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To: Bureau Chief Financial Officers
Bureau Procurement Chiefs
Bureau Senior Asset Management Officers

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Subject: Implementation Guidance for the Statement of Federal Financial Accounting Standards 44: *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*

Effective fiscal year (FY) 2015, the Statement of Federal Financial Accounting Standards (SFFAS) 44: *Accounting for Impairment of General Property, Plant, And Equipment Remaining in Use*, will require Federal entities to account for partial impairment of general property, plant, and equipment (G-PP&E) remaining in use, except for internal use software. It requires Federal entities to adjust the net book value of the impaired G-PP&E and recognize impairment losses as they occur rather than as part of the ongoing depreciation expense or upon disposal of the G-PP&E. Please note that there are specific criteria identified in SFFAS 44 that must all be met for a loss to be considered a partial impairment. For the Department of the Interior (DOI), such conditions will be extremely rare. In addition, SFFAS 44 should not be directed to those G-PP&E that have an immaterial impact on cost of services.

Existing Federal accounting standards address G-PP&E that is removed from service due to full impairment through SFFAS 6, *Accounting for Property, Plant, and Equipment,* and Technical Release 14, *Implementation Guidance on the Accounting for the Disposal of General Property, Plant, and Equipment.* Impairment of internal use software is addressed in SFFAS 10, *Accounting for Internal Use Software*.

The attached document is DOI's guidance for bureaus to follow when identifying and reporting partial and full impairment to G-PP&E. Bureaus should leverage existing processes to identify impairment; however, bureaus are not required to retroactively search for potential impairments.

If you have any questions, please contact Sherry Lee, Staff Accountant in the Office of Financial Management, at (202) 219-4096 or via e-mail at Sherry_Lee@ios.doi.gov or Craig Lasser in the

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Attachment

cc: Financial Statements Guidance Team
Finance Officers Partnership

ACCOUNTING FOR IMPAIRMENT OF GENERAL PROPERTY, PLANT, AND EQUIPMENT

The Federal Accounting Standards Advisory Board (FASAB) issued the Statements of Federal Financial Accounting Standards (SFFAS) 44: *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use,* to provide Federal entities accounting and reporting requirements for partial impairment of general property, plant, and equipment (G-PP&E) and construction work-in-process effective fiscal year (FY) 2015. Full impairment of G-PP&E is addressed in SFFAS 6: *Accounting for Property, Plant, and Equipment*, and Technical Release (TR) 14: *Implementation Guidance on the Accounting for the Disposal of General Property, Plant, and Equipment.* Impairment of internal use software is addressed in SFFAS 10: *Accounting for Internal Use Software.*

Although the term "impairment" is not used in SFFAS 6 and TR 14, the accounting treatment for fully impaired assets is covered in the guidance provided in SFFAS 6 and TR 14 when accounting for disposal, retirement, or removal from service of G-PP&E. In addition, note that accounting for impairment only applies to G-PP&E and not to Heritage Assets or Stewardship Land as it involves adjusting the net book value of the PP&E.

In accordance with SFFAS 6, SFFAS 44, and TR 14, this document provides guidance to the Department of the Interior (Department) bureaus and offices (bureaus) on defining, identifying, determining, measuring, and reporting of partial and full impairment to G-PP&E.

I. DEFINING IMPAIRMENT

The SFFAS 44 defines **impairment** as a **significant and permanent decline in service utility of G-PP&E or expected service utility for construction work-in-process**. Service utility is considered impaired if the usable capacity is reduced due to abnormal or extraordinary events or circumstances that were not expected at acquisition, such as physical damage, obsolescence, new laws or regulations, change in environmental or economic factors, or change in the manner or duration of use. The events or changes in circumstances that lead to impairment **are not considered normal and ordinary**. That is, at the time the G-PP&E was acquired, the event or change in circumstance would not have been (a) expected to occur during the useful life of the G-PP&E or, (b) if expected, sufficiently predictable to be considered in estimating its useful life. <u>Reduction in service utility due to normal use or ordinary events is not considered impairment</u>.

