



October 14, 2011

Memorandum

To: Members of the Board  
From: Domenic N. Savini, Assistant Director  
Through: Wendy M. Payne, Executive Director  
Subj: **Draft Materials: *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use.* – Tab H<sup>1</sup>**

**MEETING OBJECTIVE**

The objective for the October meeting is to review materials prepared based upon guidance received from members during the August meeting so that staff can either (1) begin pre-balloting procedures or (2) obtain further direction for incorporation into the next revision of the draft Exposure Draft document. This memorandum includes (1) edits to the August version of the draft Exposure Draft document, (2) enhancements/edits to the flowcharts and decision table, (3) enhancements/edits to impairment loss illustrations, notably 1c, 1d, 2b, 4a, 7a, and 7d, and (4) deletion of impairment loss illustration 4b.

**BRIEFING MATERIALS**

1. **Attachment 1 - Clean Version** of draft Exposure Draft on *Accounting and Financial Reporting for Impairment of General Property, Plant, and Equipment Remaining in Use*.
2. **Attachment 2- Track Changes Version** of draft Exposure Draft on *Accounting and Financial Reporting for Impairment of General Property, Plant, and Equipment Remaining in Use*.
3. **Appendix A-** GASB 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*.
4. **Appendix B** – Various Financial Analyses of Internal Use Software

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<sup>1</sup> 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.

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## **NEXT STEPS**

### **December 2011 – Asset Impairment**

#### **Either:**

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

### **April 2012– Asset Impairment**

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

### **June 2012– Asset Impairment**

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

### **August 2012– Asset Impairment**

- Proceed with final Ballot

### **September 2012– Asset Impairment**

- Issue Final SFFAS

## BACKGROUND

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### BACKGROUND

At the August 25, 2011 meeting the Board discussed the revised draft Exposure Draft (ED) document incorporating the June Board meeting comments entitled, *Accounting and Financial Reporting for Impairment of Capitalized Property, Plant, and Equipment Remaining in Use*.

Members reviewed the revised draft ED, proposed impairment illustrations and process flowcharts in connection with recent task force recommendations. As a result of the Board's review, members reaffirmed that entities are not expected to apply this proposed standard in a manner that would require them to "survey" their asset portfolios solely to search for potential impairments. However, members concluded that there is a presumption and reasonable expectation that entities should have systems in place that communicate impairment events to senior decision makers. Also, the Board reviewed input from the task force which suggested that certain aspects of the draft ED, when taken together might in effect preclude significant impairments from being reported. The Board examined the use of the replacement/restoration approaches and has asked staff to review the conceptual basis for using these methods on PP&E that will not be remediated. Lastly, the Board asked staff to further research the area of impairments of internal use software and develop a recommendation.

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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](mailto:savinid@fasab.gov).

# TABLE OF CONTENTS

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## TABLE OF CONTENTS

Questions for the Board .....	5
Attachment 1 – Draft ED: Clean Version of <i>Accounting and Financial Reporting for Impairment of General Property, Plant, and Equipment Remaining in Use.</i> ....	9
Attachment 2 - Draft ED: Track Changes Version of Accounting and Financial Reporting for Impairment of General Property, Plant, and Equipment Remaining in Use. ....	10
Appendix A - GASB 42, <i>Accounting and Financial Reporting for Impairment of Capital Assets and for insurance Recoveries.</i> .....	11
Appendix B – Various Financial Analyses of Internal Use Software.....	12

## Questions for the Board

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### Questions for the Board

**Questions 1 through 4** – Members asked staff to (1) incorporate various edits to the August version of the draft Exposure Draft document notably paragraphs 8, 11, 13, 17a, and 17b, (2) enhance/edit the flowcharts and decision table, (3) enhance/edit impairment loss illustrations, notably 1c, 1d, 2b, 4a, 7a, and 7d, and (4) delete the impairment loss illustration 4b.

#### Question 1 –

**Question 1 - Refer to Attachment 2, paragraphs 8, 11, 13, 14, 17a, and 17b:**

**Does the Board believe that the proposed edits (1) are consistent with its expectations and (2) satisfactorily address the Board's intent concerning:**

**Paragraph 8 - when provisions of this statement apply?**

- Shift focus to “indications of impairment” from “significant events”

**Paragraph 8 – existing entity processes?**

- No requirement to search solely for “indications of impairment.”
- Includes: G-PP&E assessments, mission requirements, prominent events, changed circumstances, and DM&R.

**Paragraphs 11, 13, 14 – how/when impairments can arise?**

- Prominent events, changed circumstances, and routine asset management processes

**Paragraph 17a – describing magnitude of the decline in utility?**

- Previous costs significantly greater than costs that would otherwise be incurred for new service utility.
- Costs include operation, maintenance, and depreciation
- Judgment factors: costs, percentage, other.

**Paragraph 17b – describing reasonable expectation?**

- Specific plans, set aside or obligated funding, history of remediation

## Questions for the Board

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### Question 2 -

**Question 2 - Refer to Attachment 2, pages 27 and 28:**  
**Does the Board believe that the revised flowcharts (1) are consistent with the revised ED impairment methodology and (2) satisfactorily explain to users the revised PP&E decision process?**

### Question 3 -

**Question 3 - Refer to Attachment 2, page 29:**  
**Does the Board believe that the revised decision table (1) is consistent with the revised ED measurement methodology and (2) satisfactorily explains to users the selection of a method that reasonably estimates the historical cost of diminished service utility?**

### Question 4 -

**Question 4 - Refer to Attachment 2 for the Impairment Loss Illustrations beginning on page 30:**  
**Does the Board believe that the revised illustrations (1c, 1d, 2b, 4a, 7a, and 7d) better reflect their respective measurement methods?**

## Questions for the Board

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### **Question 5** – Applicability of the standards to SFFAS 10, *Accounting for Internal Use Software*.

At the August meeting the Board asked staff to further research the area of impairments of internal use software and develop a recommendation. Staff has (1) obtained consultation from federal managers (financial and Information Technology (IT)) and task force representatives with expertise in software development and maintenance and (2) developed various analyses of the 24 CFO Act agency FY2010 financial statements included as Appendix B<sup>2</sup>.

Based upon the foregoing, staff proposes excluding internal use software from the provisions of this proposed standard. Due to the unique nature of internal use software, additional considerations and factors beyond the scope of this project should be addressed in a comprehensive review of SFFAS 10.

The basis for this recommendation follows (refer to Appendix B for related analyses):

1. **Questionable benefits in relation to costs** - Internal use software (IUS) represents less than 2.0% of G-PP&E.<sup>3</sup> Staff does not believe the IUS issues are significant enough to warrant further research regarding the key differences discussed below.

An analysis of SFFAS 10, paragraphs 28 and 29 which address instances of impairment for software (remaining-in-use), compared to the impairment provisions of this proposed standard reveal the following key differences:

- a. SFFAS 10 does not include the requirement that the impairment be considered permanent before a loss is recognized.
- b. Options for measuring the loss are tailored to internal use software but are in principle similar to the certain proposed methods.
- c. SFFAS 10 allows the continued amortization of the remaining book value of impaired software over the remaining useful life if the loss due to impairment cannot be measured.
- d. SFFAS 10 does not permit use of the loss measurement method applicable to cash or revenue generating assets (i.e., the undiscounted cash flow method).
- e. SFFAS 10 does not address recoveries or reversals.

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<sup>2</sup> Internal use software information was not: (1) separately reported by the General Services Administration, (2) reported by the Department of Commerce, and (3) discernable from the financial statements or footnotes of either the Nuclear Regulatory Commission or the Office of Personnel Management..

<sup>3</sup> Refer to Appendix B, Figure 1.0

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## Questions for the Board

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Individuals, including task force members with relevant IT experience, offered the following views:

2. **Most Internal Use Software has a short economic life**<sup>4</sup> - and is usually amortized over a very short period. Software with short amortization periods should not be subject to impairment testing.
3. **Nature of IT maintenance programs** - that in effect correct impairments on a fairly current basis rendering them temporary and not permanent. With each release, fixes/upgrades are laid over the preceding version and become the new foundation.
4. **Partial impairments of software do not apply in the same way as other assets** – because defects or bugs are remediated via maintenance activity and do not adversely impact net book value (NBV). The only time NBV should be impacted is if the software is no longer usable and is taken out of service.
5. **Partial impairments of software arising from technological changes or obsolescence should be addressed through depreciation** – as it makes little to no sense asking agencies to “impair” software that can become obsolete soon after purchase or development.

**Question 5. Does the Board concur with the staff recommendation to exclude internal use software from said provisions? If not, please provide rationale.**

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<sup>4</sup> Refer to Appendix B, Figure 5.0



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

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

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***Attachment 2 - Draft ED: Track Changes Version of Accounting and Financial Reporting for Impairment of General Property, Plant, and Equipment Remaining in Use.***

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**Attachment 2 - Draft ED: Track Changes Version of Accounting and Financial Reporting for Impairment of General Property, Plant, and Equipment Remaining in Use.**

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

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## **Appendix B – Various Financial Analyses of Internal Use Software**

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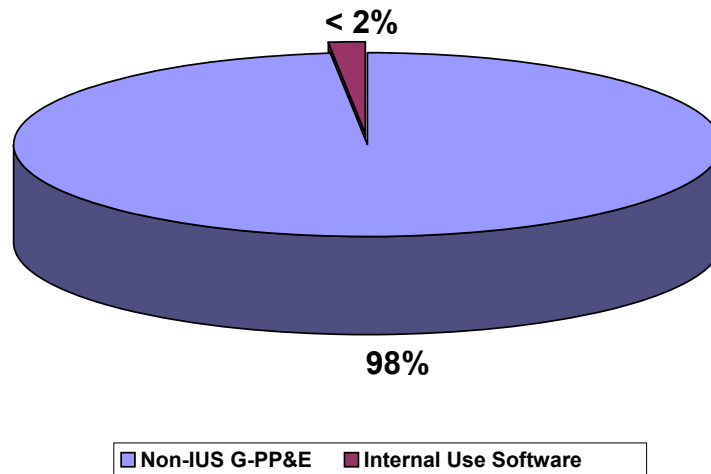
## Appendix B – Various Financial Analyses of Internal Use Software

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**Figure 1.0**  
**FY2010**  
**Internal Use Software vs. Total PP&E**  
**Acquisition Cost**

Source: FY2010 CFR, Page 77, Note 8, PP&E.

Total Internal Use Software Cost of \$27.00 divided by Total  
PP&E Cost of \$1,640.50 = 1.65%



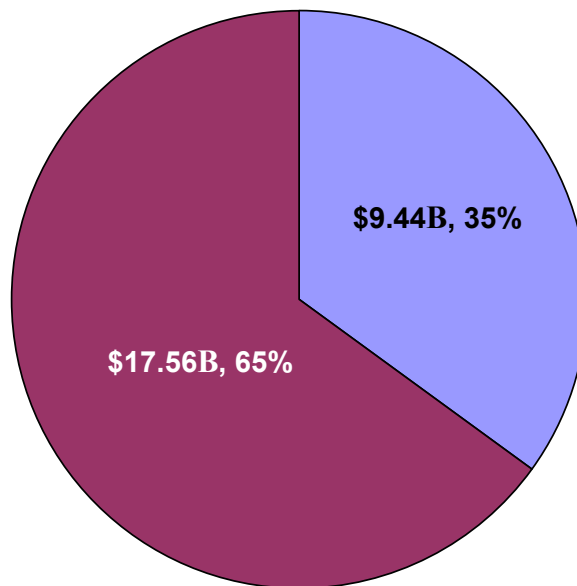
## Appendix B – Various Financial Analyses of Internal Use Software

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**Figure 2.0**  
**FY2010**  
**Internal Use Software**  
**Acquisition Cost**  
**Defense vs. Non-Defense Agencies**

Source: FY2010 CFR, Page 77, Note 8, PP&E and DoD  
FY2010 AFR, Page 88, Note 10, PP&E.

