In 2012 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.

Management does not believe that the loss of service utility will impede their operations and consequently, do not plan to remediate the mold contamination. 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 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 management personnel in consultation with the Comptroller's office advise management to use the service units approach instead of the replacement cost approach because using construction cost estimates are not likely to result in a materially different potential impairment loss amount. Management agrees to select the service units approach because it reasonably represents diminished service utility and given the circumstances, it is the most efficient and practicable method to use.

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Comment: Per S. Showalter email dated 21 October. I think we need better reasons for using a method other than we are running out of time and materiality. The method should have some reason why it would be used other than time and materiality. Why is it preferred over others?

Staff: Does not disagree noting that time constraints add realism to the case. Please see suggested edit.

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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	5 floors
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	**40.00%**
Potential impairment loss	**$606,000**

Reporting Considerations

The potential impairment loss and corresponding reduction of the book value of the building is $606,000.

Comment: Per M. Granof at 27 October board meeting. Delete references to "material" in the illustrations.

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Illustration 2a

Normal and Ordinary Lost Service Utility: *Physical Damage to a Multi-use Heritage Asset* [17]

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 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."

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. 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. 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.

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

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 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 historically accurate materials and methods, as well as historic preservation and conservation methods as appropriate 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 although subsequent levels could be restored in the future, no such plans should be undertaken nor should any monies be committed. Displaced staff were moved to nearby vacant office space.

Comment: As per W. Jackson and J. Hamilton at 27 October board meeting. "Set-aside" is not an appropriate action that can be taken consider using "committed".

Deleted: set-aside

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 is not reasonably expected to be restored, the impairment is considered permanent and 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 would cost $2.0 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 management:

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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)	**$2,500,000**

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
Total restoration cost (all 3 levels)	4,500,000
Restoration cost percentage	**55.5%**

Calculate potential impairment loss:

Net Book Value (historical cost of wing)	**$1,750,000**
Multiplied by: Restoration cost percentage	**55.5%**
Potential impairment loss	**$971,250**

Reporting Considerations

The potential impairment loss and corresponding reduction of the book value of the building is $971,250.

Comment: Per M. Granof at 27 October board meeting. Delete references to "material" in the illustrations.

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Illustration 3a

Service Units Approach - Recoverable Service Utility: Technological Development or Evidence of Obsolescence *-Underutilized Magnetic Resonance Imaging Machine* [18]

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 management is evaluating the asset’s continued service use and whether or not to book an impairment loss.

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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

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, management has concluded that there is no potential impairment loss because the asset can achieve its expected

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

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

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Measurement of potential impairment

Calculate Net Book Value:

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

Calculate Acquisition cost per service unit:

a	Acquisition cost, 2010	$2,250,000
c	Originally expected service units (7 years × 52 weeks per year × 5 days per week × 10 uses per day)	18,200
d	**Acquisition cost per service unit (a divided by c) (rounded)**	**$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
e	Remaining number of service units = (4 years plus 3 extended years × 52 weeks per year × 5 days per week × 6 uses per day)	10,920
f	**Remaining service costs to be recovered (d multiplied by e)**	**$1,354,080**

Calculate Potential Impairment Loss:

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

Reporting Considerations

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.

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 management’s attention to evaluate the asset’s continued service use.

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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)	964,286
b	**Net Book Value, 2013**	**$1,285,714**

Calculate Acquisition cost per service unit:

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

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

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

Calculate Potential Impairment Loss:

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

Reporting Considerations

The potential impairment loss and corresponding reduction of the book value of the equipment is $1,156,754.

Comment: Per M. Granof at 27 October board meeting. Delete references to "material" in the illustrations.

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Illustration 4a

Deflated Depreciated Current Cost Approach: Change in Manner or Duration of Use – *Training Facility Used for Storage*[19]

Assumptions

In 2013, 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.

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This training facility was constructed in 2001 at a cost of $10 million. The estimated useful life of the facility is fifty years. Entity 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.

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Because no physical damage occurred that would require detailed cost repair estimates, management decides to use the deflated-depreciated current 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.

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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.

Measurement of potential impairment

[19] Illustration 4a adapted from: GASB 42, Illustration 5, *Change in Manner or Duration of Use – School Used for Storage.*

Calculate Net Book Value:

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

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

Calculate Depreciated current cost (current dollars):

	Replacement cost of warehouse, 2013	$4,200,000
	Accumulated depreciation (12 / 50 years)	1,008,000
b	**Depreciated current cost**	**$3,192,000**

Calculate Deflation factor:

c	Commercial construction index, 2001	100
d	Commercial construction index, 2013	150
e	**Deflation factor (c divided by d)**	**0.67**

Apply deflation factor to depreciated current cost:

b	Depreciated current cost	$3,192,000
e	Deflation factor (c divided by d)	0.67
f	**Deflated depreciated current cost (b × e)**	**$2,138,640**

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Calculate Potential impairment loss:

a	Net Book Value, 2013	$7,600,000
f	Deflated depreciated current cost (b × e)	2,138,640
	Potential impairment loss (a - f)	**$5,461,360**

Reporting Considerations

The potential impairment loss and corresponding reduction of the book value of the facility is $5,461,360.