II. IDENTIFYING POTENTIAL IMPAIRMENT

Bureaus should identify potential impairment to G-PP&E through the periodic asset condition assessment processes, as part of response actions for disasters, or other facilities management activities. Condition assessment is the periodic inspection of real property to determine its current condition, validate inventory data, and to identify and provide a cost estimate for necessary repairs and other work types. Bureaus should follow Departmental guidance for conducting condition assessment available from the Office of Acquisition and Property

Management (PAM).

In addition, bureaus may identify potential impairment when significant events or changes in circumstances occur. Significant events or changes in circumstances are conspicuous or known to bureau management. Bureaus are not required to conduct surveys solely to identify asset impairment.

Bureaus should consider the following as indicators of potential impairment[1]:

1. Evidence of physical damage;
2. Enactment or approval of laws or regulations which limit or restrict G-PP&E usage;
3. Changes in environmental or economic factors;
4. Technological changes or evidence of obsolescence (primarily for IT systems);
5. Changes in the manner or duration of use of G-PP&E;
6. Construction stoppage or contract termination; and
7. G-PP&E idled or unserviceable for excessively long periods.

III. DETERMINING IMPAIRMENT

Bureaus are required to report **partial** impairment to G-PP&E and construction work-in-process only if the impairment is **significant and permanent**.

Impairment **is considered significant based on the bureau management's professional judgment**. Bureau management may consider (1) the relative costs of providing the service before and after the decline, (2) the percentage decline in service utility, or (3) other considerations. When determining whether the impairment is significant, bureaus should consider the impact on operations such as cost of service rather than the materiality for financial reporting. Determining if a decline in service utility is significant is separate and distinct from materiality considerations.

The decline in the service utility is **considered permanent when bureau management has no intention or reasonable expectation to replace or restore the lost utility**. Bureaus should not report impairment if bureau management has (1) specific plans to replace or restore the lost service utility; (2) committed or obligated funding for the remediation efforts; or (3) a history of remediating lost service utility in similar cases or for similar G-PP&E. In such cases the cost to restore the lost service utility should be reported in the appropriate category of financial liability (e.g., Deferred Maintenance and Repair, Environmental and Disposal Liability, etc.) and consider the accounting treatments discussed in Section VI below. Because the Department does have a long history of remediating lost service utility in similar situations, this condition will rarely be met.

[1] Per SFFAS 44, 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 12 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."

Impairment of the G-PP&E is considered **full** if the G-PP&E no longer provides service or there is no expectation of future service in the case of construction work in process, and the loss in service must meet the following conditions:

1. The G-PP&E's use is terminated, and
2. There is documented evidence of Bureau management's decision to remove permanently the G-PP&E from service.

IV. MEASURING IMPAIRMENT LOSSES

Bureaus should estimate **partial** impairment losses for G-PP&E using a measurement method that reasonably reflects the diminished service utility of the G-PP&E. Bureaus may consider the following methods:

1. **<u>Replacement approach</u>:** 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. This cost can be converted to historical cost by deflating the estimated cost to replace the diminished utility using an appropriate cost index such as RS Means inflation index. Alternatively, bureaus may 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. For real property classified as G-PP&E this is the preferred approach.

Example 1: Replacement Approach		
a	Estimated replacement cost of lost service utility	$2,000,000
b	Deflation factor	0.67
c	Estimated impairment loss (a x b)	$1,340,000
	Or	
d	Estimated replacement cost of lost service utility	$2,000,000
e	Total replacement cost of G-PP&E	$5,000,000
f	Ratio (d / e)	40.00%
g	Net book value	$4,000,000
h	Estimated impairment loss (f x g)	$1,600,000

In Example 1, the potential estimated impairment loss and corresponding reduction of book value of the G-PP&E is $1,340,000 or $1,600,000, depending on the method chosen.

2. **<u>Restoration approach</u>:** Impairment of improvements made to stewardship land and multi-use heritage assets with physical damage may be measured using the 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 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 deflating the estimated restoration cost using an appropriate cost index. Alternatively, bureaus may 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.

Example 2: Restoration Approach		
a	Estimated cost of restoring the lost service utility	$1,000,000
b	Deflation factor	0.72
c	Estimated impairment loss (a x b)	$720,000
	or	
d	Estimated cost of restoring the lost service utility	$1,000,000
e	Total estimated restoration cost of G-PP&E	$5,000,000
f	Ratio (d /e)	20.00%
g	Net book value	$4,000,000
h	Estimated impairment loss (f x g)	$800,000

If more than one method is reasonable, bureaus should select the method that is most efficient and practical. In Example 2, the potential estimated impairment loss and corresponding reduction of book value of the G-PP&E is $720,000 or $800,000, depending on the method chosen.