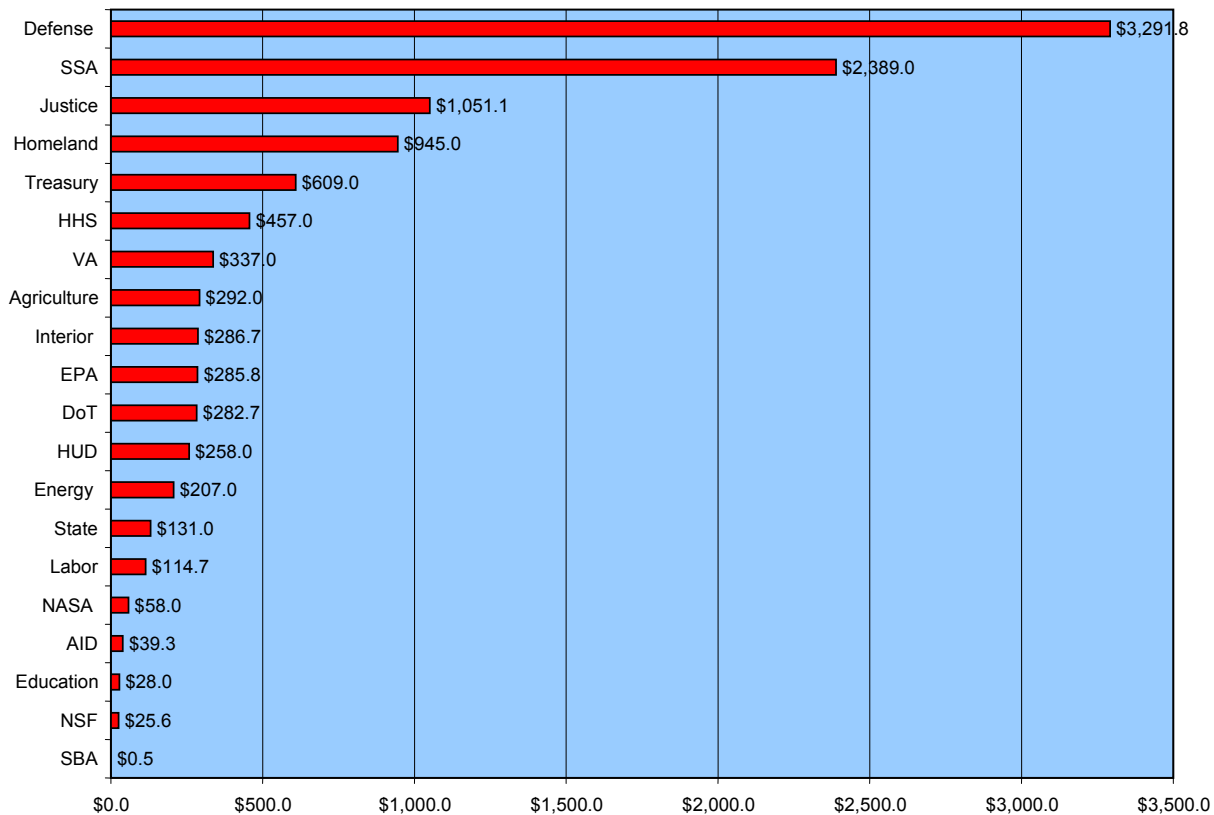
DoD IUS of \$9.44B plus Non-DoD of \$17.56 = \$27.0 B



■ Defense IUS ■ Non-Defense IUS

## Appendix B – Various Financial Analyses of Internal Use Software

**Figure 3.0**  
**FY2010**  
**Internal Use Software**  
**Net Book Value Dollar Distribution by Agency**



(millions of dollars)

<u>Agency</u>	<u>PP&amp;E</u> <u>Net Book Value</u>	<u>IUS</u> <u>NBV</u>
Defense	\$595,656.6	\$3,291.8
SSA	\$2,825.0	\$2,389.0
Justice	\$9,741.1	\$1,051.1
Homeland	\$19,074.0	\$945.0
Treasury	\$2,031.0	\$609.0
HHS	\$5,263.0	\$457.0
VA	\$16,730.0	\$337.0
Agriculture	\$2,964.0	\$292.0
Interior	\$19,691.2	\$286.7
EPA	\$915.1	\$285.8
DoT	\$13,907.5	\$282.7
HUD	\$258.0	\$258.0

Source: Agency FY2010 Financial Reports, PP&E Note disclosures.

The FY2010 CFR, Page 77, Note 8 reports \$11.6B of IUS @ NBV. These 20 CFO Act agencies comprise \$11.1B or 96.0%.

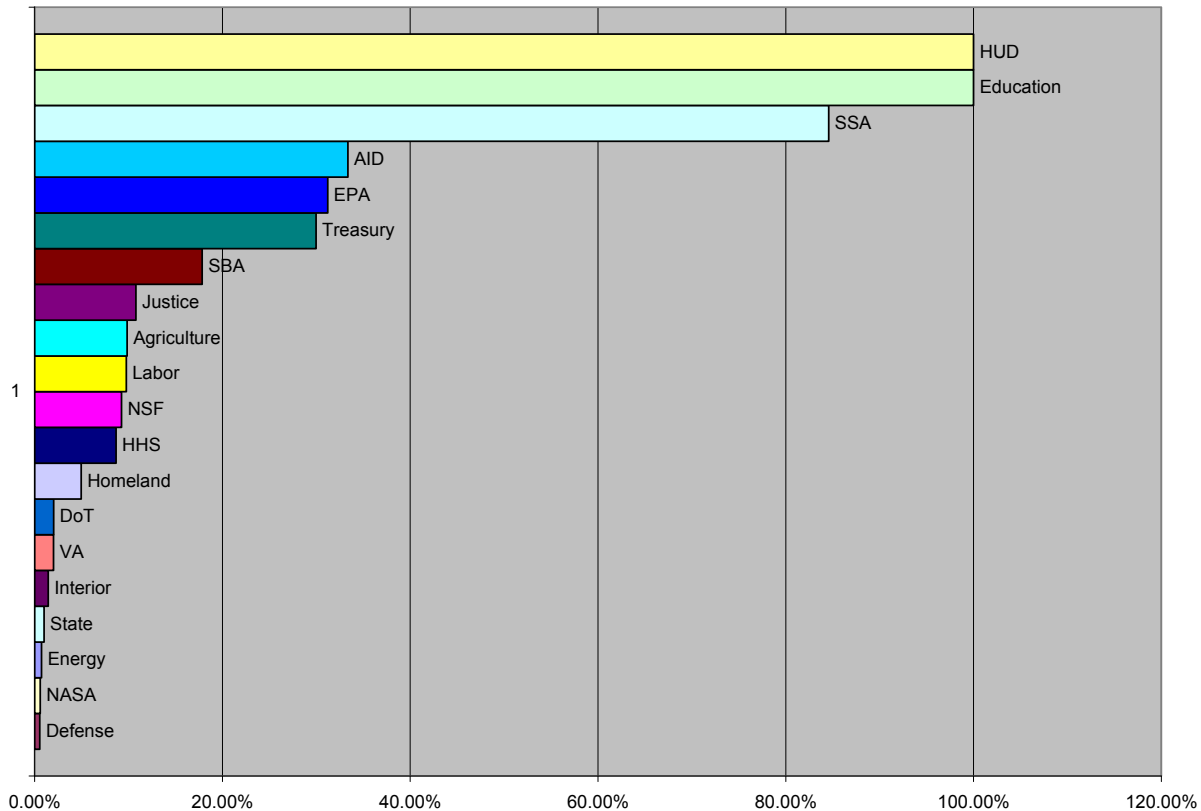
Energy	\$27,654.0	\$207.0
State	\$12,880.0	\$131.0
Labor	\$1,174.7	\$114.7
NASA	\$9,635.0	\$58.0
AID	\$117.8	\$39.3
Education	\$28.0	\$28.0
NSF	\$276.7	\$25.6
SBA	\$2.8	\$0.5
Total	\$740,825.50	\$11,089.2

## Appendix B – Various Financial Analyses of Internal Use Software

Figure 4.0

FY2010

### Net Book Value Percent Distribution Agency Internal Use Software compared to Total Agency PP&E



(millions of dollars)

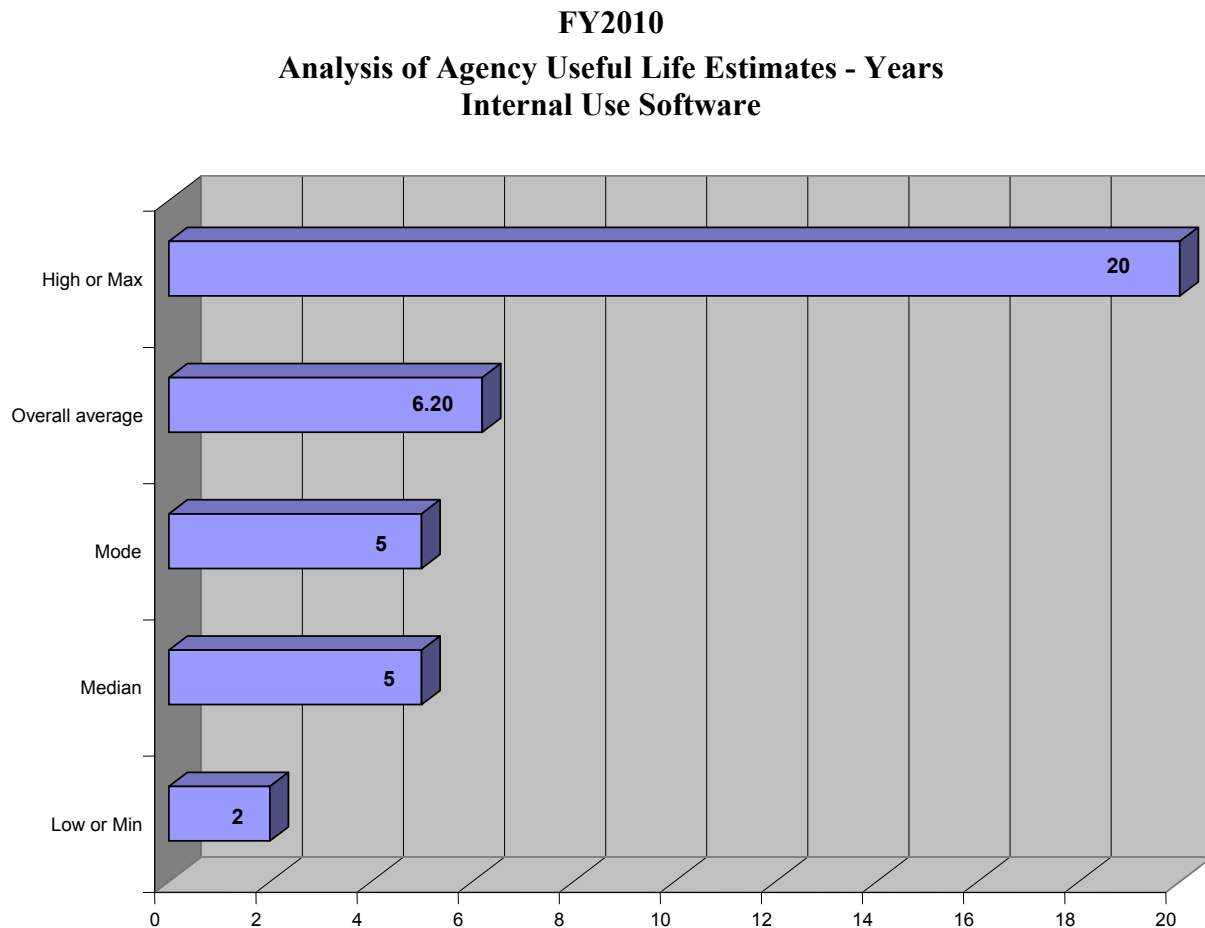
<u>Agency</u>	<u>PP&amp;E</u> <u>Net Book Value</u>	<u>IUS</u> <u>NBV</u>	<u>Percent</u>
HUD	\$258.0	\$258.0	100.00%
Education	\$28.0	\$28.0	100.00%
SSA	\$2,825.0	\$2,389.0	84.57%
AID	\$117.8	\$39.3	33.36%
EPA	\$915.1	\$285.8	31.23%
Treasury	\$2,031.0	\$609.0	29.99%
SBA	\$2.8	\$0.5	17.86%
Justice	\$9,741.1	\$1,051.1	10.79%
Agriculture	\$2,964.0	\$292.0	9.85%
Labor	\$1,174.7	\$114.7	9.76%
NSF	\$276.7	\$25.6	9.25%
HHS	\$5,263.0	\$457.0	8.68%
Homeland	\$19,074.0	\$945.0	4.95%
DoT	\$13,907.5	\$282.7	2.03%
VA	\$16,730.0	\$337.0	2.01%
Interior	\$19,691.2	\$286.7	1.46%
State	\$12,880.0	\$131.0	1.02%
Energy	\$27,654.0	\$207.0	0.75%
NASA	\$9,635.0	\$58.0	0.60%
Defense	\$595,656.6	\$3,291.8	0.55%
Total	\$740,825.50	\$11,089.2	1.50%

Source: Agency FY2010 Financial Reports, PP&E Note disclosures.



