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February 27, 2003

Mr. David R. Bean, Director of Research  
Project No. 9-3E  
Governmental Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

Dear Mr. Bean:

On behalf of the Association of Government Accountants (AGA), the Financial Management Standards Board (FMSB) appreciates the opportunity to provide comments on the Governmental Accounting Standards Board's (GASB) Exposure Draft *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This proposed Statement provides guidance for accounting for impairment of capital assets and for insurance recoveries.

The FMSB, comprised of 21 members with accounting and auditing backgrounds in federal, state, and local government, academia, and public accounting, reviews and responds to proposed standards and regulations of interest to AGA members. Local AGA chapters and individual members are also encouraged to comment separately.

The FMSB supports the attempt by the GASB to provide guidance for reporting impairment of capital assets and for insurance recoveries. We are supportive of the overall guidance but have several suggestions that we believe would clarify and improve the guidance. We are also appreciative of the examples provided in the ED. This response will first deal with the four issues in the front of the Exposure Draft. Additional comments follow.

#### Issue 1

**Paragraphs 7 through 14 identify indicators of impairment, the impairment test, and the specific methods for measuring impairment that generally would be used for capital assets that will continue to be used by the government. The Basis for Conclusions (in paragraphs 33-46) explains the Board's reasons for selecting these indicators, tests, and methods. Do you agree with the Board's proposal? Do you agree that measurement methods for capital assets that will continue**



**to be used by the government should be based on historical cost? If not, which additional measurement method or methods should the Board prescribe? Why?**

The FMSB supports the use of historical cost as a base when deciding on impairment, as long as historical cost is used as the basis for recording capital assets. (Whether historical cost is appropriate is beyond the scope of this project.) The FMSB also generally supports the indicators of impairment, the impairment test, and measurement. A few comments are offered, primarily for clarification.

First, paragraphs 11 through 13 use the term “generally should be measured” when linking the causes (physical damage, etc.) to the measurement methods (restoration cost approach, etc.). Does the term “generally” give more leeway to governments and their auditors than if the word were not present, or does the term “generally” include the notion that a different measurement method must be justified, just like any other accounting principle? If the former is the case, the FMSB recommends providing more guidance as to the conditions under which another method could be used? If the latter, the FMSB recommends the word “generally” should be deleted.

Second, paragraph 9 lists two factors that must be considered when deciding whether or not a capital asset is impaired (magnitude of decline in service utility and the unexpected nature of the decline in service utility). Paragraph 5 suggests that **both** factors must exist to have an impairment. If so, we suggest that the wording of the lead-in to paragraph 9 be changed to “A capital asset that presents an indicator of impairment should be tested to determine whether the nature of the impairment exhibits both of the following factors”. If both are not required, then the wording should be changed.

Third, the FMSB believes the last sentence in paragraph 9a which states “Management’s action to address the situation is an indication that the expenses are too high in relation to the benefit” is ambiguous. For example, does the term “benefit” mean current service utility and would “inaction” (to not replace or repair a capital asset) necessarily mean that the benefits exceed the expenses?

Finally, as an example, Illustration 1 indicates that the disclosure of mold remediation costs is limited to the portion relating to demolition and mold removal. We believe disclosure of the total remediation cost of

\$4,000,000 provides useful information to the readers and recommend that it be disclosed in the illustration.

## **Issue 2**

**This proposal would apply the approach to identification and measurement of impairment to all capital assets (that is, governmental and subsidized capital assets (defined in paragraph 31) as well as business enterprise capital assets (also defined in paragraph 31) rather than applying a cash flow approach to business enterprise capital assets. The Basis for Conclusions (in paragraphs 31 and 32) explains the Board's reason for this decision. Do you agree with the Board's proposal? If not, why not?**

The FMSB agrees with the Board's proposal to use the same criteria for all capital assets of a government rather than to use a discounted cash flow approach to enable comparison to the private sector counterparts. Even in the case of enterprise funds, cash flow maximization is not the goal; rather the goal is to provide service or a product.

## **Issue 3**

**The proposal would not require capital assets that are temporarily impaired to be written down. This proposal would establish a criterion for determining whether an impairment is temporary by treating all impairments as permanent unless evidence is available to demonstrate that the impairment is temporary. The Basis for Conclusions (in paragraphs 49 and 50) explains the Board's reasons for this decision. Do you agree with the Board's proposal? If not, why not?**

The FMSB agrees with the basic concept that capital assets that are temporarily impaired should not be written down. The FMSB agrees with the requirement that impairments be considered permanent unless evidence indicates that the impairments are temporary (except for capital assets which are accounted for using the modified approach where the presumption is that impairments are considered temporary).

