TBH Consulting LLC

Impairment of Long-Lived Assets: ASC 360-10

Executive Summary

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I. Introduction

ASC 360-10 provides recognition, measurement, and disclosure guidance for the impairment or disposal of long-lived assets.

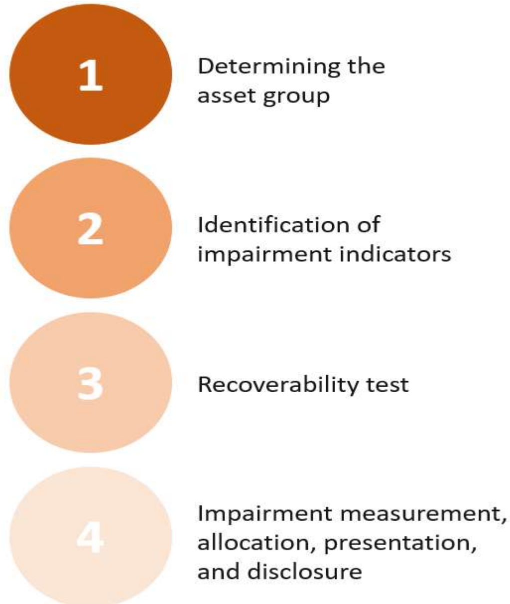
A long-lived asset is considered impaired when its carrying amount is not recoverable and exceeds its fair value. In that case, the impaired asset is written down to its recoverable amount and an impairment loss is recognized.

Scope and exclusions

Depending on your organization’s intent for their use, long-lived assets are accounted for and tested for impairment differently according to ASC 360-10. Long-lived assets that are intended to be held and used in operations, which includes those that the entity intends to abandon, distribute to owners, or exchange in a nonmonetary transaction, are tested for impairment by means of a recoverability test once a triggering event occurs. Those intended to be sold are tested upon classification as held for sale in each subsequent reporting period by means of comparing their carrying amount with fair value less costs to sell.

Steps to the impairment test

There are four steps to identify, recognize, and measure the impairment of a long-lived asset (group) to be held or used:



Upon the occurrence of a triggering event or impairment indicator, long-lived assets that are classified as held and used need to be tested for recoverability, as such an event or change in circumstances indicates that the carrying amount may not be recoverable. When testing for recoverability, long-lived assets should be grouped with other assets and possibly liabilities at the lowest level whose cash flows that are largely independent of those of other assets and liabilities, according to ASC 360-10-35-23. This grouping is referred to as an asset group.

II. Determining the Asset Group

The first step in the impairment test is to determine the asset group to which recoverability testing will be based.

Defining an asset group

Long-lived assets that are intended to be held and used in operations are tested for impairment at the asset group level. When performing the recoverability test in accordance with ASC 360-10, it is important to note that cash flows from one asset group should not be used to offset shortfalls in another. Therefore, it is critical to properly determine the asset group. As defined by the ASC Master Glossary:

> An asset group is the unit of account for a long-lived asset or assets to be held and used, which represents the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets and liabilities.

Entity-wide asset group

Long-lived assets that are shared among several asset groups, such as a corporate headquarters facility or a centralized research facility, are considered entity-wide or enterprise assets. According to ASC 360-10-35-24, when a long-lived asset's cash flows are not separately identifiable and largely independent from those of other assets, liabilities, and other asset groups, an entity should evaluate its recoverability for impairment on an entity-wide basis. Entity-wide assets result in the identification of an additional (higher-level) asset group, which compromises the asset and related lower-level asset groups. Recoverability will be dependent on the testing of net cash flows performed for any lower-level asset groups. The asset's carrying amount should not be allocated to lower-level asset groups for impairment testing.

The cash flows available to recover the entity-wide asset of an asset group are determined by using either the residual approach or the global approach, both of which will yield the same result. First, an entity should group long-lived assets and liabilities (if applicable) at the lowest level for which there are identifiable cash flows that are largely independent of those of the other assets and liabilities. These lower-level asset groups should be the first to be tested for recoverability and assessed for impairment. If using the residual approach to perform the impairment test, the lower-level asset groups are tested for recoverability across the entity based on only the available cash flows that benefit from or fund the costs of the asset tested (plus those attributable to the entity-wide asset). The carrying amount of the entity-wide asset is subtracted from the sum of the remaining cash flows available from the lower-level groups over their carrying amounts plus estimated future cash flows of the entity-wide asset.