## Appendix B – Various Financial Analyses of Internal Use Software

Figure 5.0



Source: Agency FY2010 Financial Reports, PP&E Note disclosures.

<u>Agency</u>	<u>IUS</u> <u>NBV</u>	<u>Service Life</u> <u>Years</u>	<u>Agency</u> <u>Average</u>				
				Energy	\$207.0	3 to 7	5
				State	\$131.0	5	5
				Labor	\$114.7	2 to 15	8.5
Defense	\$3,291.8	2 - 5, or 10	4.8	NASA	\$58.0	5	5
SSA	\$2,389.0	10	10	AID	\$39.3	3 to 5	4
Justice	\$1,051.1	3 to 10	6.5	Education	\$28.0	3	3
Homeland	\$945.0	2 to 7	4.5	NSF	\$25.6	5	5
Treasury	\$609.0	2 to 10	6	SBA	\$0.5	2 to 5	3.5
HHS	\$457.0	5 to 10	7.5	GSA	\$0.0	3 to 10	6.5
Agriculture	\$292.0	5 to 8	6.5	OPM	\$0.0	5	5
Interior	\$286.7	5	5				
EPA	\$285.8	2 to 10	6	Low or Min	2	Mode	5
DoT	\$282.7	15 - 20	17.5	Median	5	Overall	6.20
HUD	\$258.0	4	4	High or Max	20	average	

## **Appendix B – Various Financial Analyses of Internal Use Software**

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Federal Accounting Standards Advisory Board

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**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

Working Draft – Comments Are Not Requested on This Draft

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## **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](http://www.fasab.gov).

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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](mailto: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

### 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)<sup>1</sup> 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. Impairment losses would be recognized subject to a two-step process. The loss would 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

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<sup>1</sup> 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*.

## Table of Contents

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1	<b>Table of Contents</b>	
2	Executive Summary .....	4
3	What is the Board proposing? .....	4
4	How would this proposal improve federal financial reporting and contribute to meeting the federal	
5	financial reporting objectives? .....	4
6	Questions for Respondents.....	6
7	Purpose.....	8
8	Materiality.....	8
9	Effective Date.....	9
10	Proposed Standard .....	10
11	Applicability .....	10
12	Definition of Impairment.....	10
13	Recognition of Impairment.....	11
14	Measurement .....	13
15	Reporting Impairment Losses .....	16
16	G-PP&E That Do Not Meet the Impairment Test.....	16
17	G-PP&E That Is No Longer Being Used .....	16
18	Reversing Previously Reported Impairments.....	16
19	Recoveries .....	17
20	Consolidated Financial Report of the US Government.....	17
21	Effective Date.....	17
22	Appendix A: Basis for Conclusions .....	18
23	Appendix B: Flowcharts, Decision Table and Illustrations .....	26
24	Appendix C: Abbreviations.....	63
25	Appendix D: Glossary .....	64

## 1 Questions for Respondents

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

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

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

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

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

24 All responses are requested by March X, 2012.



**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 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 each of the measurement methods identified to estimate diminished or lost service utility of G-PP&E? Please provide the rationale for your answer.**

## 1 Introduction

### 2 Purpose

- 3 1. Statement of Federal Financial Accounting Standards (SFFAS) 6, *Accounting for*  
4 *Property, Plant, and Equipment*, contains principles-based guidance concerning  
5 **general property, plant, and equipment (G-PP&E)**<sup>2</sup> that is removed from service  
6 due to total impairment of G-PP&E or other reasons. SFFAS 6 requires that G-  
7 PP&E be removed from G-PP&E accounts along with associated accumulated  
8 depreciation/amortization, if prior to disposal, retirement or removal from service it  
9 no longer provides service in the operations of the entity.
- 10 2. SFFAS 10, *Accounting for Internal Use Software*, provides guidance for the  
11 impairment of **internal use software**.<sup>3</sup> According to SFFAS 10 criteria, in order for  
12 software to be considered impaired, it would have to have lost its service potential  
13 such that the federal entity would plan to remove it from service or the software  
14 would have had its capabilities reduced. This proposal would not alter existing  
15 requirements regarding internal use software.
- 16 3. This proposed Statement would provide accounting requirements for all G-PP&E  
17 **partial impairment** not addressed in SFFAS 6 or SFFAS 10.

### 18 Materiality

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

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<sup>2</sup> Terms defined in the Glossary are shown in **bold-face** the first time they appear.

<sup>3</sup> 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.

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- 1       **Effective Date**
- 2       5. The proposed standards would be effective for reporting periods beginning after
- 3       September 30, 2014. Earlier implementation is encouraged.

DRAFT

## Proposed Standard

### 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 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.<sup>4</sup> 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 indications 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.

### Definition of Impairment

8. **Impairment** is a significant<sup>5</sup> 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.<sup>6</sup> That is, at the time the G-PP&E was acquired, the event or change in circumstance (a) would

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

<sup>5</sup> 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.

<sup>6</sup> 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.

not have been 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, is a two-step process of (a) identifying potential impairments and (b) testing for impairment. G-PP&E that are potentially impaired are identified as a result of the occurrence of prominent events or changes in circumstances, or routine asset management processes. When these suggest that G-PP&E is potentially impaired, the first step – identifying the presence of indicators of impairment – is taken. 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.

#### **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—that is, 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 discussion<sup>7</sup> by oversight entities, senior management, or 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,<sup>8</sup>

<sup>7</sup> The types of discussion that may be prompted include but are not limited to internal managerial analyses or reviews, conferences or consultations with experts, media or public relations interviews, or external industry scrutiny.

<sup>8</sup> 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 are subject to obsolescence can be addressed through depreciation, particularly by using accelerated methods that yield a lower capital cost per year as the asset's utility diminishes when compared to that of later versions of the same asset.

- 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.<sup>9</sup>

## 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 operation, maintenance, and depreciation. Judgment is needed 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 event, (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) set aside or obligated funding for remediation efforts, or (3) a history of remediating lost service utility in similar cases or for similar G-PP&E.

## Measurement

17. Impairment losses on G-PP&E that will continue to be used by the entity<sup>10</sup> should be estimated using the measurement method that reasonably<sup>11</sup>

<sup>9</sup> 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.

<sup>10</sup> 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.



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 do not reasonably reflect 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 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

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<sup>11</sup> Given a choice among comparable methods, entities should adopt the most efficient and practical method available under the circumstances.



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<sup>12</sup> or value-in-use estimate.<sup>13</sup> The net book value of the G-PP&E is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the G-

<sup>12</sup> 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.

<sup>13</sup> 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)

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 so and the test of impairment 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.

### 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 US Government

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

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

## 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, although, it is feasible that the effects of partial impairment are 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 Statement (GASB) No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*<sup>14</sup>

<sup>14</sup> © Financial Accounting Foundation, Governmental Accounting Standards Board, 401 Merrit 7, Norwalk, CT. All Rights Reserved. GASB 42, November 2003.

- 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

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 at 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, senior 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 changed 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.

The Board also notes that common indicators of potential impairment can be discovered during different types of asset management reviews which including 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



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 indicators of impairment and (b) testing to determine whether 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

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, management's action to address the situation is an indication that the expenses are too high in relation to the benefit. If senior management has not addressed the matter, and has not initiated any action, there may be a presumption, absent other facts, that the magnitude of the decline is not significant and that the test of impairment would 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.



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 approaches should yield a reasonable estimate. That is, there should not be a presumption of reasonableness attached to the use of any of these methods if the resultant calculations lead to a measure that does not reasonably reflect the remaining service utility of the G-PP&E. 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 100.0% write-down of the carrying value. However, if the asset is to remain in use, the 100.0% write-down would be inappropriate because existing 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 being 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 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 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 does not (1) seek exacting precision in determining the lost service utility of the asset and (2) intend to direct or prescribe the use of any particular method listed in paragraph 17.

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 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.