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Comment: Per M. Granof at 27 October board meeting. Delete references to "material" in the illustrations.

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Illustration 5

Construction Stoppage—Special Purpose Test Equipment [20]

Assumptions

In 2012, in response to a Congressional order canceling a major program, 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 purposes all of which have potential commercial application. The entity's program manager advised 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.

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Upon further inquiry, 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.

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Evaluation of potential impairment

The indicator of impairment is the construction stoppage. It appears to meet the test of impairment in that management would not have initiated the 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 $10 million) are significant in both percentage and monetary terms. However, there is no potential impairment loss to report in accordance with this standard 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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[20] Illustration 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. 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.

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 Considerations

The potential impairment loss and corresponding reduction of the book value of the equipment is $45 million.

Comment: Per M. Granof at 27 October board meeting. Delete references to "material" in the illustrations.

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Illustration 7a

Cash flow approach – Grouped Assets

Assumptions

An entity manages and operates a shared-services center on a post-wide basis that provides administrative and information technology support. The entity groups the individual services separately into two distinct categories rather than on an individual basis. The net book values are $12 million and $11 million for the administrative and information technology groups, respectively.

In December 20X1, the entity's 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. 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. An appraisal was conducted to ascertain the amount that could be recovered from selling each of the groups. The appraisal report noted (1) that net realizable value (NRV) amounts were greater than value-in-use estimates and (2) the NRV amounts of $13 million and $8 million for the Administrative and IT groups, respectively. The Chief Financial Officer identified the following cash flow information: (a) cash from continuing operations of $12 million and $9 million for the Administrative and IT groups, respectively and (b) cash flows from disposal activities of $2 million and $1 million for the Administrative and IT groups, respectively.

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

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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.

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. To apply the 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.

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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 net realizable value [21] or value-in-use estimate.[22] A potential impairment loss would be measured as the amount by which the net book value of the grouped assets exceed the higher of their net realizable value or value-in-use estimate(s).

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

Calculate Net book value:

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

[21] 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.

[22] 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)

1 **Calculate undiscounted cash flows:**

Undiscounted cash flows:	**Asset Group: Administrative**	**Asset Group: Information Technology**
Undiscounted cash flows from future operations	$12,000,000	$9,000,000
Undiscounted cash flows from future 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: Administrative**	**Asset Group: Information Technology**
Total - undiscounted cash flows (b)	**$14,000,000**	**$10,000,000**
Assets' net book values at 12/31/X1 (a)	**12,000,000**	**11,000,000**
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**

4

Calculate potential impairment:

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 value or value-in-use estimate. Because the Administrative group has undiscounted cash flows greater than related net book values, recoverability is met and there is no potential impairment. However, because the Information Technology group has undiscounted cash flows lower than related net book values, recoverability is not met and the potential for impairment exists. A $3 million potential impairment loss exists because the $11 million net book value of the Information Technology group's G-PP&E exceeds the higher of its net realizable value or value-in-use estimate (in this case we are given that the $8 million NRV amount is higher than the value-in-use estimate).

Potential impairment:	Asset Group: Administrative	Asset Group: Information Technology
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	$11,000,000
Excess of net book value over Net Realizable Value	N/A	$3,000,000
Potential impairment loss	N/A	$3,000,000

Reporting Considerations

The potential impairment loss and corresponding reduction of the book value of the IT asset group is $3.0 million.

Comment: Per M. Granof at 27 October board meeting. Delete references to "material" in the illustrations.

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Illustration 7b

Cash flow approach – Equipment: Technological Development or Evidence of Obsolescence - *Underutilized Magnetic Resonance Imaging Machine*[23]

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. The average user fee for MRI services is $20.00 per use. 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 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), management is considering the possibility of selling the old machine and using its proceeds to help purchase the “open” MRI system.

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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, 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.

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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 management’s attention to evaluate the asset’s continued service use. Potential impairment loss using the cash flow approach would be determined as follows:

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Measurement of potential impairment

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

Calculate Net Book Value:

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

Calculate undiscounted cash flows:

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

Calculate Recoverability: (b minus a)

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

Calculate Potential Impairment Loss:

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 value or value-in-use estimate. Because management believes that the open market price of $750,000 is a reasonable estimate of the asset's net realizable value, it is compared to the asset's value-in-use estimate to determine which amount is higher. However, because the $364,000 undiscounted cash flows amount (prior to calculating the net present value to determine a value-in-use estimate) is lower than net realizable value amount of $750,000, there is no need to present value the cash flows to calculate a value-in-use estimate.

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

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

Reporting Considerations

The potential impairment loss and corresponding reduction of the book value of the equipment is $535,714.

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Illustration 7c

Cash flow approach – Facility: Changes in manner or duration of use -
***Government owned-contractor operated (GOCO) manufacturing facility*[24]**

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 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.

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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.

