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COVID-19 Asset Impairment Considerations Long-Lived Assets

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Many entities and practitioners face asset impairment testing and accounting challenges as a result of the COVID-19 pandemic. A recent Wall Street Journal article¹ indicates that impairment charges for the first 6 months of 2020 are up 187% from the same period in 2019. The total figure for write-downs in the first half of the year is among the highest for the past 20 years, but lower than such charges in all of 2008 and 2015.

Impairment models under U.S. generally accepted accounting principles (U.S. GAAP) vary depending on the asset subject to the impairment test. Impairment models consideration of future events also vary significantly under current U.S. GAAP.

This report addresses the impairment of long-lived assets to be held and used by an entity. An illustrative example is presented in the appendix. The primary source of U.S. GAAP related to the impairment of long-lived assets is FASB ASC 360, *Property, Plant, and Equipment*, which includes subsections on asset impairment. The impairment guidance in FASB ASC 360 applies to long-lived assets of entities, including not-for-profit entities, to be held and used or to be disposed of, which includes:

U.S. companies are writing down more of their assets during the coronavirus pandemic than they have in years.

¹ Maurer, Mark. "Company Write-Downs Surge as Business Slows During COVID-19." Wall Street Journal, August 19, 2020.

- Land
- Buildings
- Plant and equipment
- Capital leases of lessees, if FASB ASC 842, *Leases*, has not been adopted
- Finite-lived intangible assets
- Long-lived assets of lessors subject to operating leases
- Long-term prepaid assets
- Assets and liabilities included in an asset group (see asset group discussion below)
- Internal use software
- Implementation costs of hosting arrangements that are service contracts, if ASU 2018-15, *Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract (A Consensus of the FASB Emerging Issues Task Force)*, has been adopted
- Proved oil and gas properties that are being accounted for using the successful-efforts method of accounting
- Right-of-use assets of lessees, if FASB ASC 842, *Leases*, has been adopted
- Real estate projects, or parts thereof, that are substantially completed and that are to be sold
- Real estate held for development, including property to be developed in the future as well as that currently under development, and to real estate projects, or parts thereof, that are substantially completed and that are to be held and used (for example, for rental)

Impairment testing related to long-lived assets as a reputation of being difficult and may need the involvement of valuation experts.

Grouping Assets/Unit of Accounting

The unit of accounting for impairment analyses of long-lived assets is an asset group. An asset group are 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. An asset group may contain a single long-lived asset. In grouping assets, company-specific operating characteristics are assessed, including the interdependency of revenues and shared cost structures. Generally, impairment testing is meant to be performed at a low level of an entity and the grouping of assets should be done with that principle in mind.

As indicated in FASB ASC 360-10-35-24-25, a long-lived asset may not have identifiable cash flows that are largely independent of the cash flows of other assets and liabilities

and of other asset groups. In those circumstances, the asset group for that long-lived asset shall include all assets and liabilities of the entity. A common example is a corporate headquarters. Such long-lived assets are sometimes referred to as enterprise assets, as they support the cash flows of more than one asset group.

Practice Note: Identifying an asset group is a significant judgment area and a company-specific exercise. Essentially, management should group assets that are used together in generating cash flows. Nuanced details can have an impact on the asset grouping determination. As indicated in FASB ASC 360-10-55-35:

Varying facts and circumstances will inevitably justify different groupings of assets for impairment review. While grouping at the lowest level for which there are identifiable cash flows for recognition and measurement of an impairment loss is understood, determining that lowest level requires considerable judgment.

FASB ASC 360-10-55-36 provides an example of grouping assets in the context of a bus company operating five separate routes. Below are two more examples of identifying asset groups.

Illustration of Identifying an Asset Group – Example 1

Mainland Hotel operates a hotel, spa, and restaurant on leased property. The spa is available only to hotel guests. The restaurant obtains substantial business from the local community in addition to hotel guests. Mainland also owns and operates a small adventure park on adjacent leased property, which is open to the public and hotel guests. Both leases are classified as operating leases in accordance with FASB ASC 840, *Leases*.

For impairment testing purposes, Mainland identifies 3 asset groups:



All three groups have their own separately identifiable cash flows. The hotel and spa are combined into a separate group because the spa can only be used by hotel guests.

Illustration of Identifying an Asset Group – Example 2

Sassy Susanne's Clothing business operates a small company headquarters, 4 stores, and 2 distribution centers. Inventory is ordered by the headquarters and stored at a distribution center until the time it is needed by a store. Once inventory is needed by a store, a purchase order is submitted from the store to the distribution center and the product is shipped to the store. Each distribution center stocks identical inventory but services specific stores.

For impairment testing purposes, Sassy identifies 7 asset groups:



Given that each of the stores has its own separately identifiable cash flows (sales and purchases from the distribution centers), management likely would conclude that each of the 4 stores represents a separate asset group. Given that each distribution center services specific stores, management also likely would conclude that each center represents an asset group along with the stores each services. The corporate headquarters does not have identifiable cash flows that are largely independent of the cash flows of other assets and liabilities and of the other asset groups. As such, the headquarters is deemed to be a separate asset group. The asset group for that long-lived asset would include all assets and liabilities of the entity.