1 Appendix B: Flowcharts, Decision Table and Illustrations

2

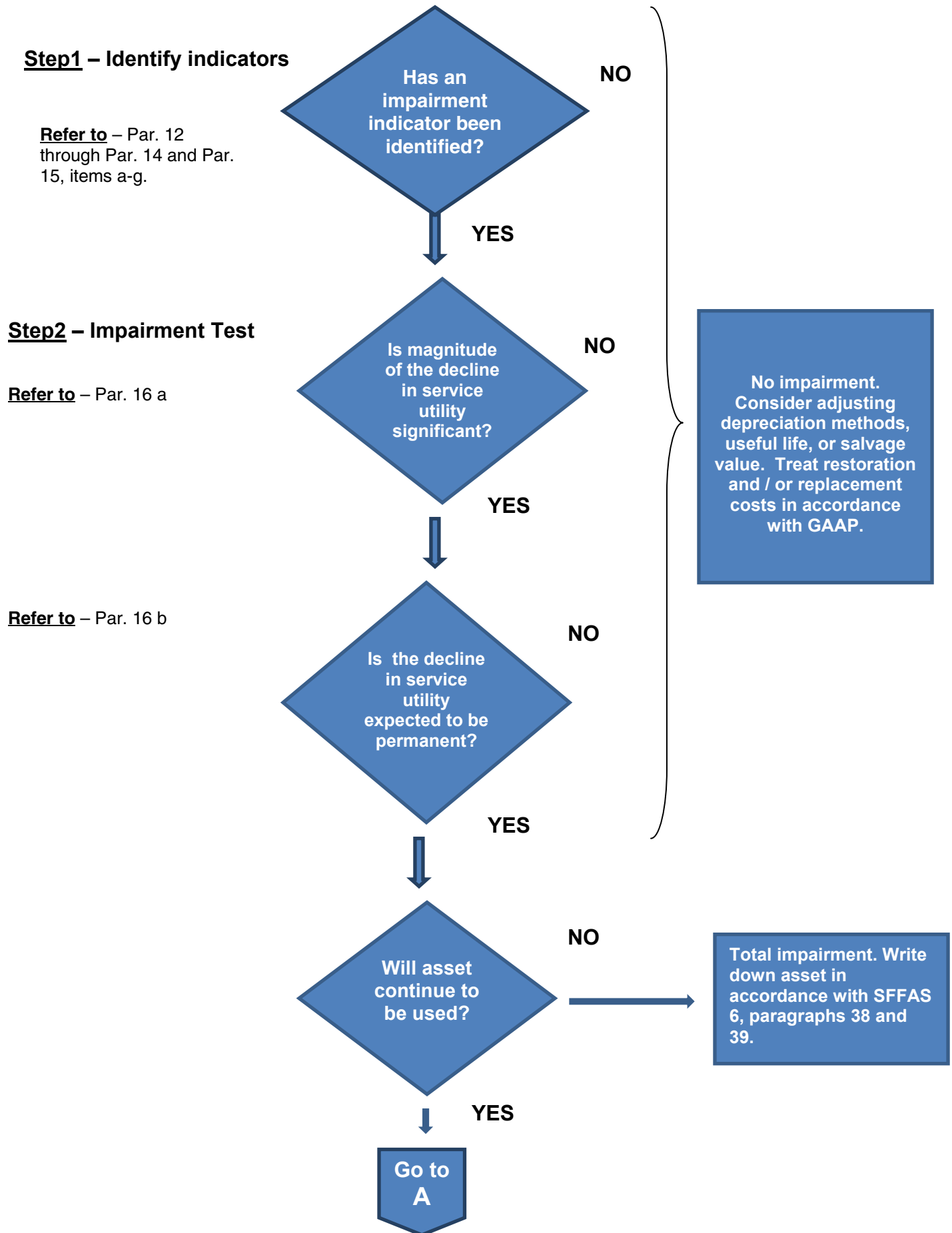
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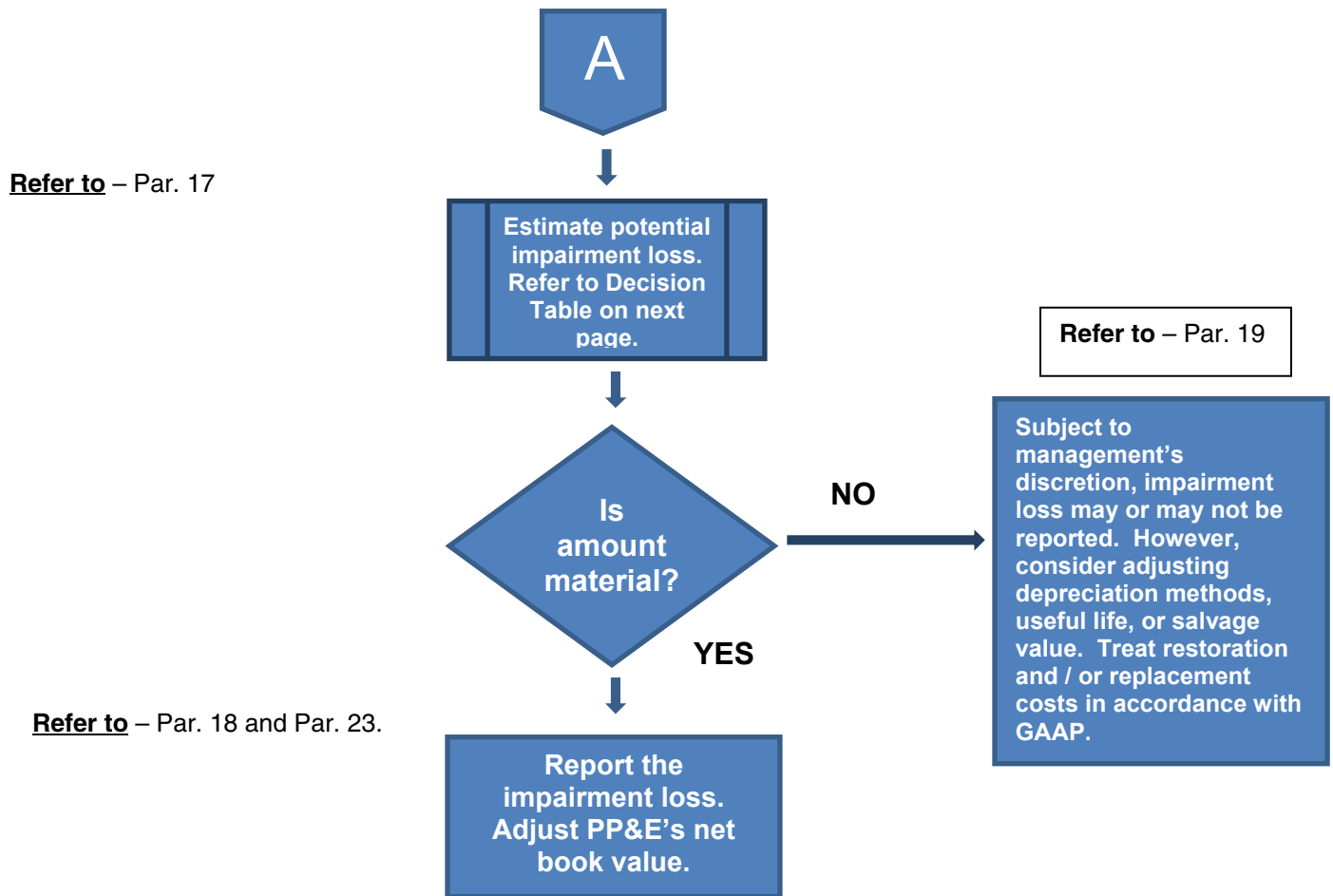
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# General PP&E Impairment Decision Table

## Selecting a Measurement Method

29

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.

Some Acceptable Measurement Methods <sup>15</sup>	Potential Indicators	Type of PP&E *	Reference	Illustrations that may be appropriate
Replacement Approach	<ul style="list-style-type: none"> <li>Physical Damage</li> </ul>	All G-PP&E	Par. 17 a	1c
Restoration Approach	<ul style="list-style-type: none"> <li>Physical Damage</li> </ul>	Multi-use Heritage PP&E	Par. 17 b	2b
Service Units Approach	<ul style="list-style-type: none"> <li>Enactment or approval of laws/regulations</li> <li>Changes in environmental or economic factors</li> <li>Technological changes or obsolescence</li> </ul>	All G-PP&E	Par. 17 c	1d, 3a, 3b
Deflated Depreciated Current Cost Approach	<ul style="list-style-type: none"> <li>Change in manner or duration of use.</li> </ul>	All G-PP&E	Par. 17 d	4a
Cash Flow Approach	<ul style="list-style-type: none"> <li>Any of the indicators as listed at Paragraph 15 (a through g)</li> </ul>	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	<ul style="list-style-type: none"> <li>Construction stoppage / Contract terminations</li> </ul>	All G-PP&E	Par. 17 f	5, 6a, 6b

\* = excluding internal use software

<sup>15</sup> Other industry-accepted methods may be appropriate.

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## ILLUSTRATIONS

This appendix illustrates the application of the provisions of this Statement to assist in clarifying their meaning. The facts assumed in these examples are illustrative only and are not intended to modify or limit the requirements of this Statement or to indicate the Board's endorsement of the situations or methods illustrated. Additionally, these illustrations are not intended to provide guidance on determining the application of materiality. Application of the provisions of this Statement may require assessing facts and circumstances other than those illustrated here and require reference to other applicable Standards.

### Illustration 1a

#### **Temporary Declines in Service Utility: *Physical Damage to an Office Building with Mold Contamination***<sup>16</sup>

##### **Assumptions**

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

Senior management 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.

##### **Evaluation of potential impairment**

The mold contamination is evidence of physical damage – an impairment indicator. Also, the magnitude of the event (i.e., closure of the building) is a significant decline in service utility. However, because senior management 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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<sup>16</sup> 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 senior entity officials became aware of extensive mold contamination at one of its office buildings. Facilities management personnel advised that the building be closed due to health and safety concerns. Shortly afterwards, the office building was vacated and closed.

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

**Evaluation of potential impairment**

The mold contamination is evidence of physical damage – an impairment indicator. Also, the magnitude of the event (i.e., closure of the building) is a significant decline in service utility. Because senior management does not believe that remediation efforts will begin, the lost service utility of the building is permanent. However, because the entire office building will be taken out of service and prepared for disposal purposes, no impairment loss is recognized. Instead, the provisions of SFFAS 6, *Accounting for Property, Plant, and Equipment* 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 senior 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 the damaged building would 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 mold remediation (involving removal and rebuilding of the interior walls and improving site drainage) would cost \$24 million.

After a detailed review, senior 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.

**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 senior 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.

**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	<u>\$100,000</u>		<u>\$100,000</u>
Building acquisition, 1982	\$1,200,000	\$600,000	\$600,000
Improvements	1,235,000	320,000	915,000
<b>Total - Building &amp; Improvements</b>	<b><u>\$2,435,000</u></b>	<b><u>\$920,000</u></b>	<b><u>\$1,515,000</u></b>

**Calculate estimated cost to replace lost service utility:**

Total remediation cost	\$2,000,000
Percentage wall & foundation cost	<u>90%</u>
<b>Wall &amp; Foundation Remediation cost</b>	<b><u>\$1,800,000</u></b>

**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)	<u>8,500,000</u>
<b>Wall &amp; Foundation Remediation cost percentage</b>	<b>21.18%</b>

**Calculate potential impairment loss:**

**Net book value (historical cost)** **\$1,515,000**

<b>Multiplied by: Wall &amp; Foundation Remediation cost percentage</b>	<b><u>21.18%</u></b>
<b>Potential impairment loss</b>	<b><u>\$320,877</u></b>

**Reporting**

If material, the potential impairment loss of \$320,877 and corresponding reduction of the book value of the building would be reported.

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**Illustration 1d****Choice Among Methods - Permanent Declines in Lost Service Utility: *Physical Damage to an Office Building with Mold Contamination*****Assumptions**

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

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

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

**Evaluation of potential impairment**

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

**Measurement of potential impairment**

Facilities management personnel in consultation with the Comptroller's office advise senior management to use the service units approach instead of the replacement cost approach because (1) time is of the essence with year-end fast approaching and (2) using construction cost estimates are not likely to result in a materially different potential impairment loss amount. Senior 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.

**Calculate percentage of lost service utility in terms of units:**

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

**Calculate potential impairment loss:**

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

**Reporting**

If material, the potential impairment loss of \$606,000 and corresponding reduction of the book value of the building would be reported.

**Illustration 2a****Normal and Ordinary Lost Service Utility: *Physical Damage to a Multi-use Heritage Asset***<sup>17</sup>**Assumptions**

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

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

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

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

**Evaluation of potential impairment**

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

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

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

A fire recently destroyed a 3-story wing addition of an historic building. The building addition housed 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 19<sup>th</sup> century and the added wing in the 20<sup>th</sup> 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 set-aside. Displaced staff were moved to nearby vacant office space.

**Evaluation of potential impairment**

The destruction of the 3-story wing is evidence of physical damage – an impairment indicator. Also, the magnitude of the event (i.e., loss of senior administrative office space) would be evaluated as a significant decline in service utility. Because the Board of Regents provided for partial restoration (one level) of the multi-use heritage asset, the lost service utility of the other two levels of the administrative wing is deemed permanent. As a result, because the lost service utility from these two levels 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 senior management:

#### Calculate estimated cost to restore lost service utility:

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

#### 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
<b>Restoration cost percentage</b>	<b>55.5%</b>

#### Calculate potential impairment loss:

<b>Net Book Value (historical cost of wing)</b>	<b>\$1,750,000</b>
<b>Multiplied by: Restoration cost percentage</b>	<b><u>55.5%</u></b>
<b>Potential impairment loss</b>	<b><u>\$971,250</u></b>

### Reporting

If material, the potential impairment loss of \$971,250 and corresponding reduction of the book value of the building would be reported.

**Illustration 3a****Service Units Approach - Recoverable Service Utility: Technological Development or Evidence of Obsolescence -*Underutilized Magnetic Resonance Imaging Machine*<sup>18</sup>****Assumptions**

In 2010, a hospital purchased a magnetic resonance imaging (MRI) system at a cost of \$2.25 million. The hospital estimated that the system would have an estimated useful life of seven years and that on average the system would be used for ten tests per day for five days per week. After installation, the utilization of the system was approximately at the levels estimated.

In 2013, an affiliated entity transferred an “open” MRI system to the hospital. The transferred MRI system began to be used more frequently than the original “closed” MRI system because the “open” MRI was more comfortable for patients and provided a superior image. Instead of providing ten images a day, the original MRI system was being used only on an overflow basis and averaged six images per day; a decrease to 60 percent of prior levels. Furthermore, the expenses associated with the continued operation and maintenance (O&M) of the “closed” MRI system continue to be incurred and senior management is evaluating the asset’s continued service use and whether or not to book an impairment loss.

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

**Evaluation of potential impairment**

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

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

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

### Measurement of potential impairment

#### Calculate Net Book Value:

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

#### Calculate Acquisition cost per service unit:

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

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

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

**Calculate Potential Impairment Loss:**

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

**Reporting**

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

**Illustration 3b****Service Units Approach - Non-recoverable Service Utility: Technological Development or Evidence of Obsolescence -*Underutilized Magnetic Resonance Imaging Machine*****Assumptions**

In 2010, a hospital purchased a magnetic resonance imaging (MRI) system at a cost of \$2.25 million. The hospital estimated that the system would have an estimated useful life of seven years and that on average the system would be used for ten tests per day for five days per week. After installation, the utilization of the system was approximately at the levels estimated.

In 2013, an affiliated entity transferred an “open” MRI system to the hospital. The transferred MRI system began to be used more frequently than the original “closed” MRI system because the “open” MRI was more comfortable for patients and provided a superior image. Instead of providing ten images a day, the original MRI system was being used only on an overflow basis and averaged one image per day; decrease to 10 percent of prior levels. Furthermore, the expenses associated with the continued operation and maintenance of the “closed” MRI system continue to be incurred and has drawn senior management’s attention to evaluate the asset’s continued service use.