The global approach would subtract the aggregate of the lower-level asset group carrying amounts and entity-wide asset carrying amount from the sum of estimated future cash flows of the lower-level asset groups and those related to the entity-wide asset. If available, impute an appropriate charge to the lower-level asset groups for the use of the shared entity-wide assets.

Recognize an impairment loss if the carrying amount of the entity-wide assets (asset group) exceeds the aggregated excess undiscounted cash flows from the lower-level asset groups and those for any expenses directly attributable to the entity-wide assets. If an impairment indicator is nonexistent within any of the lower-level asset groups, separate testing for recoverability of each lower-level asset group is not necessary before testing the entity-wide asset.

The sum of the aggregated excess undiscounted cash flows of the lower-level asset groups and any imputed charge less the cash flows for any directly attributable expenses equal the cash flows attributable to the entity-wide assets.

Determining the asset group

Some long-lived assets should be tested for impairment individually. These include assets that may have cash flows that are largely independent from other assets in the group. Under this circumstance, the unit of account for impairment testing is the asset group. Some asset groups contain other assets outside of the scope of ASC 360-10.

The determination of asset groups requires sound judgment and the consideration of all relevant facts and circumstances. An assessment of the interdependency of revenue producing activities between groups of assets, the presence of shared cost structures, the interchangeability of assets used in operations, and business management and utilization of assets can help determine the appropriate level at which to group assets for impairment testing. In some circumstances, a higher-level grouping may be necessary due to factors such as an entity's operating structure or contractual requirements. Keep in mind that support activities and routine shared service activities should often be allocated to a lower level since they may not be significant to the asset group's cash flows. Typically, when assessing whether a reporting entity should group assets at a higher level, allocated direct costs would not be considered shared costs.

The measurement of intercompany purchase and sale transaction cash flows are not addressed specifically in ASC 360-10, and it may be difficult to identify the proper level of independent cash flows. As a result, it may be appropriate to identify the asset group at a higher-level.

Changes to asset groups

Changes to asset groups could represent a triggering event or impairment indicator for the affected asset group(s). These changes may be necessary when a significant change occurs in business operations or long-lived assets utilization, such as an acquisition or disposition, which impacts the interdependency of cash flows. Changes in facts and circumstances could result in changes to asset groups and should be accounted for prospectively according to ASC 250-10 as a change in accounting estimate.

III. Identification of Impairment Indicators

The second step in the impairment test is to identify any impairment indicators that may be present for an individual asset within a broader asset group.

Order of impairment testing

The guidance in ASC 360-10-35 provides that long-lived assets that are held and used should be reviewed for impairment. Accounting could be impacted when an asset group includes assets that are not covered by ASC 360-10. As a result, it is crucial to perform impairment testing in sequential order as the amount of impairment recognized is impacted by each step. There are three types of impairment testing to be followed in sequential order (in accordance with ASC 360-10):

1. Test other assets (accounts receivable, inventory) and liabilities (accounts payable, long-term debt, AROs) that are not within the scope of ASC 360-10 under applicable guidance as well as indefinite-lived intangible assets (other than goodwill) under ASC 350.

2. Test long-lived assets (asset group)

3. Goodwill should be included in an asset group and tested for impairment only if the asset group is or includes a reporting unit. If a lower asset group includes only part of a reporting unit, goodwill should not be included in the asset group.

Prior to performing the next test, carrying values should be adjusted, as necessary.

When to test for impairment

Annual impairment testing for long-lived assets that are held and used is not required to be performed in accordance with ASC 360-10.

However, recoverability testing is required for a long-lived asset (asset group) that is held and used when triggering events indicate that its carrying amount may not be recoverable. ASC 360-10-35-21 provides examples of triggering events that may require impairment testing:

Except from ASC 360-10-35-21

a) A significant decrease in the market price of a long-lived asset (asset group)
b) A significant adverse change in the extent or way a long-lived asset (asset group) is being used or in its physical condition
c) A significant adverse change in legal factors or in the business climate that could affect the value of a long-lived asset (asset group), including an adverse action or assessment by a regulator
d) An accumulation of costs significantly more than the amount originally expected for the acquisition or construction of a long-lived asset (asset group)
e) A current period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with the use of a long-lived asset (asset group)
f) A current expectation that, more likely than not, a long-lived asset (asset group) will be sold or otherwise disposed of significantly before the end of its previously estimated useful life. The term *more likely than not* refers to a level of likelihood that is more than 50 percent.