The FMSB suggests that two sentences in paragraph 50 be moved from the Basis for Conclusions to the basic standard. The first is "Generally, if management would have to take action to reverse the impairment, such as restoration of a capital asset with physical damage, the impairment would be considered permanent." The second is, "Therefore, impairment from

physical damage of capital assets accounted for using the modified approach should be considered temporary in nature and should not be recorded unless the government concludes that it will no longer maintain that system or subsystem.” The FMSB believes that moving these sentences to the standard will improve clarity.

One concern is the requirement of paragraph 18 to disclose temporarily impaired capital assets that are idle. We do not believe that temporarily impaired assets should be treated differently, based on whether those assets are idle or in use. We do not believe that it is more important to disclose the temporary impairment of an idle capital asset than that of a temporary impaired capital asset currently in use or an unimpaired idle capital asset. We suggest paragraph 18 be revised to state “if not otherwise apparent in the financial statements or notes to the financial statements, permanently impaired capital assets that are idle should be disclosed.” To be consistent, we also recommend that the third sentence in paragraph 16 be amended to read “In such circumstances, the capital asset should not be written down *or disclosed.*”(emphasis added)

If the Board decides to require disclosure of idle temporarily impaired capital assets, guidance should be given regarding whether the assets are idle on the balance sheet date, for a certain period of time, etc.

#### **Issue 4**

**This proposed Statement would require impairments indicated by a change in legal factors to be reported in the period that the change in law occurs, as discussed in paragraph 36 in the Basis for Conclusions and illustrated in Appendix C, Illustration 3. Do you agree with the Board’s position? If not, why not?**

The FMSB agrees with the Board position. Illustration 3 has a situation in which the useful life of an asset was reduced from 40 years to 11 due to environmental regulations. The issue is whether a loss should be recorded now, recorded 11 years from now, or spread out over the 11 remaining years (estimate revision). The loss should be recorded now.

The FMSB believes the Standard should contain a section stating that impairments indicated by a change in legal factors be reported in the period that the change in law occurs rather than mentioning this only in the Basis for Conclusions. We recommend a section with a heading and a paragraph in the Standard clearly explaining this concept.

### **Additional Comments (in the Form of Questions)**

1. Is it clear in the Exposure Draft that the standards apply to capital assets using both the depreciation approach and the modified approach? Paragraph 50 describes a different presumption (permanent vs. temporary) for capital assets using the two approaches. In circumstances where an individual capital asset which is part of a system or subsystem using the modified approach is permanently impaired, (for example, when a bridge isn't replaced), should that impairment be recognized? Is the standard sufficiently clear that it applies to all capital assets? Would it be useful to include an illustration or two for capital assets using the modified approach?
2. In paragraphs 19 and 20, would it be helpful to state specifically that the gross amounts be shown in the notes when an impairment loss and insurance recovery are netted?
3. In paragraphs 15 and 19, reporting of impairment losses and insurance recoveries include the option of reporting as a special item. Paragraph 56 of Statement 34 indicates that special items are within the control of management. Paragraph 9b indicates that an impairment has to be unexpected. Can a loss be under the control of management and be unexpected? Is it possible to report the loss and/or insurance recovery as special items?
4. Related to (4), would it be useful to provide more guidance as to when each of the respective classifications should be used?
5. Related to (4) also, Illustration 2 reports a gain due to an earthquake as an extraordinary item in the Statement of Activities. However, in the governmental fund statements, the cost to restore is reported as an expenditure and the insurance recovery is reported as an other financing source. While a gain or loss would not be recognized on the fund statements, wouldn't a \$2.5 million earthquake insurance recovery be considered both unusual in nature and infrequent in occurrence thereby meeting the criteria for treatment as an extraordinary item on the fund statements?

Again, the FMSB appreciates the opportunity to provide comments on the Exposure Draft. Should you have any questions, or desire further details on the FMSB's position, please contact me at [Sharon.Russell@Examiners.state.al.us](mailto:Sharon.Russell@Examiners.state.al.us) or (334) 242-9224 or the GASB facilitator, John Engstrom, at [Jengstrom@niu.edu](mailto:Jengstrom@niu.edu) or (815) 753-6097.

Sincerely,

A handwritten signature in cursive script that reads "Sharon R. Russell".

Sharon R. Russell, CPA, CGFM, Chair  
AGA Financial Management Standards Board

Cc: William J. Anderson, Jr., CGFM  
AGA National President