**Evaluation of potential impairment**

The indicator of potential impairment is the change in technology, which has resulted in a permanent reduction in the usage of the “closed” MRI system. The magnitude test (i.e., decline in service utility relative to operating costs) has also been met due to the fact that the cost of operating the “closed” MRI system has remained the same while the service provided has decreased to 10 percent of prior levels. Potential impairment loss using the service units approach would be determined as follows:

**Measurement of potential impairment****Calculate Net Book Value:**

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

**Calculate Acquisition cost per service unit:**

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

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

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

**Calculate Potential Impairment Loss:**

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

**Reporting**

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

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**Illustration 4a****Deflated Depreciated Current Cost Approach: Change in Manner or Duration of Use – *Training Facility Used for Storage*<sup>19</sup>****Assumptions**

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

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

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

**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.

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

**Measurement of potential impairment****Calculate Net Book Value:**

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

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

**Calculate Depreciated current cost (current dollars):**

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

**Calculate Deflation factor:**

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

**Apply deflation factor to depreciated current cost:**

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



**Calculate Potential impairment loss:**

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

**Reporting**

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

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**Illustration 5*****Construction Stoppage—Special Purpose Test Equipment***<sup>20</sup>**Assumptions**

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

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

**Evaluation of potential impairment**

The indicator of impairment is the construction stoppage. It appears to meet the test of impairment in that senior management would not have initiated the project if it had expected either program cancellation or lack of any potential commercial use. The situation passes the magnitude test because the costs-to-date (75% or \$7.5 million) are significant in both percentage and monetary terms. However, there is no potential impairment loss to report 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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<sup>20</sup> 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**

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

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

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

**Evaluation of potential impairment**

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

Senior management is concerned that the presence of an impairment indicator might affect its plan regarding the future use of the shared-services if the analysis indicates that the net book value of the assets are not recoverable. 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.

## 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<sup>21</sup> or value-in-use estimate.<sup>22</sup> 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: <u>Administrative</u>	Asset Group: <u>Information Technology</u>
Assets' net book values at 12/31/X1 (a)	<u>\$12,000,000</u> (a)	<u>\$11,000,000</u> (a)

<sup>21</sup> 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.

<sup>22</sup> 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: <u>Administrative</u>	Asset Group: <u>Information Technology</u>
Undiscounted cash flows from future operations	\$12,000,000	\$9,000,000
Undiscounted cash flows from future disposal of assets	2,000,000	1,000,000
<b>Total - undiscounted cash flows (b)</b>	<b>\$14,000,000</b> (b)	<b>\$10,000,000</b> (b)

2

## 3 Calculate Recoverability:

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

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

**Reporting**

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



**Illustration 7b****Cash flow approach – Equipment: Technological Development or Evidence of Obsolescence - *Underutilized Magnetic Resonance Imaging Machine*<sup>23</sup>****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 senior management’s attention to evaluate the asset’s continued service use. Because similar used MRI machines in the open market can be purchased from authorized dealers for \$750,000 (their mark-up percentages are unknown), senior management is considering the possibility of selling the old machine and using its proceeds to help purchase the “open” MRI system.

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

**Evaluation of potential impairment**

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

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

## Measurement of potential impairment

### Calculate Net Book Value:

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

### Calculate undiscounted cash flows:

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

### Calculate Recoverability: (b minus a)

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

**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 senior 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".

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

**Reporting**

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

**Illustration 7c****Cash flow approach – Facility: Changes in manner or duration of use -  
Government owned-contractor operated (GOCO) manufacturing facility<sup>24</sup>****Assumptions**

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

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

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

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

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

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

<sup>24</sup> 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

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

### 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 senior 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, senior management intends to convert a portion of the facility for public storage; a change in the manner of use.

### Measurement of potential impairment

#### Calculate Net book value:

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

#### Calculate undiscounted cash flows:

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

**Calculate Recoverability: (b minus a)**

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

**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*<sup>25</sup>****Assumptions**

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

**Evaluation of potential impairment**

In this case the entity should (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:**

<b>Calculate undiscounted cash flows:</b>	<b><u>Undiscounted</u></b>	<b><u>PV Factor</u></b>	<b><u>Discounted</u></b>
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
<b>Total - cash flows (b)</b>	<b>\$5,375,000</b>		<b>\$2,497,510</b>

<sup>25</sup> 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

**Calculate Recoverability: (b minus a)**

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

**Calculate potential impairment:**

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

**Reporting**

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



**1 Appendix C: Abbreviations**

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

22

23

## 1 Appendix D: Glossary

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

6 **Impairment** - a significant<sup>26</sup> and permanent, gradual or sudden, decline in the service  
7 utility of G-PP&E.

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

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

12 **Partial impairment** - less than full or total impairment.

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

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

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<sup>26</sup> 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.

1 **FASAB Board Members**

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**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

Working Draft – Comments Are Not Requested on This Draft

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## 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](http://www.fasab.gov).

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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.”

Comment: As per ED review on 7 October.

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](mailto: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

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)<sup>1</sup> 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. Impairment losses would be recognized subject to a two-step process. The loss would 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.

**Comment:** As per ED review on 7 October. Please see this additional language and the Line 12 edit below.

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.

**Deleted:** because it requires

**Comment:** As per ED 28 Sept review.

**Deleted:** better understand when

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**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

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.

<sup>1</sup> 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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## Table of Contents

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1	<b>Table of Contents</b>		
2	Executive Summary .....	4	
3	What is the Board proposing? .....	4	
4	How would this proposal improve federal financial reporting and contribute to meeting the federal		
5	financial reporting objectives? .....	4	
6	Questions for Respondents .....	<del>6</del>	Deleted: 7
7	Purpose .....	<del>8</del>	Deleted: 9
8	Materiality .....	<del>8</del>	Deleted: 9
9	Effective Date .....	<del>9</del>	Deleted: 10
10	Proposed Standard .....	<del>10</del>	Deleted: 11
11	Applicability .....	<del>10</del>	Deleted: 11
12	Definition of Impairment .....	<del>10</del>	Deleted: 11
13	Recognition of Impairment .....	<del>11</del>	Deleted: 12
14	Measurement .....	<del>13</del>	Deleted: 14
15	Reporting Impairment Losses .....	<del>16</del>	Deleted: 17
16	G-PP&E That Do Not Meet the Impairment Test .....	<del>16</del>	Deleted: 17
17	G-PP&E That Is No Longer Being Used .....	<del>16</del>	Deleted: 17
18	Reversing Previously Reported Impairments .....	<del>16</del>	Deleted: 17
19	Recoveries .....	<del>17</del>	Deleted: 18
20	Consolidated Financial Report of the US Government .....	<del>17</del>	Deleted: 18
21	Effective Date .....	<del>17</del>	Deleted: 18
22	Appendix A: Basis for Conclusions .....	<del>18</del>	Deleted: 19
23	Appendix B: Flowcharts, Decision Table and Illustrations .....	<del>26</del>	Deleted: 27
24	Appendix C: Abbreviations .....	<del>64</del>	Deleted: 65
25	Appendix D: Glossary .....	<del>65</del>	Deleted: 66



**1 Questions for Respondents**

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

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

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

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

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

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

1 **Q1.** The Board proposes to establish a requirement to recognize impairment losses when  
 2 there is a *significant and permanent* decline, whether gradual or sudden, in the service utility of  
 3 G-PP&E. Refer to paragraphs 8 and 10 of the proposed standards and paragraphs A3 through  
 4 A5 in Appendix A - Basis for Conclusions for a discussion and related explanation.

Deleted: and

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

8 **Q2.** The Board proposes that this Statement should not require entities to search their G-PP&E  
 9 portfolios solely for potential impairments. Entities are not expected to alter existing surveillance  
 10 methods as a direct consequence of the proposed standards. Refer to paragraphs 12 and 13 of  
 11 the proposed standards and paragraphs A3b, and A4 through A9 in Appendix A - Basis for  
 12 Conclusions for a discussion and related explanation.

Deleted: (1) be used in limited and rare instances and (2) does

13 **Do you agree or disagree with the Board's proposal that this Statement should not**  
 14 **require entities to search their G-PP&E portfolios solely for potential impairments?**  
 15 **Please provide the rationale for your answer.**

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Deleted: (1) be used in limited and rare instances and (2) does

16 **Q3.** The Board has identified the following as indicators of G-PP&E impairments: evidence of  
 17 physical damage, enactment or approval of laws or regulations, changes in environmental or  
 18 economic factors, technological changes or evidence of obsolescence, changes in the manner  
 19 or duration of use of G-PP&E, and construction stoppage or contract termination, and G-PP&E  
 20 scheduled or awaiting (i.e., idled or unserviceable) disposal, retirement, or removal for  
 21 excessively long periods. Refer to paragraph 15 of the proposed standards and paragraphs A4  
 22 through A9 and A11 through A16 in Appendix A - Basis for Conclusions for a discussion and  
 23 related explanation.

Deleted: conditions giving rise to

24 **Do you agree or disagree with each of the indicators of G-PP&E impairment? Please**  
 25 **provide the rationale for your answer.**

Deleted: conditions identified as giving rise to impairments of G-PP&E

26 **Q4.** The Board believes that impairment losses should be estimated using a measurement  
 27 method that reasonably reflects the diminished or lost service utility of the G-PP&E. The Board  
 28 has identified the following methods to measure diminished service utility: replacement  
 29 approach, restoration approach, service units approach, deflated depreciated current cost  
 30 approach, cash flow approach and for construction stoppages/contract terminations the lower of  
 31 (1) net book value or (2) the higher of its net realizable value or value-in-use estimate approach.  
 32 Refer to paragraph 17 of the proposed standards and paragraphs A11 through A19 in Appendix  
 33 A - Basis for Conclusions for a discussion and related explanation.

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Deleted: used

Deleted: undiscounted

Deleted: recoverable amount

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

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## 1 Introduction

## 2 Purpose

- 3 1. Statement of Federal Financial Accounting Standards (SFFAS) 6, *Accounting for*  
 4 *Property, Plant, and Equipment*, contains principles-based guidance concerning  
 5 **general property, plant, and equipment (G-PP&E)**<sup>2</sup> that is removed from service  
 6 due to total impairment of G-PP&E or other reasons. SFFAS 6 requires that G-  
 7 PP&E be removed from G-PP&E accounts along with associated accumulated  
 8 depreciation/amortization, if prior to disposal, retirement or removal from service it  
 9 no longer provides service in the operations of the entity.
- 10 2. SFFAS 10, *Accounting for Internal Use Software*, provides guidance for the  
 11 impairment of **internal use software**.<sup>3</sup> According to SFFAS 10 criteria, in order for  
 12 software to be considered impaired, it would have to have lost its service potential  
 13 such that the federal entity would plan to remove it from service or the software  
 14 would have had its capabilities reduced. This proposal would not alter existing  
 15 requirements regarding internal use software.

- 16 3. This proposed Statement would provide accounting requirements for all G-PP&E  
 17 partial impairment not addressed in SFFAS 6 or SFFAS 10.

## 18 Materiality

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

<sup>2</sup> Terms defined in the Glossary are shown in **bold-face** the first time they appear.

<sup>3</sup> 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:** As per ED 28 Sept review. Delete because covered in Par. 4.

**Deleted:** The Federal Accounting Standards Advisory Board (FASAB) has not previously established specific requirements for the accounting and financial reporting of the impairment of general PP&E. Therefore, the objective of this proposed Statement is to establish accounting requirements for the impairment of general PP&E remaining in use.

**Comment:** Per H. Steinberg email dated 20 August. Paragraphs 2 and 4 seem to clash.

Staff suggested clarifying that SFFAS 6 deals with "total" impairments whereas this proposed standard deals with "partial" impairments.

Mr. Steinberg concurred.

**Deleted:** general

**Deleted:** general

**Deleted:** e

**Deleted:** is expected to

**Deleted:** general

**Comment:** Per H. Steinberg email dated 20 August. Paragraphs 2 and 4 seem to clash.

Staff suggested clarifying that SFFAS 6 deals with "total" impairments whereas this proposed standard deals with "partial" impairments.

Mr. Steinberg concurred.