Note that these examples do not automatically indicate that the asset (asset group) may not be recoverable and additional impairment indicators should also be considered, such as goodwill impairment or a decline in stock price.

Impairment indicators

An impairment indicator or triggering event for an asset within an asset group motions the reporting entity to consider the asset's significance in the overall group and the facts and circumstances surrounding the impairment indicator before proceeding with the recoverability test. For example, if the asset is insignificant to the broader asset group, you may not have an impairment indicator and therefore, would not need to perform impairment testing. On the other hand, significant individual assets may more broadly impact the overall asset group to the extent that impairment testing may need to be performed at the asset group level.

Ultimately, judgment and the consideration of the combined effect of all indicators will be critical when determining whether an asset (asset group) may not be recoverable. If the carrying amount is determined to not be recoverable, proceed to the next step in determining whether the asset (asset group) is impaired in accordance with ASC 360-10.

IV. Recoverability Test

The third step in the impairment test is to perform the recoverability test to determine whether the long-lived assets are recoverable by comparing the carrying amount to the sum of estimated undiscounted net cash flows to be generated from the use and future disposal of that asset group.

Testing for recoverability

An entity must determine whether the long-lived asset (group) is recoverable, and the outcome of the recoverability test is used to evaluate whether the asset group is impaired.

When triggering events occur that indicate an asset (asset group) may not be recoverable, impairment testing is required, and the asset (asset group) should be tested for recoverability by first estimating the undiscounted cash flows expected to be generated from the use of the long-lived asset (group) and its future disposition.

The next step is to compare the undiscounted estimated future cash flows to the carrying amount of the long-lived asset (group). Assets are recoverable if the undiscounted net cash flows exceed the net carrying value of the asset group. As a result, there is no impairment, and a loss cannot be recognized even if the net carrying value of the long-lived assets exceeds their fair value.

Assets are not recoverable if the net carrying value of the asset group exceeds the undiscounted net cash flows. As a result, an impairment loss would be recognized for the amount by which the net carrying value of the asset group exceeds its fair value. The fair value of the asset group will need to be measured to determine the amount of impairment loss.

The assessment of recoverability should include considerations for changes in the estimate of the useful life of an asset or multiple within the overarching group. As per ASC 360-10-35-22, the useful life or salvage value may need to be adjusted following review of depreciation policies and amortization estimates for the long-lived asset (group).

Each time a recoverability test is performed, an entity should assess whether its asset groupings continue to be appropriate since significant changes to the planned use of each asset within the group may impact the related asset grouping. All steps performed in the recoverability test are subjective and will require the exercise of significant judgment.

Estimates of future cash flows

<u>Cash Flow Estimation Approach</u>

This approach allows an entity to use a single-most-likely estimate of expected future cash flows. The cash flows used in measuring the asset group fair value, which is based on market participant assumptions, differ from those used in the recoverability test, which require significant judgement as their estimation is subjective. As per ASC 360-10-35-29, the recoverability test is based on estimates of net future cash flows directly associated with and expected to arise from the use and eventual disposition of the asset (asset group), excluding interest charges. Cash flow estimates should not reflect subsequent events but should reflect conditions and assumptions that existed as of the measurement date. Estimates of future cash flows for performing the recoverability test are undiscounted and should incorporate the assumptions and all available evidence used to develop other information the entity uses for comparable periods, such as internal budgets and projections, accruals related to incentive compensation plans, or information communicated to others, according to ASC 360-10-35-30.

<u>Cash Flow Estimation Period</u>

The period of time for which to determine estimates of future cash flows for the recoverability test is based on the remaining useful life of the asset (asset group), which is based on the remaining useful life of the primary asset of the group, according to ASC 360-10-35-31. This would be the period over which the principal long-lived asset will be depreciated or amortized.

As defined by ASC 360-10-35-31:

> [T]he primary asset is the principal long-lived tangible asset being depreciated or intangible asset being amortized that is the most significant component asset from which the asset group derives its cash-flow-generating capacity.

Therefore, the primary asset cannot be land, an asset with an indefinite life, or an intangible asset since neither cannot be amortized or depreciated. According to ASC 360-10-35-32, factors that an entity should consider in determining whether a long-lived asset is the primary asset of an asset group include:

a) Whether other assets of the group would have been acquired by the entity without the asset

b) The level of investment that would be required to replace the asset

c) The remaining useful life of the asset relative to other assets of the group. If the primary asset is not the asset of the group with the longest remaining useful life, estimates of future cash flows for the group shall assume the sale of the group at the end of the remaining useful life of the primary asset.