Auditing Note. Identifying an asset group related to impairment testing is one of the more judgmental and tricky areas of asset impairment accounting where many entities and practitioners struggle. Auditors are cautioned that, even though impairment testing is meant to be performed at a low level of an entity, management sometimes may group assets at high levels to lower the chances of recognizing an impairment loss.

Given the complexity and infrequent occurrence of a need for an asset group determination, private company clients generally are not well experienced in making asset group determinations under FASB ASC 360. With that said, many private companies will

closely track operational performance for parts of their business based on the lowest level of identifiable cash flows. For example, divisional or product line monthly operational performance statements may be generated and closely watched within the entity for management reporting. Often the existence of these divisional or product line performance statements indicates some amount of independent revenue and costs. Therefore, these types of performance statements could form the foundation of the asset group for impairment purposes under FASB ASC 360-10.

When to Test Long-Lived Assets for Impairment

The impairment testing sequence for long-lived assets starts when events or changes in circumstances indicate that an asset's or asset group's carrying amount may not be recoverable. This is often referred to as a triggering event. (The carrying amount of a long-lived asset or asset group is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset or asset group.) FASB ASC 360-10-35-21 lists examples of such events or changes in circumstances. Three examples from that list of particular relevance are:

- (b) a significant adverse change in the extent or manner in which a long-lived asset or asset group is being used
- (c) a significant adverse change in the business climate that could affect the value of a long-lived asset or 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) (emphasis added)

COVID-19 Triggering Event. Based on the list in FASB ASC 360-10-35-21, many entities will conclude that a triggering event has occurred in 2020. In fact, expectations are that many entities will find asset impairment testing inescapable as a result of the pandemic. That said, some entities within certain industries (such as certain entities in technology or medical supply) experienced increases in demand and profitability during the pandemic and impairment triggering events may not be identified.

The exact timing of a potential triggering event depends on the nature of the circumstances. Discrete events that significantly impact recoverability of long-lived assets such as release of an unanticipated government regulation could be traced to a particular day. However, more common are broad based declines in economic conditions that unfold over a period of time without a discrete event to mark the commencement of the decline. The COVID-19 triggering event is likely the latter circumstance, a decline in business activity that cannot be traced to a particular day but can be more clearly seen over a longer period of time – weeks or a month. The public company COVID-19 FASB

ASC 360-10 impairments analyzed did not indicate a particular date for the impairment assessment but, rather, indicated the COVID-19 FASB ASC 360-10 impairment expense for the quarter of the FASB ASC 360-10 impairment assessment. Given the circumstances for the COVID-19 economic decline, it would appear that some degree of flexibility exists for the exact trigger date for a COVID 19 related FASB ASC 360-10 impairment within a short-term period of time such as a few weeks or months. Thereafter, an entity would need to continue to monitor whether another triggering event occurred.

We do not think that such flexibility extends to an entire annual reporting period. For example, it would not be appropriate to avoid an impairment test for recoverability under FASB ASC 360-10 if it was clear that an impairment trigger happened in March 2020 for COVID-19 but later, in the same annual reporting period, it also was clear that based on later improvements in economic circumstances that long-lived assets were recoverable.

Practice Note: While the COVID-19 pandemic is global, permanent impairment charges for long-lived assets are likely to be largely concentrated to those reporting under U.S. GAAP. Under FASB ASC 360-10-35-20, once an impairment loss is recognized it may not be reversed. This contrasts with International Financial Reporting Standards (IFRS) which permits reversal of impairment losses for long-lived assets (except for goodwill), under International Accounting Standard (IAS) 36, *Impairment of Assets*. IFRS for Small- and Medium-Sized Entities (SMEs) has similar provisions and only requires assessments for indications of impairment at reporting dates. The combination of a requirement to test for recoverability “whenever events or changes in circumstances” indicate non-recoverability and the prohibition on reversals of previously recognized impairment losses make the FASB ASC significantly more challenging for reporting entities and practitioners.

Testing Recoverability of the Carrying Amount (Step 1)

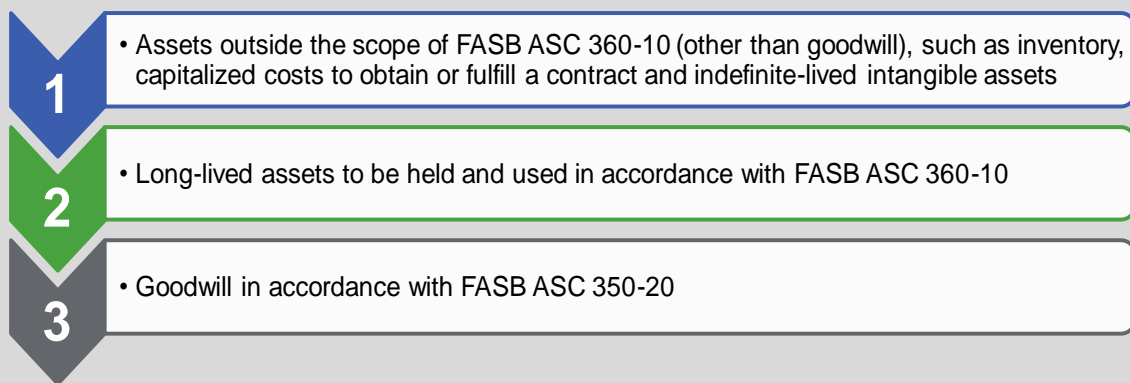
If an impairment trigger is identified, an entity performs step 1 of the impairment analysis and tests the asset group’s carrying value for recoverability. The recoverability assessment is based on the carrying amount of the asset group at the date it is tested for recoverability, whether in use (see FASB ASC 360-10-35-33) or under development (see FASB ASC 360-10-35-34).