**Deleted:** yet

**Deleted:** and SFFAS 10.

**Deleted:** general

**Effective Date**

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

**Deleted:** (beginning in fiscal year 2015)

DRAFT

## Proposed Standard

### 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 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.<sup>4</sup> 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 indications 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:** As per 25 August Board meeting. Incorporating R. Kearney edit; ADD "remaining in use."

**Comment:** As per 25 August Board meeting. Incorporating S. Showalter suggested language as modified by Board at meeting.

**Deleted:** This Statement is intended to be applied in limited and rare instances and does not require that entities search their G-PP&E portfolios for potential impairments.

**Inserted:** G-

### Definition of Impairment

8. **Impairment** is a significant<sup>5</sup> 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.<sup>6</sup> That is, at the time the G-PP&E was acquired, the event or change in circumstance (a) would

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

<sup>5</sup> 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.

<sup>6</sup> 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.

**Deleted:** , such as an impairment event

**Deleted:** n item

**Deleted:** life cycle

not have been 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, is a two-step process of (a) identifying potential impairments and (b) testing for impairment. G-PP&E that are potentially impaired are identified as a result of the occurrence of prominent events or changes in circumstances, or routine asset management processes. When these suggest that G-PP&E is potentially impaired, the first step – identifying the presence of indicators of impairment – is taken. 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.

### 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—that is, 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

**Comment:** Par. 11 - As per 25 August Board meeting. Messrs Steinberg and Dacey. HS – does materiality rule out all impairments? BD – Probably yes at CFR level but not necessarily so at component level. See related Showalter/Granof comments below.

Staff proposes adopting the Showalter/Granof/Jackson recommendation to eliminate references to "materiality."

**Deleted:** Impairments to G-PP&E that are recognized should arise from significant events and those without a material impact to the financial statements need not be recognized.

**Comment:** Par. 12 - Per W. Jackson email dated 24 August. There is too much cross referencing.

Staff notes: Please see deletions below and suggested edits.

**Deleted:** are prominent and

**Deleted:** , such as those described in paragraphs 13 and 15 below

**Deleted:** , as described in paragraph 16,

**Deleted:** as defined in paragraph 9 and explained in paragraphs 10 through 14

**Deleted:** Identification of

**Deleted:** That May Indicate Impairment

**Comment:** As per ED 28 Sept review. Add "...management or oversight entities."

**Comment:** Par. 13 - As per 25 August Board meeting. H. Steinberg proposed clarifying sentence by eliminating "Absent any such...."

Staff notes: please see deletion.

**Deleted:** Absent any such events or changes in circumstances,

**Comment:** As per 25 August Board meeting. B. Dacey questioned the phrase "additional procedures" as additional to what?

Staff reply: please see deletion.

**Deleted:** additional



expected to have prompted discussion<sup>7</sup> by oversight entities, senior management, or 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,<sup>8</sup>

<sup>7</sup> The types of discussion that may be prompted include but are not limited to internal managerial analyses or reviews, conferences or consultations with experts, media or public relations interviews, or external industry scrutiny.

<sup>8</sup> 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 are subject to obsolescence can be addressed through depreciation, particularly by using accelerated methods that yield a lower capital cost per year as the asset's utility diminishes when compared to that of later versions of the same asset.

**Comment:** Per M. Granof email dated 22 August - What is meant by "prompted discussion."; also, again do we need to mention materiality? I'm still unsure of what constitutes a "prominent" event.

Staff reply: please see added footnote and deletion of materiality reference.

**Comment:** Per W. Jackson email dated 24 August - I would strike the last sentence on "materiality." Again, this goes without saying although I understand your reasoning for including it.

**Staff reply** – see deletion of materiality reference.

**Deleted:** Prominent or significant events or changes in circumstances without a permanent loss in service utility

**Deleted:** need not be reported as an impairment loss. ¶ Impairment Indicators Can Be

**Inserted:** or changes in circumstances

**Inserted:** out

**Deleted:** but without a material impact on the financial statements,

**Inserted:**

**Inserted:** Impairment Indicators Can Be

**Deleted:** are eligible for recognition if they meet the requirements set forth in paragraphs 16 and 17 below

**Deleted:** should b

**Inserted:** should b

**Deleted:** e

**Deleted:** Assessment results without a permanent loss in service utility need not be reported as a ... [1]

**Inserted:** e

**Comment:** Per H. Steinberg email dated 20 August. Can a phrase ... [2]

**Comment:** Per M. Granof email dated 22 August. I would omit ... [3]

**Deleted:** . As entities evaluate prominent events or changes in ... [4]

**Deleted:** not unexpected

- 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.<sup>9</sup>

## 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 operation, maintenance, and depreciation. Judgment is needed 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 event, (2) the percentage decline in service utility, or (3) other considerations.

**Deleted:** The expenses associated with continued operation and maintenance (including depreciation) or costs associated with replacement or restoration of the G-PP&E are significant in relationship to the currently expected service utility

**Comment:** As per 28 Sept ED review. Add "Judgment is needed .....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) set aside 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:** As per 25 August Board meeting. B. Dacey – "If we can clarify 16a it will achieve its intended purpose". H. Steinberg proposed via 25 August email: "The costs associated with previous service utility are significantly greater than the costs that would otherwise be associated with the new expected service utility."

**Comment:** Per W. Jackson email dated 24 August. The last sentence seems unnecessary. It seems to go without saying.

**Staff Reply –** Staff advises that we explicitly state that the impaired asset is expected to remain in use; provide future utility. If not, it defaults to SFFAS 6 "removal from service" treatment. This is also consistent with paragraph 8 language added by R Kearney.

**Comment:** As per 25 August Board meeting. Messrs Allen, Showalter & Dacey – explain what we mean by reasonable expectation. Link back to plans.

## Measurement

17. Impairment losses on G-PP&E that will continue to be used by the entity<sup>10</sup> should be estimated using the measurement method that reasonably<sup>11</sup>

<sup>9</sup> 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.

<sup>10</sup> 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.



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 do not reasonably reflect 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 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

**Comment:** As per 25 August Board meeting. Staff asked to review conceptual basis for using this and the restoration method on PP&E that will not be remediated.

Staff's review follows:

1. GASB and IPSASB endorse these methods when assets are damaged.

2. GASB 42, Par. 49 notes that in cases of damaged assets, using the service units approach is not appropriate because this approach does not "capture the latent service capacity."

3. GASB 42 at Appendix E, paragraph 68 seems to imply that even in cases where the asset will continue to be used (i.e., repair to restore lost utility has not taken place), the restoration approach is appropriate and should be used.

Staff suggests that we retain these methods (see revised illustrations 1c and 1d). Staff is particularly concerned that eliminating the approaches will have the unintended consequences of (1) reducing management's flexibility by limiting them to the service units method and (2) overstating asset write-downs because as GASB notes, the service units approach does not "capture the latent service capacity."

UPDATE – Per MG 28 Sept telecon – general agreement to retain and staff to propose language in standard for consideration. See below Comment.

**Comment:** As per M. Granof email & telecon on 28 Sept concerning extreme but not unusual cases where following a method could lead to illogical conclusions.

Staff reply: Please see suggested language here and at A13f.

**Deleted:** either

**Deleted:** either

**Deleted:** or by applying a

<sup>11</sup> Given a choice among comparable methods, entities should adopt the most efficient and practical method available under the circumstances.

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<sup>12</sup> or value-in-use estimate.<sup>13</sup> The net book value of the G-PP&E is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the G-

<sup>12</sup> 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.

<sup>13</sup> 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)

**Comment:** As per 25 August Board meeting. W. Jackson suggested clarification of this term in connection with Illustration 7d. Mr. Dacey noted that the recoverability test in fact uses undiscounted dollars and he suggested changing the 7d title to reflect that discounted cash flow dollars could be used as a proxy for value-in-use.

Staff notes: Please see title change, suggested edits and revised Illustration 7d.

**Deleted:** Undiscounted c

**Deleted:** measured

**Deleted:** n undiscounted

**Deleted:** Source: FASAB Glossary, Appendix E

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 so and the test of impairment 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.

## 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

**Comment:** As per 28 Sept ED review. Members sought greater clarity; please make title change and edits to this paragraph.

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**Comment:** As per 16 Sept ED review: Our statement of net costs doesn't show functional or natural cost classifications.

Staff reply: Concur. Unless the Board believes differently, staff is not proposing that we adopt this GASB requirement. Please see suggested edit.

**Deleted:** If not otherwise apparent from the face of the financial statements, a

**Comment:** Per M. Granof email dated 22 August. Divide the first sentence in two. A "but" and a "yet" in one sentence is a bit much.

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**Comment:** Per S. Showalter email dated 8 September. Suggested we address "reversals".

Staff reply: Please see proposed new paragraph.

**Deleted:** along with any related costs (e.g., site preparation, installation, etc.) becomes the G-PP&E's new cost basis

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*.

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#### 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.

**Comment:** Per W. Jackson email dated 24 August. "Extraordinary item" – does that exist in our reporting regime?

**Comment:** As per ED 28 Sept review. Is recognition guidance consistent with SFFAS7?

Staff Reply: SFFAS 7, Par 16 addresses revenues and OFS but not gains. Please see suggested edit.

**Deleted:** a gain, or extraordinary item,

#### Consolidated Financial Report of the US Government

23. The U. S. government-wide financial statements need not disclose the measurement methods used in recognizing impairment losses. However, the following information should be disclosed:
- if G-PP&E impairment is reported, a general description of what constitutes G-PP&E impairment,
  - the consolidated G-PP&E impairment losses reported by component entities, and
  - reference(s) to component entity report(s) for additional information.

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**Comment:** Per H. Steinberg email dated 20 August. The general description of what constitutes impairment should be required only if impairment is reported. That should be made clear.

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#### Effective Date

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

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

## 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, although, it is feasible that the effects of partial impairment are 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.

**Comment:** As per ED review on 7 October.

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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 Statement (GASB) No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*<sup>14</sup>

<sup>14</sup> © Financial Accounting Foundation. Governmental Accounting Standards Board, 401 Merrit 7, Norwalk, CT. All Rights Reserved. GASB 42, November 2003.



- 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.

**Comment:** As per Ed Review on 7 October.

### Significant and Permanent Decline in Service Utility

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

a. For financial reporting to be:

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

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

(iii) consistent over time - an accounting principle or reporting method should be used for all similar transactions and events unless there is good cause to

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

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 at 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, senior 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 changed 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.

The Board also notes that common indicators of potential impairment can be discovered during different types of asset management reviews which including 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

**Comment:** Per M. Granof email 22 August and 25 August Board meeting. "In the background section and several other places we say that impairment losses should be recognized only in "very rare" instances. I question whether we should say this. Instead, I believe we should simply set forth the criteria for loss recognition. If properly stated the criteria would, by itself, limit the recognition to unusual instances. By establishing the criteria as rare we open ourselves to the obvious question – i.e., why is the Board wasting so much time and energy on rare transactions."

**Comment:** As per ED 28 Sept review. Briefly discuss paragraphs 12 -15 in A4 and then merge A10 into A4. Delete A11.

**Staff reply:** Please see suggested language.

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**Deleted:** As discussed at paragraphs 12 through 15, 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. Impairments are Limited and/or Rare Instances¶ The Board views impairments of G-PP&E as prominent or significant events known by the entity because they are conspicuous or readily identifiable. Such events are generally unusual and significant in nature. That is, the events or changes in circumstances that lead to impairments are not considered ... [5]

**Deleted:** G-PP&E Impairments Can Also Be Identified From Asset Management Reviews¶ <#>Potential impairments identified from such assessments as discussed above in items a. through c. are eligible for recognition if they meet the requirements set forth in parag ... [6]

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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 indicators of impairment and (b) testing to determine whether 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.

**Comment:** Per H. Steinberg email dated 20 August. Remove the word "potentially." The presence of the two indicators have revealed the property is impaired. The next step is to measure the impairment.

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**Comment:** As per 25 August Board meeting. B. Dacey – "If we can clarify 16a it will achieve its intended purpose". H. Steinberg proposed via 25 August email: "The costs associated with previous service utility are significantly greater than the costs that would otherwise be associated with the new expected service utility."

Staff proposes that we amplify what we mean in the BFC with this suggested language.