At the end of the undiscounted cash flow period (end of the life of the primary asset), the residual value of the asset group should be calculated and maximized based on considerations in the recoverability test. The cash flow estimates used to test recoverability of a long-lived asset (group) that is in use should be based on the existing service potential of the asset (group) at the date tested, which encompasses the asset's remaining estimated useful life, cash flow generating capacity, and physical output capacity for tangible assets. Management's estimate of undiscounted cash flows may include utilization increases and cash flows associated with future expenditures necessary to maintain the existing service potential, such as repairs and replacements, but do not include those associated with future capital expenditures that would increase service potential.

<u>Probability-Weighted Cash Flow Estimates</u>

The probability-weighted cash flow estimation approach is encouraged, but not required, by ASC 360-10 in performing the recoverability test. The cash flows used in recoverability testing should be based on conditions that exist as of the date of testing. If an entity is contemplating the sale of a held and used asset, the cash flows should account for the probability-weighted various courses of action that could be taken. This alternative allows an entity to use a range of possible future outcomes as opposed to a single-most-likely estimate of expected future cash flows.

According to ASC 360-10, if alternative courses of action to recover the carrying amount of a long-lived asset or asset group are under consideration, or a range is estimated for the amount of possible future cash flows, the likelihood of those possible outcomes should be considered. This expected cash flow approach uses a set of cash flows that represents the probability-weighted average of all possible cash flows, while cash flow estimation approach uses a single set of cash flows that represents management's best estimate of the most likely outcome within a range of possible estimated amounts.

V. Impairment Loss Measurement

The fourth and final step in the impairment test is to recognize, allocate, present, and disclose any impairment loss in the financial statements in accordance with the subsections of ASC 360-10 guidance.

If the asset (asset group) fails the recoverability test and is determined to not be recoverable, an impairment loss would be calculated as the amount by which the carrying amount of the long-lived asset (asset group) exceeds its fair value.

After applying ASC 360-10, any resulting impairment loss should reduce only the carrying amounts of the long-lived assets in the asset group. The other assets in the group (excluding goodwill) outside of the scope of ASC 360-10 should be tested for impairment in accordance with other GAAP before testing long-lived assets for impairment.

Impairment loss recognition

ASC 360-10-35-23 provides guidance for the Grouping of Long-Lived Assets Classified as Held and Used for purposes of recognition and measurement of an impairment loss. According to ASC 360-10-35-23:

A long-lived asset or assets shall be grouped with other assets and liabilities at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities. However, an impairment loss, if any, that results from applying this Subtopic shall reduce only the carrying amount of a long-lived asset or assets of the group in accordance with paragraph 360-10-35-28.

ASC 360-10-35-28 provides guidance on Allocating of Impairment Losses to an Asset Group. According to ASC 360-10-35-28:

An impairment loss for an asset group shall reduce only the carrying amounts of a long-lived asset or assets of the group. The loss shall be allocated to the long-lived assets of the group on a pro rata basis using the relative carrying amounts of those assets, except that the loss allocated to an individual long-lived asset of the group shall not reduce the carrying amount of that asset below its fair value whenever that fair value is determinable without undue cost and effort.

In summary, the guidance serves as in indicator that only long-lived asset impairment is to be measured in determining impairment loss, which is computed by comparing the fair value to the net carrying amount of the long-lived asset group.

Fair value considerations

ASC 360-10 requires the determination of the asset group's fair value in order to recognize and measure any amount of impairment loss. ASC 820 guidance is principles-based and is intended to provide a framework for measuring fair value, which is defined as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." The determination of fair value should incorporate all long-lived assets within the asset group, whether they be recognized or unrecognized. For example, unrecognized customer relationships should be considered if it is reasonable that a market-participant would assign value to them.

Fair value considerations include appropriate discount rates, valuation techniques and approaches, the most advantageous market, the perspective of market participants, and assumptions about the highest and best use of the asset group. A long-lived asset's continued use indicates service potential, so its fair value is expected to be above zero.

Right-of-use asset considerations

The Impairment or Disposal of Long-Lived Assets subsection of ASC 360, along with ASC 842 guidance, discusses the subsequent measurement of a right-of-use asset. According to ASC 842-20-35-9, a lessee should determine whether a right-of-use asset is impaired and recognize any impairment loss in accordance with ASC 360-10-35.