3. Service units approach: This approach is appropriate for measuring impairment of G-PP&E that are affected by new laws or regulations or other changes in environmental/economic factors or are subject to technological changes or obsolescence. This approach compares the service units provided by the G-PP&E before and after the impairment event or change in circumstance to isolate the historical cost of the lost service utility of the G-PP&E. The amount of impairment is determined by evaluating the service provided by the G-PP&E – either maximum or total estimated service units or throughout the life of the G-PP&E – before and after the event or change in circumstance.

Example 3: Service Unit Approach		
a	Percentage of lost service utility in terms of units	33.0%
b	Net book value	$4,000,000
c	Estimated impairment loss (a x b)	$1,320,000
	or	
d	Acquisition cost	$8,000,000
e	Originally expected service units	200,000
f	Acquisition cost per expected service unit (d / e)	$40
g	Remaining service units	35,000
h	Remaining service cost to be recovered (f x g)	$1,400,000
i	Net book value	$4,000,000
j	Estimated impairment loss (h - i). **Note: if j = or > 0, Net Book Value is recoverable and no Impairment Loss is recognized. If j < 0, impairment is recognized.**	($2,600,000)

If more than one method is reasonable, bureaus should select the method that is most efficient and practical. In Example 3, the potential estimated impairment loss and corresponding reduction of book value of the G-PP&E is $1,320,000 or $2,600,000, depending on the method chosen.

4. **Deflated depreciated current cost approach:** Impairment of G-PP&E that is subject to a change in manner or duration of use generally may be measured using a deflated depreciated current cost approach. 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).

Example 4: Deflated Depreciated Current Cost Approach		
a	Replacement cost (current cost to replace current service level)	$1,000,000
b	Less: Depreciation	$800,000
c	Depreciated current cost (a - b)	$200,000
d	Deflation factor	0.65
e	Deflated depreciated current cost (c X d)	$130,000
f	Net book value	$300,000
g	Estimated impairment loss (e - f). **Note: if g = or > 0, no Impairment Loss is recognized.**	($170,000)

In Example 4, the potential estimated impairment loss and corresponding reduction of book value of the G-PP&E is $170,000.

5. **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[2] or value-in-use estimate. The net book value of the G-PP&E is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the G-PP&E. That assessment should be based on the net book value of the G-PP&E at the date it is tested for recoverability, whether in use or under development. If the net book value is not recoverable, the impairment loss is the amount by which the net book value of the G-PP&E exceeds the higher of its net realizable value or value-in-use estimate. No impairment loss exists if the net book value is less than the higher of the G-PP&E's net realizable value or value-in-use estimate.

[2] 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.

Example 5: Cash Flow Approach		
a	Required modification cost (if any)	($50,000)
b	Undiscounted cash flows from future operations	$2,000,000
c	Undiscounted cash flows from future disposal of asset	$500,000
d	Total undiscounted cash flows (a + b + c)	$2,450,000
e	Net book value	$3,000,000
f	Recoverability (d - e). **Note: if f = or > 0, Net Book Value is recoverable and no impairment loss is recognized. If f < 0, calculate impairment loss as follows:**	($550,000)
g	Net realizable value	$1,500,000
h	Estimated impairment loss (g - e). **Note: if h = or > 0, no Impairment Loss is recognized).**	($1,500,000)
	or	
i	Average service fee per unit	$18
j	Remaining service units	50,000
k	Undiscounted cash flows	$900,000
l	Net book value	$3,000,000
m	Recoverability (k - l). **Note: if m = or > 0, Net Book Value is recoverable and no impairment loss is recognized. If m < 0, calculate impairment loss as follows:**	($2,100,000)
n	Net realizable value	$2,800,000
o	Estimated impairment loss (n - l). **Note: if p = or > 0, no Impairment Loss is recognized.**	($200,000)

Bureaus should choose the most reasonable and efficient method of estimating the impairment loss. In Example 5, the potential estimated impairment loss and corresponding reduction of book value of the G-PP&E is $1,500,000 or $200,000, depending on the method selected.