### **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, management's action to address the situation is an indication that the expenses are too high in relation to the benefit. If senior management has not addressed the matter, and has not initiated any action, there may be a presumption, absent other facts, that the magnitude of the decline is not significant and that the test of impairment would 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:

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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.

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

**Deleted:** undiscounted

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 approaches should yield a reasonable estimate. That is, there should not be a presumption of reasonableness attached to the use of any of these methods if the resultant calculations lead to a measure that does not reasonably reflect the remaining service utility of the G-PP&E. 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 100.0% write-down of the carrying value. However, if the asset is to remain in use, the 100.0% write-down would be inappropriate because existing 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 being used.

**Comment:** As per M. Granof email & telecon on 28 Sept concerning extreme but not unusual cases where following a method could lead to illogical conclusions.

Staff reply: Please see suggested language here and at Par 18g.

#### 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 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 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 does not (1) seek exacting precision in determining the lost service utility of the asset and (2) intend to direct or prescribe the use of any particular method listed in paragraph 17.

**Comment:** As per ED 28 Sept review.

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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 replacement approach uses estimates reflecting today's current labor and

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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.

**Comment:** Department of Interior edit via 8 Sept email.

**Deleted:** curatorial-approved

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- 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

**Comment:** Per S. Showalter email dated 8 September.

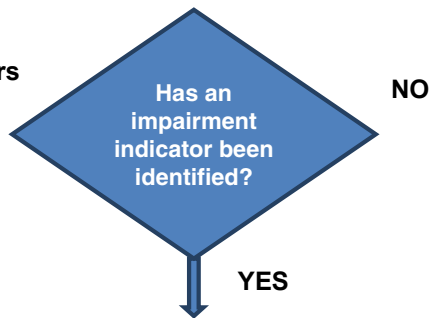
- A20. In reaching the decision not to allow for reversals of G-PP&E impairment losses, the Board concluded that because reversal events are expected to be rare occurrences, there is no compelling need for complexity or increased burden as benefits do not appear to justify costs. Further, the Board concluded 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.

Appendix B: Flowcharts, Decision Table and Illustrations

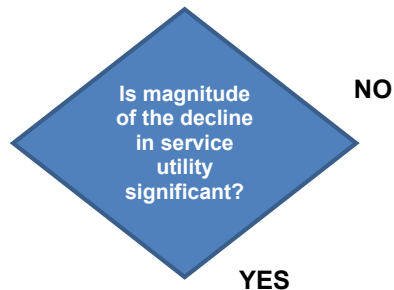
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**Step1 – Identify indicators**

**Refer to** – Par. 12 through Par. 14 and Par. 15, items a-g.

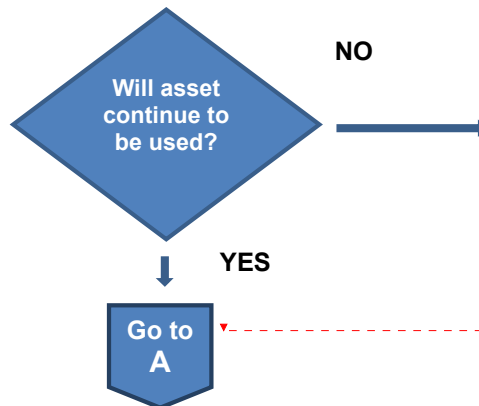
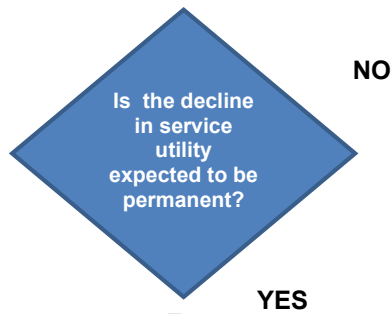
**Step2 – Impairment Test**

**Refer to** – Par. 16 a



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



Total impairment. Write down asset in accordance with SFFAS 6, paragraphs 38 and 39.

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♦(202) 512-7350 ♦fax (202) 512-7366

A

Refer to – Par. 17

Estimate potential impairment loss. Refer to Decision Table on next page.

Is amount material?

NO

Refer to – Par. 19

Subject to management's discretion, impairment loss may or may not be reported. However, consider adjusting depreciation methods, useful life, or salvage value. Treat restoration and / or replacement costs in accordance with GAAP.

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YES

Refer to – Par. 18 and Par. 23.

Report the impairment loss. Adjust PP&E's net book value.

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# General PP&E Impairment Decision Table

## Selecting a Measurement Method

29

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.

<u>Some Acceptable Measurement Methods<sup>15</sup></u>	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	<ul style="list-style-type: none"> <li>• Enactment or approval of laws/regulations</li> <li>• Changes in environmental or economic factors</li> <li>• Technological changes or obsolescence</li> </ul>	All G-PP&E	Par. 17 c	1d, 3a, 3b
Deflated <del>Depreciated</del> Current Cost Approach	• Change in manner or duration of use.	All G-PP&E	Par. 17 d	4a
Cash Flow <del>Approach</del>	• <u>Any of the indicators as listed at Paragraph 15 (a through g)</u>	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 termination <del>s</del>	All G-PP&E	Par. 17 f	5, 6a, 6b

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**Comment:** Per H. Steinberg & W. Jackson emails dated 20 August and 25 August, respectively.

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**Comment:** As per 25 August Board meeting. Board agreed with Task Force recommendation to delete this illustration and instead, re-work paragraph 16a; "magnitude."

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**Comment:** Per S. Showalter email dated 19 August.

**Deleted:** Depreciation

**Comment:** Per S. Showalter email dated 19 August.

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**Comment:** Per W. Jackson email dated 24 August.

**Deleted:** Cash or revenue generating assets

**Comment:** Per S. Showalter email dated 19 August.

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\* = excluding internal use software

<sup>15</sup> 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*<sup>16</sup>

##### Assumptions

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

Senior management 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.

**Comment:** Per ED 28 Sept review.

Staff Reply: See suggested edits and refer to Par. 17b language.

##### Evaluation of potential impairment

The mold contamination is evidence of physical damage – an impairment indicator. Also, the magnitude of the event (i.e., closure of the building) is a significant decline in service utility. However, because senior management 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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<sup>16</sup> 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 senior entity officials became aware of extensive mold contamination at one of its office buildings. Facilities management personnel advised that the building be closed due to health and safety concerns. Shortly afterwards, the office building was vacated and closed.

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

**Evaluation of potential impairment**

The mold contamination is evidence of physical damage – an impairment indicator. Also, the magnitude of the event (i.e., closure of the building) is a significant decline in service utility. Because senior management does not believe that remediation efforts will begin, the lost service utility of the building is permanent. However, because the entire office building will be taken out of service and prepared for disposal purposes, no impairment loss is recognized. Instead, the provisions of SFFAS 6, *Accounting for Property, Plant, and Equipment* paragraphs [38](#) and [39](#) are applicable.

## Illustration 1c

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

**Comment:** Per M. Granof email 22 August.

**Deleted:** with Mold Contamination

**Assumptions**

In 2012 senior 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 the damaged building would 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 mold remediation (involving removal and rebuilding of the interior walls and improving site drainage) would cost \$24 million.

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**Deleted:** the first three floors of the building could continue to be safely used.

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

After a detailed review, senior 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.

**Deleted:** mold contamination

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**Deleted:** (i.e., contamination of two of the five floors of the building)

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**Deleted:** decline in service utility

**Deleted:** does not plan to replace the lost service utility of these floors

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**Deleted:** mold remediation (involving removal and rebuilding of the interior walls and improving site drainage)

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**Deleted:** demolition and mold removal

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**Deleted:** rebuilding the interior building walls.

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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 senior 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.

**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, <del>2012</del>	Net Book Value, <del>2012</del>
Land	<u>\$100,000</u>		<u>\$100,000</u>
Building acquisition, 1982	\$1,200,000	\$600,000	\$600,000
Improvements	1,235,000	320,000	915,000
<b>Total - Building &amp; Improvements</b>	<b><u>\$2,435,000</u></b>	<b><u>\$920,000</u></b>	<b><u>\$1,515,000</u></b>

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## 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~~

Deleted: mold

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Deleted: rebuilding

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## 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%~~

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Calculate potential impairment loss:

Net book value (historical cost) \$1,515,000

Multiplied by: Wall & Foundation Remediation cost  
percentage

21.18%

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Potential impairment loss

\$320,877

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Deleted: 452

Reporting

If material, the potential impairment loss of \$320,877 and corresponding reduction of the book value of the building would be reported.

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**Illustration 1d****Choice Among Methods - Permanent Declines in Lost Service Utility: *Physical Damage to an Office Building with Mold Contamination*****Assumptions**

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

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

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

**Evaluation of potential impairment**

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

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

**Measurement of potential impairment**

Facilities management personnel in consultation with the Comptroller's office advise senior management to use the service units approach instead of the replacement cost approach because (1) time is of the essence with year-end fast approaching and (2) using construction cost estimates are not likely to result in a materially different potential impairment loss amount. Senior 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.

**Deleted:** Same as Illustration 1c.¶

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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	<u>5 floors</u>
---	-----------------

<b>Percentage of lost service utility in terms of units</b>	<b>40.00%</b>
---	---------------

**Calculate potential impairment loss:**

<b>Net Book Value (historical cost)</b>	<b>\$1,515,000</b>
---	--------------------

<b>Multiplied by: percentage of lost service utility - units</b>	<b><u>40.00%</u></b>
--	----------------------

<b>Potential impairment loss</b>	<b><u>\$606,000</u></b>
----------------------------------	-------------------------

**Reporting**

If material, the potential impairment loss of \$606,000 and corresponding reduction of the book value of the building would be reported.

**Comment:** Per S. Showalter email dated 19 August.

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**Illustration 2a****Normal and Ordinary Lost Service Utility: *Physical Damage to a Multi-use Heritage Asset***<sup>17</sup>**Assumptions**

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

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

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

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

**Evaluation of potential impairment**

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

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

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## Illustration 2b

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

A fire recently destroyed a 3-story wing addition of an historic building. The building addition housed 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 19<sup>th</sup> century and the added wing in the 20<sup>th</sup> 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 set-aside. Displaced staff were moved to nearby vacant office space.

**Evaluation of potential impairment**

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

**Comment:** Per M. Granof email 22 August. Something seems wrong here. Two-thirds of the administrative wing was destroyed. The wing has a book value of \$1,750,000. Yet the recognized impairment loss is only \$218,750 or 12.5%. How can that be? Isn't the applicable percent  $\$2.5/4.5$  -- i.e., 55.55% and the loss  $\$1,750,000 \times .55 = \$977,222$ . Even that seems low, however. If 2/3 of the wing is destroyed and will not be repaired why shouldn't it simply be 2/3 of \$1,750,000?

Staff notes: Math is correct, however, using the \$20 million PRV was illogical because the restoration costs for all three floors of the wing only amounted to \$4.5 million.

Staff has used Mr. Granof's rationale to improve illustration.

**Comment:** Per ED review 28 Sept. Reference to "Visitor Welcome Center" detracts from illustration.

Staff Reply: Concur – see deletion.

**Deleted:** a visitor welcome center and housed

**Comment:** Department of Interior edit via 8 Sept email.

**Deleted:** curatorial and conservation

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### 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 senior management:

**Deleted:** As recorded in the entity's asset management system, the estimated plant replacement value (PRV) of the wing is \$20 million.

#### 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
<b>Cost to restore lost service utility (2<sup>nd</sup> and 3<sup>rd</sup> levels)</b>	<b><u>\$2,500,000</u></b>

#### 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

<u>Total restoration cost (all 3 levels)</u>	<u>4,500,000</u>
<b>Restoration cost percentage</b>	<b><u>55.5%</u></b>

**Deleted:** Plant Replacement Value of wing (estimate to restore entire wing in current dollars)

**Deleted:** 20,000,000

**Deleted:** 12.5

#### Calculate potential impairment loss:

Net Book Value (historical cost of wing)	<b>\$1,750,000</b>
Multiplied by: Restoration cost percentage	<u>55.5%</u>
<b>Potential impairment loss</b>	<b><u>\$971,250</u></b>

**Deleted:** 12.5

**Deleted:** \$218,750

### Reporting

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If material, the potential impairment loss of ~~\$971,250~~ and corresponding reduction of the book value of the building would be reported.

