

## Q&amp;A



## IMPAIRMENT ASSESSMENT 101

*The keys to planning a smooth analysis.*

Impairment is the condition that exists when the carrying amount of a long-lived asset, or asset group, exceeds its fair value. Examples include goodwill, intangible assets such as customer relationships, and property, plant, and equipment (PP&E). U.S. GAAP provides some very specific requirements that define when you should assess whether impairment exists, but no matter your market, impairment analysis will likely play a part in your annual financial process. Preparation is key to conducting a successful impairment effort. The following tips will help ensure a smooth assessment:

- **Plan ahead.** Impairment assessments require substantial analysis. Review the process from the prior year and begin data collection efforts before a last-minute crunch.
- **Know the rules.** Knowing when to evaluate trigger events, realizing what dates to select for impairment assessments, and identifying and documenting your reporting units makes the process easier.
- **Stay alert.** Generally, economic downturns increase the likelihood of impairments. If a downturn is occurring in your market, be ready for the possibility of impairment.
- **Be prepared.** If you anticipate impairment, you should perform an analysis of the impact on any financial metrics you maintain for loan or other covenants. Discuss the impact with lenders and equity sources early on.

With proper planning and guidance, you can develop an assessment process that is specifically aligned to your organization's unique needs. Understanding the process and how you can prepare for it by identifying interim events and choosing the optimal date will ease the burden of impairment assessments.

### *Challenges of Impairment Efforts:*

- Turning a blind eye to the possibility of impairment can cause unwelcome surprises.
- Impairment may require obtaining waivers for loan and other covenants.
- In turbulent economic times, trigger events often force interim assessments.
- Impairment testing results are subject to intense auditor scrutiny and fair value judgment.

**Q Why is so much attention paid to identifying reporting units? Can I perform an overall company-wide impairment analysis?**

Most companies are complex enough to have more than one reporting unit. U.S. GAAP requires that you assign recorded goodwill to reporting units and test each reporting unit's goodwill for impairment on an annual basis. A reporting unit is either an operating segment or one level below an operating segment, also known as a component. The criteria for determining reporting units are both qualitative and quantitative.

Generally, two or more components can be aggregated into one reporting unit if they share similar economic characteristics such as reporting structure, financial shape, shared assets, and similar customers, products, and services. An operating segment can be considered a single reporting unit if all of its components share similar economic characteristics. However, components that relate to different operating segments may not be aggregated to a single reporting unit even if they share similar economic characteristics.

**Q We seem to be in a rut at my company—each year calling in the impairment experts who crank out their analysis. Sometimes we need to make an adjustment, but more often than not, we don't. What about interim events?**

Interim events can play a big part in determining the timing of an impairment assessment. These events, commonly referred to as "trigger events" because they trigger an impairment assessment, are slightly different for goodwill compared to non-goodwill intangibles. However, they both apply the same philosophical approach: Has there been a significant adverse event that would impact the value of the intangible?

GAAP does not propose an exact listing, but it gives examples such as: "a significant adverse change in legal factors or in the business climate," or "a significant adverse change in the extent or manner in which a long-lived asset (asset group) is being used or in its physical condition." ASC 350-20-35-30 (formerly FAS 142 paragraph 30) and ASC 360-10-35-21 (formerly FAS 144 paragraph 8) contain the definitive listings of examples for goodwill and other intangibles, respectively.

Your auditors and SOX compliance resources will look for controls that document that you performed an assessment of potential trigger events for each reporting period and responded accordingly. The following table summarizes the timing and citations for key impairment events under GAAP:

|  | AMORTIZE?  | EVALUATE REMAINING USEFUL LIFE?                                       | CONDUCT IMPAIRMENT ANALYSIS?  |
|--|--|---|---|
| Intangible assets with finite lives<br>ASC 350-30-35                 | Yes  | N/A   | Yes, if triggered<br>(see ASC 360-10-35-21).                                    |
| Intangible assets with indefinite lives<br>ASC 350-30-35             | No   | Yes, evaluate each reporting period to determine if still indefinite. | Yes, at least annually and more frequently if triggered (see ASC 360-10-35-21). |
| Goodwill<br>ASC 350-20-35  | No   | N/A   | Yes, annually and more frequently if triggered<br>(see ASC 350-20-35-30).       |
| Other long-lived assets<br>(PP&E, cap leases, etc.)<br>ASC 360-10-35 | Depreciate per applicable accounting literature. | N/A   | Yes, if triggered<br>(see ASC 360-10-35-21).                                    |

**Q Is there any magic to choosing the date of an annual impairment assessment?**

Yes, there are some considerations to take into account when choosing a date. We recommend performing an assessment as of October 1 or November 1.

First and foremost, the impairment assessment needs to contain data that is representative of the conditions at the end of the reporting period. So if you happen to be performing an annual assessment and your year-end is December 31, the assessment needs to reasonably represent the conditions that were present on December 31. This speaks to an assessment performed later in the year.

Secondly, if the assessment is performed earlier than Q4, you will have to book the results in an earlier period. For example, if your assessment date was September 30 and you had a write-down, you would need to run the adjustment through your Q3 financial statements with its related impact on earnings. By waiting one day until October 1, you could simply run your results through your Q4 (annual) financials. This speaks to Q4 timing.

Finally, if you wait until December, the assessment results are likely to be finished right in the middle of closing the books for the year. No one wants the headache of dealing with a major accounting issue late in the game during closing. As a result, this pushes us to early Q4 timing.

**Q What do I need to perform the assessment? Can I conduct the assessment myself?**

To conduct the fair value test, you will need more than just historical financial statements and several years of cash flow projections for each of your reporting units. The fair value of the reporting unit must reflect the perspective of a market participant by using observable market data to determine cost of debt, cost of capital, capital structure, etc.

We recommend seeking out professional guidance early in the process. A valuation expert can provide your management team and staff with the technical support they need to reduce the risk of impairment testing errors. Considering the amount of professional judgment used to determine fair value, you can expect a high level of scrutiny from your auditors. A valuation expert can prove to be a great ally in minimizing those challenges.