6. **<u>Lower of (a) Net Book Value or (b) Higher of Net Realizable Value or Value-in-Use approach</u>:** The 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.[3]

[3] SFFAS 44 paragraph 18, a through f.

Example 6: Lower of (a) Net Book Value or (b) Higher of Net Realizable Value or Value-in-Use Approach		
a	Construction or contract costs incurred	$5,000,000
b	Percentage recoverable	60.0%
c	Impaired asset book value (= net realizable amount)	$3,000,000
d	Impairment loss (c - a)	($2,000,000)
	or	
e	Average fee per use	$40
f	Remaining usable service units	50,000
g	Value-in-use	$2,000,000
h	Net realizable value	$1,500,000
i	Higher of g or h	$2,000,000
j	Net book value	$3,000,000
k	Lower of I or j = Impaired asset's recoverable amount (this will be the new book value)	$2,000,000
l	Impairment loss (k - j)	($1,000,000)

Flowcharts, decision tables, and illustrations of the above estimation methods to assist bureaus in making the choice can be found in Appendix B of SFFAS 44.[4] The method chosen should reasonably estimate the portion of the net book value associated with the diminished service utility; it should not result in an unreasonable net value associated with the remaining service utility of the G-PP&E, and the impairment loss should be limited to the G-PP&E's net book value at the time of the partial impairment. If the current net book value is $0, then no impairment loss is recognized and the entire process of identifying and determining impairment does not apply. If more than one method is reasonable, bureaus should select the method that is most efficient and practical. Bureaus may consult with the Office of Financial Management and PAM for further guidance when determining the appropriate method to estimate partial impairment losses to G-PP&E.

For **full** impairment of G-PP&E, the impairment loss is the net book value associated with the G-PP&E adjusted for any recovery.

V. RECOGNIZING AND REPORTING OF IMPAIRMENT LOSS

Bureaus should write off the net book value associated with the impairment to the G-PP&E as determined in Sections I through IV above and report the impairment loss as "Program Costs" or "Cost Not Assigned to Programs".[5] For full impairment, the G-PP&E's acquisition cost and associated accumulated depreciation are removed from the G-PP&E account. Bureaus should report impairment loss net of any recovery associated with the impairment if the recovery and loss occur in the same period. If the recovery occurs subsequent to the period in which impairment loss is recognized, bureaus should report the recovery as revenue or other financing

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[4] http://www.fasab.gov/pdffiles/handbook_sffas_44.pdf

[5] The determination of the impairment loss as "Program Costs" or "Costs Not Assigned to Programs" should be consistent with guidance in SFFAS 4: *Managerial Cost Accounting Standards and Concepts*.

source as appropriate in the period the recovery occurs.

If during the permanent removal process for fully impaired G-PP&E, the G-PP&E is disassembled and spare parts or sub-components are salvaged to be used for other purposes, the spare parts or sub-components should be recorded as new and separate G-PP&E in accordance with SFFAS 6 or SFFAS 3, *Accounting for Inventory and Related Property*.

The Department will report the impairment loss in the Statement of Net Cost and may present it as a separate line item or line items depending on the materiality of the loss to the financial statements or other qualitative considerations.

Bureau should provide the Department with a general description of the G-PP&E remaining in use for which an impairment loss is recognized, the nature and the amount of the impairment, and the financial statement classification of the impairment loss for disclosing in the notes to the financial statement in the Department’s Agency Financial Report (AFR).

In the Required Supplementary Information disclosure of the AFR, bureaus should not include the cost of repairing or replacing the assets as Deferred Maintenance and Repairs if the cost is reported as impairment loss.

VI. CONSIDERATIONS FOR G-PP&E REMAINING IN USE

If bureaus determine that the diminished service utility to the G-PP&E does not meet the criteria for impairment but the future service utility of the G-PP&E remaining in use is adversely affected, bureaus should consider adjusting the depreciation methods, useful life or salvage value estimates, as appropriate, for the G-PP&E remaining in use.

If bureaus remedy (i.e., repair or replace) previously impaired G-PP&E remaining in use, bureaus should follow the Department’s capitalization policy for costs incurred to replace or restore the lost service utility.