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**Illustration 3a****Service Units Approach - Recoverable Service Utility: Technological Development or Evidence of Obsolescence -Underutilized Magnetic Resonance Imaging Machine<sup>18</sup>****Assumptions**

In 2010, a hospital purchased a magnetic resonance imaging (MRI) system at a cost of \$2.25 million. The hospital estimated that the system would have an estimated useful life of seven years and that on average the system would be used for ten tests per day for five days per week. After installation, the utilization of the system was approximately at the levels estimated.

In 2013, an affiliated entity transferred an “open” MRI system to the hospital. The transferred MRI system began to be used more frequently than the original “closed” MRI system because the “open” MRI was more comfortable for patients and provided a superior image. Instead of providing ten images a day, the original MRI system was being used only on an overflow basis and averaged six images per day; a decrease to 60 percent of prior levels. Furthermore, the expenses associated with the continued operation and maintenance (O&M) of the “closed” MRI system continue to be incurred and senior management is evaluating the asset’s continued service use and whether or not to book an impairment loss.

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

**Evaluation of potential impairment**

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

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

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

### Measurement of potential impairment

#### Calculate Net Book Value:

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

#### Calculate Acquisition cost per service unit:

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

**Comment:** Per S. Showalter email dated 19 August.

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

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

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**Calculate Potential Impairment Loss:**

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

**Reporting**

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

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**Illustration 3b****Service Units Approach - Non-recoverable Service Utility: Technological Development or Evidence of Obsolescence -*Underutilized Magnetic Resonance Imaging Machine*****Assumptions**

In 2010, a hospital purchased a magnetic resonance imaging (MRI) system at a cost of \$2.25 million. The hospital estimated that the system would have an estimated useful life of seven years and that on average the system would be used for ten tests per day for five days per week. After installation, the utilization of the system was approximately at the levels estimated.

In 2013, an affiliated entity transferred an “open” MRI system to the hospital. The transferred MRI system began to be used more frequently than the original “closed” MRI system because the “open” MRI was more comfortable for patients and provided a superior image. Instead of providing ten images a day, the original MRI system was being used only on an overflow basis and averaged one image per day; decrease to 10 percent of prior levels. Furthermore, the expenses associated with the continued operation and maintenance of the “closed” MRI system continue to be incurred and has drawn senior management’s attention to evaluate the asset’s continued service use.

**Evaluation of potential impairment**

The indicator of potential impairment is the change in technology, which has resulted in a permanent reduction in the usage of the “closed” MRI system. The magnitude test (i.e., decline in service utility relative to operating costs) has also been met due to the fact that the cost of operating the “closed” MRI system has remained the same while the service provided has decreased to 10 percent of prior levels. Potential impairment loss using the service units approach would be determined as follows:

**Measurement of potential impairment****Calculate Net Book Value:**

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

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**Calculate Acquisition cost per service unit:**

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

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

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

**Calculate Potential Impairment Loss:**

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

**Reporting**

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

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**Illustration 4a****Deflated Depreciated Current Cost Approach: Change in Manner or Duration of Use – Training Facility Used for Storage<sup>19</sup>****Assumptions**

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

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

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

**Comment:** Per S. Showalter email dated 19 August.

**Deleted:** replacement

**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.

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

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**Measurement of potential impairment****Calculate Net Book Value:**

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

Deleted: replacement

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

**Calculate Depreciated current cost (current dollars):**

Deleted: replacement

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

Deleted: replacement

Deleted: (current dollars)

**Calculate Deflation factor:**

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

**Apply deflation factor to depreciated current cost:**

Deleted: replacement

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(current dollars)

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

Deleted: replacement

Deleted: (current dollars)

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**Calculate Potential impairment loss:**

a Net Book Value, 2013	\$7,600,000
f Deflated depreciated <u>current</u> cost (b × e)	2,128,640

**Deleted:** replacement

<b>Potential impairment loss (a - f)</b>	<b><u>\$5,471,360</u></b>
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**Reporting**

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

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**Illustration 5****Construction Stoppage—Special Purpose Test Equipment<sup>20</sup>****Assumptions**

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

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

**Evaluation of potential impairment**

The indicator of impairment is the construction stoppage. It appears to meet the test of impairment in that senior management would not have initiated the project if it had expected either program cancellation or lack of any potential commercial use. The situation passes the magnitude test because the costs-to-date (75% or \$7.5 million) are significant in both percentage and monetary terms. However, there is no potential impairment loss to report 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.

**Deleted:** Illustration 4b¶¶  
Deflated Depreciated Replacement Cost Approach: Change in Manner or Duration of Use – *Training Facility Used for Storage*¶¶  
Assumptions¶¶  
Same as illustration 4a except that senior management is not concerned with the facility's operating costs – maintenance and repair, depreciation, insurance, utilities, security, etc., because they are considered to be low relative to the storage benefits received.¶¶  
Evaluation of potential impairment¶¶  
Although impairment is indicated because the manner of use of the training facility has changed from training students to storage, because the situation does not pass the magnitude test, no test for potential impairment is required. However, senior management should consider adjusting the facility's depreciation method, useful life and/or salvage value estimates.¶**Comment:** Per H. Steinberg email dated 20 August.

<sup>20</sup> Illustration 5 adapted from: GASB 42, Illustration 9, *Construction Stoppage—Airport Pavements*.

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**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.

**Comment:** Per M. Granof email 22 August. Was the contract terminated for "convenience" (I assume that's a technical contracting term) or for "default."?

**Staff Reply** – Default. This was a typo.

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

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

**Evaluation of potential impairment**

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

**Measurement of potential impairment**

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

**Reporting**

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

## Illustration 7a

### Cash flow approach – Grouped Assets

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#### 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 senior management decided to implement a public-private strategic initiative that could eventually over several years transition these shared-services operations to private ownership. Both national and local private interests have asked their respective political representatives to accelerate the entity's implementation time-table and influence a favorable outcome. Senior management was directed to (1) immediately estimate the amount that could be recovered from selling the operations and (2) identify to the lowest level identifiable, operating information to include cash flows for each category. 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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**Comment:** Per W. Jackson email dated 24 August. From where is the "undiscounted cash flows from future operations" derived? Is it from continued operations if not sold? Its source should be stated somewhere.

Staff reply: Please review suggested language.

**Comment:** Per W. Jackson email dated 24 August. From where is the "net realizable value of assets at 12/31/X1" derived? On page 58 this amount from management's belief that the open market price of ... is a reasonable estimate..... If the point on page 58 is relevant, it should also be inserted on page 55?

Staff reply: Please review suggested language.

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

#### Evaluation of potential impairment

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

Senior management is concerned that the presence of an impairment indicator might affect its plan regarding the future use of the shared-services if the analysis indicates that the net book value of the assets are not recoverable. 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<sup>21</sup> or value-in-use estimate.<sup>22</sup> 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: <u>Administrative</u>	Asset Group: <u>Information Technology</u>
Assets' net book values at 12/31/X1 (a)	<u>\$12,000,000</u> (a)	<u>\$11,000,000</u> (a)

<sup>21</sup> 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.

<sup>22</sup> Statement of Federal Financial Accounting Concepts (SFFAC 7), *Measurement of the Elements of Accrual-Basis Financial Statements* at paragraph 50 defines value-in-use as "...the benefit to be obtained by an entity from the continuing use of an asset and from its disposal at the end of its useful life."

Paragraph 51 further states that, "Value in use is a remeasured amount for assets used to provide services. It can be measured at the present value of future cash flows that the entity expects to derive from the asset, including cash flows from use of the asset and eventual disposition. Value in use is entity specific and differs from fair value. Fair value is intended to be an objective estimate of the amount of an asset exchanged between willing parties that also is applicable to similar exchanges between other parties. Value in use is an entity's subjective assessment of the value to the entity of an asset that it owns. Thus, value in use is useful in assessing the financial position and operating results of that entity, but because the amount is entity specific, it may not be comparable when making assessments of other entities." (underscoring added for emphasis)

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## 1 Calculate undiscounted cash flows:

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

2

## 3 Calculate Recoverability:

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

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## 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).

**Comment:** Per W. Jackson email dated 24 August. From where is the "net realizable value of assets at 12/31/X1" derived? On page 58 this amount from management's belief that the open market price of ... is a reasonable estimate..... If the point on page 58 is relevant, it should also be inserted on page 55?

Staff reply: Please review suggested language.

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

## Reporting

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

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## Illustration 7b

### Cash flow approach – Equipment: Technological Development or Evidence of Obsolescence - Underutilized Magnetic Resonance Imaging Machine<sup>23</sup>

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#### 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 senior management’s attention to evaluate the asset’s continued service use. Because similar used MRI machines in the open market can be purchased from authorized dealers for \$750,000 (their mark-up percentages are unknown), senior management is considering the possibility of selling the old machine and using its proceeds to help purchase the “open” MRI system.

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

#### Evaluation of potential impairment

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

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

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**Measurement of potential impairment**

**Calculate Net Book Value:**

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

**Calculate undiscounted cash flows:**

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

**Calculate Recoverability: (b minus a)**

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

**Calculate Potential Impairment Loss:**

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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 senior 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".

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

### Reporting

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

**Illustration 7c****Cash flow approach – Facility: Changes in manner or duration of use -  
Government owned-contractor operated (GOCO) manufacturing facility<sup>24</sup>**

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**Assumptions**

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

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

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

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

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

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

<sup>24</sup> Illustration 7c adapted from: Military law Review, Volume 131 Winter 1991 - Government Owned – Contractor Operated Munitions Facilities: Are they appropriate in the age of strict environmental compliance and liability? Major Mark J. Connor

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

#### 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 senior 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, senior management intends to convert a portion of the facility for public storage; a change in the manner of use.

#### Measurement of potential impairment

##### Calculate Net book value:

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

##### Calculate undiscounted cash flows:

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

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**Calculate Recoverability: (b minus a)**

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

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## 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<sup>25</sup>

#### Assumptions

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

#### Evaluation of potential impairment

In this case the entity should (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:

Calculate undiscounted cash flows:	<u>Undiscounted</u>	<u>PV Factor</u>	<u>Discounted</u>
Required modifications (outflow)	(\$500,000)	1.00	(\$500,000)
Undiscounted cash 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
<b>Total - cash flows (b)</b>	<b>\$5,375,000</b>		<b>\$2,497,510</b>

**Comment:** Per W. Jackson & B. Dacey 25 August meeting.

W. Jackson suggested clarification of this term in connection with Paragraph 18e. Mr. Dacey noted that the recoverability test in fact uses undiscounted dollars and he suggested changing the 7d title to reflect that discounted cash flow dollars could be used as a proxy for value-in-use.

Staff notes: Please see revised title change.

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**Comment:** Per W. Jackson email dated 24 August. Is this "undiscounted." The calculated on the right side of the table is "discounted." Note 20 discusses this in the context of PV.

**Staff Reply** – Please see suggested edits.

**Deleted:** use

**Deleted:** estimate its recoverable value and not the NRV

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**Deleted:** (b)

<sup>25</sup> Adapted from: Military law Review, Volume 131 Winter 1991 - Government Owned – Contractor Operated Munitions Facilities: Are they appropriate in the age of strict environmental compliance and liability? Major Mark J. Connor

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**Calculate Recoverability: (b minus a)**

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

**Calculate potential impairment:**

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

**Reporting**

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

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**Appendix C: Abbreviations**

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

**Deleted:** JFMIP . . . Joint financial management improvement program¶

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**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<sup>26</sup> 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.

<sup>26</sup> 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] Deleted	Wendy Payne	9/16/2011 3:25 PM
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Assessment results without a permanent loss in service utility need not be reported as an impairment loss.

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Page 12: [2] Comment	Domenic Nicholas Savini	10/11/2011 11:09 AM
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Per H. Steinberg email dated 20 August. Can a phrase be inserted indicating the events are examples, in other words they are “not limited to?”

Staff suggests adding “Some”.

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Page 12: [3] Comment	Domenic Nicholas Savini	10/11/2011 11:09 AM
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Per M. Granof email dated 22 August. I would omit the phrase “they occasionally come across conditions....”. Simply state that the following events or conditions may be indicative of impairment.

Staff suggests deleting bulk of this paragraph.

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

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As discussed at paragraphs 12 through 15, 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. Impairments are Limited and/or Rare Instances

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

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

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

## **Significant Events Are Not Always Material Events**