Right-of-use assets should be assigned to an asset group and may be its own asset group in certain circumstances. Asset groupings should be reassessed by lessees when there is a change in the facts and circumstances of the interdependency of cash flows or components covered by the arrangement or if the underlying asset is to be used in a substantially different way and the level of identifiable cash flows have materially changed after a decision to sublease or dispose of a portion of a larger right-of-use asset is made. Subleasing may indicate impairment depending on the component's significance relative to the overarching asset group.

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Conditions that indicate an ASC 360 impairment trigger may also lead to, but not necessarily cause, a lease term reassessment under ASC 842.

Lease accounting is applied at the lowest component level (unit of account). For leases with multiple components, entities should determine whether they should be included in different asset groups for impairment testing. If there are multiple lease components, allocate the right-of-use asset carrying amount and lease liability to each component based on their relative fair value at lease commencement or on the date that the decision to sublease was made (if the lease commencement date is unknown).

Impairment is allocated to the entire asset group if a right-of-use asset is impaired. According to ASC 842-20-35-10, lessees should continue amortizing the lease liability for operating leases using the same effective interest method but amortizing the right-of-use asset on a straight-line basis over the shorter of its remaining useful life or remaining lease term. For finance leases, the right of use asset is amortized over the shorter of its remaining useful life or remaining lease term, the same as it was before impairment, but use the remaining useful life if title automatically transfers or if the lessee is reasonably certain to exercise a purchase option.

TBH Insight

Revisions to the useful life trigger the need for reassessment even when there is no asset impairment.

VI. Impairment Loss Allocation

Once an impairment loss has been measured, the next step is to allocate the impairment loss to the individual assets in the asset group that are covered by ASC 360-10 on a pro rata basis using their relative carrying amounts. Keep in mind that their carrying amounts cannot be reduced below their determinable fair value. If certain assets within the group are to be abandoned, an entity is generally prohibited from allocating the entire held and used impairment loss to those assets, even if their adjusted carrying value exceeds their fair values at the impairment date.

Goodwill, indefinite-lived intangibles, other assets outside of the scope of ASC 360-10, and liabilities are not affected by an impairment loss recognized under ASC 360-10 guidance, even if they are part of the asset group being tested for impairment.

VII. Financial Statement Presentation

An impairment loss shall be recognized only if the carrying amount of a long-lived asset (asset group) is not recoverable and exceeds its fair value, according to ASC 360-10-35-17. After it has been concluded that an impairment loss exists, an entity must determine how to present the impairment loss in its financial statements.

ASC 360-10-45-4 requires any impairment loss recognized to be included in income from continuing operations before income taxes and within income from operations if such is presented. If a subtotal is presented, the impairment loss should be included within the subtotal. After recognizing an impairment loss, the adjusted carrying amount of a long-lived asset becomes that asset's new accounting basis and should be depreciated or amortized over the asset's remaining useful life. Subsequent reversal of a previously recorded impairment loss is prohibited.

VIII. Disclosure Requirements

All impaired nonfinancial assets require similar disclosures in the financial statements, and the same apply to long-lived assets classified as held and used including:

1. Amount of the impairment loss
2. Description of the impaired asset
3. Facts and circumstances that led to asset impairment

ASC 360-10-50-2 dictates specific disclosures when an impairment loss is recognized for long-lived assets classified as held and used. ASC 360-10-50-2 lists the disclosures required in the period the impairment loss is recognized and for all periods in which the impairment is disclosed in the notes to the financial statements.

ASC 360-10-50-2

a) A description of the impaired long-lived asset (asset group) and the facts and circumstances leading to the impairment
b) If not separately presented on the face of the statement, the amount of the impairment loss and the caption in the income statement or the statement of activities that includes that loss
c) The method or methods for determining fair value (whether based on a quoted market price, prices for similar assets, or another valuation technique)
d) If applicable, the segment in which the impaired long-lived asset (asset group) is reported under Topic 280.

In addition, MD&A disclosures such as critical accounting estimates, cash flow projections, and potential future impairment losses are expected to be made by SEC registrants.

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The SEC expects enhanced discloses on how the events or conditions that led to the current period impairment loss might alter future business performance and risk of future impairments.

Impairment disclosures should focus on the business and economic conditions that gave rise to the impairment loss, not solely on the nature of the recognized impairment loss.

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