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

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[24] 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

Evaluation of potential impairment

The indicator of potential impairment is the change in manner of use. The magnitude test has also been met due to (1) federal and state scrutiny, (2) media coverage, and (3) the fact that the cost of operating the facility has drawn management's attention to evaluate the asset's continued service use and seek the comptroller's advice. Because the entity is seeking appropriate approvals to commence disposal efforts and does not know when such permission will be granted, management intends to convert a portion of the facility for public storage; a change in the manner of use.

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Measurement of potential impairment

Calculate Net book value:

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

Calculate undiscounted cash flows:

Calculate undiscounted cash flows:	**Facility**
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)**

Calculate Recoverability: (b minus a)

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

Reporting Considerations

There is no potential impairment loss to consider or report because the undiscounted cash flows to be recovered are greater than the G-PP&E's net book value.

Illustration 7d

Calculating value-in-use using (discounted) cash flows – Facility: Changes in manner or duration of use - *Government owned-contractor operated (GOCO) manufacturing facility*[25]

Assumptions

Same facts as Illustration 7c above except that (1) 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 management does not believe that a prospective buyer can be found it decides not to seek disposal authority. The entity's comptroller advises 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.

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Evaluation of potential impairment

In this case the entity should (1) use the undiscounted cash flows to calculate recoverability and (2) present value (i.e., discount) the undiscounted cash flows to calculate the value-in-use estimate. In so doing, a potential impairment loss is realized. Calculations follow:

Calculate cash flows:

Comment: Per A. Schumacher telecon 20 October and S. Showalter email dated 21 October. Format and align table amounts to titles.

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

Calculate Recoverability: (b minus a)

[25] 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

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

Calculate potential impairment:

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

Reporting Considerations

The potential impairment loss and corresponding reduction of the book value of the facility is $20,002,490.

Comment: Per B. Dacey at 27 October board meeting.

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Comment: Per M. Granof at 27 October board meeting. Delete references to “material” in the illustrations.

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Appendix C: Abbreviations

CFR	Consolidate financial report of the U.S. government
DM-AI	Deferred Maintenance and Asset Impairment (task force)
DM&R	Deferred maintenance and repair
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
FRPP	Federal Real Property Profile (GSA Asset Management Database)
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GASB	Governmental Accounting Standards Board
G-PP&E	General property, plant, and equipment
IG	Inspector General
IPSASB	International Public Sector Accounting Standards Board
IPSAS	International Public Sector Accounting Standards
IT	Information technology
M&R	Maintenance and repair
OMB	Office of Management and Budget
PP&E	Property, plant and equipment
RSI	Required supplementary information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

Appendix D: Glossary

General property, plant, and equipment (G-PP&E) - PP&E used to provide government services or goods. The cost of general PP&E is capitalized, i.e. recorded as assets on the balance sheet. For detailed characteristics of and accounting for general PP&E, see SFFAS No. 6, pars 23 through 34.

Impairment - a significant[26] and permanent, gradual or sudden, decline in the service utility of G-PP&E.

Internal use software - software that is purchased from commercial vendors "off-the shelf," internally developed, or contractor-developed solely to meet the entity's internal or operational needs (SFFAS 10, par. 8).

Level of utilization - the portion of the usable capacity currently being used.

Partial impairment - less than full or total impairment.

Service utility - the usable capacity that at acquisition was expected to be used to provide service.

Total (full) impairment - G-PP&E is no longer capable of providing service in the operations of the entity prior to the end of its useful life.

[26] The determination of whether or not an item is significant is a matter of professional judgment. Determining if a decline in service utility 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.

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Page 12: [1] Comment	Domenic Nicholas Savini	11/29/2011 2:20 PM

Per H. Steinberg email dated 17 October. The placement of this sentence here is a little confusing. The paragraph by stating there is a two-step process; then provides the guidance for the first step—identifying potential impairments, and concludes by saying the second step should be taken. However, there is then two sections containing three paragraphs (paragraphs 12-14) that further describe the identification of potential impairments. This is exacerbated by a further discussion of the two step process with the first step outlined in detail (paragraph 15). Perhaps the solution is to delete the last sentence in paragraph 11.

Staff: Concur.

Page 12: [2] Deleted	Domenic Nicholas Savini	10/19/2011 10:01 AM

For G-PP&E having indicators of impairment, the second step - a test of impairment - should be performed to determine whether the circumstance or change in condition results in an impairment.

Page 12: [3] Comment	Domenic Nicholas Savini	11/29/2011 2:20 PM

Per A. Schumacher telecon 20 October. Clarify and correct grammar in first sentence.

Staff: Please see edits to clarify this first sentence.

Page 12: [4] Comment	Domenic Nicholas Savini	11/29/2011 2:20 PM

Per A. Schumacher telecon 20 October. Consider clarifying the use of management versus senior management. Asset custody to include assessments will typically be a mid-level management function. The draft ED is unclear concerning this distinction.
Staff: Concur: Staff suggests eliminating references to “senior management” and use the more generic “management”. Trying to determine what duties/functions belong to mid-level versus senior management is problematic.