Practice Note. The guidance on recoverability testing and impairment testing overall is normally discussed in terms of the asset group. The identification and importance of the asset group was previously addressed in this report. A triggering event may indicate that a particular long-lived asset’s carrying amount may not be recoverable. But usually a long-lived asset does not generate cash flows on its own. Rather it is utilized in combination with other assets forming an asset group. Therefore, when a triggering event is identified related to a particular long-lived asset, the subsequent steps in the impairment analysis often are performed on the related asset group. It’s possible that an impairment trigger

may relate to a particular long-lived asset and that asset is not significant to the larger asset group to which it belongs. In that case, the larger asset group may not need to be tested for recoverability.

Order of Impairment Testing

When an impairment trigger is identified and the subsequent steps in the impairment analysis are to be performed, U.S. GAAP prescribes an order on how the impairment testing should be conducted. An order is necessary because it allows an entity to make any required adjustments to the carrying amount of the reporting unit (or, for private companies, an entity) prior to the performance of the goodwill impairment test in accordance with FASB ASC 350-20, *Intangibles— Goodwill and Other: Goodwill*. FASB ASC 360-10-35-27 describes the testing order. The graphic below summarizes the order.



Estimating the Cash Flows

Performing the step 1 recoverability test involves determining the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset group. Paragraphs 29 through 35 of FASB ASC 360-10-35 provide the primary guidance on estimating the undiscounted cash flows. Below are some key reminders related to estimating cash flows during the recoverability testing step.

- The recoverability test step is an entity-specific evaluation. The estimation of cash flows takes into account the plans of the entity and entity-specific circumstances.
- During step 1, the cash flows being calculated are undiscounted.
- The cash flows from the eventual disposition (e.g., sale) of the asset or asset group are included.
- FASB ASC 360-10 does not address how to handle intercompany transactions when calculating cash flows. A reasonable approach would be to include them, based on third party pricing.

- FASB ASC 360-10 does not address whether cash flows should be calculated on a pre-tax or after-tax basis. Entities should make an accounting policy election and apply it consistently. In practice, most entities follow a pre-tax basis approach.
- Cash flows should exclude interest expense.

Impact of COVID-19 Pandemic on Estimation of Cash Flows

The turbulent economic environment and the novelty of the COVID-19 pandemic introduce significant uncertainty into the process of estimating cash flows. Best efforts should be made to reflect current realities and the future impact of the COVID-19 pandemic on cash flow projections at the measurement date (not necessarily the balance sheet date). In some cases, an entity may determine that substantial doubt about its ability to continue as a going concern exists (FASB ASC 205-40). Estimates of cash flows will need to factor in that going concern determination, such as the consideration of management's plans for alleviating the substantial doubt and the range of possible future scenarios that may be contemplated.

FASB ASC 360-10-35-30 allows an entity to use a range of possible future outcomes (probability-weighted approach) when estimating future cash flows. Given the existing economic uncertainty, probability-weighted cash flows for multiple outcomes may be more appropriate in this current environment.

Auditing Note. Auditors will need to scrutinize cash flow estimates more closely in light of the uncertainty and novelty of the COVID-19 pandemic and its economic repercussions. Pre-pandemic assumptions may no longer be valid and will need to reflect known or expected events (e.g., loss of a significant customer). Assumptions need to be reasonable and supportable. A recent audit report for a public company 10-K described procedures performed in an FASB ASC 360-10 impairment analysis as a "Critical Audit Matter"

Addressing the matter involved performing procedures and evaluating audit evidence in connection with forming our overall opinion on the consolidated financial statements. These procedures included testing the effectiveness of controls relating to management's [FASB ASC 360-10] impairment assessment, including controls over the valuation of the [entity's] asset groups. These procedures also included, among others, (i) testing management's process for developing the fair value of the [entity's] asset groups; (ii) evaluating the appropriateness of the market participant approach methods; (iii) testing the completeness, accuracy, and relevance of underlying data used in the estimates; and (iv) evaluating the significant judgments and assumptions used by management, which are the market rent of comparable properties based on recently negotiated leases, as applicable, asset group's projected sales for fiscal

years 2021 through 2023 for properties with no recently negotiated leases, and the discount rate. Evaluating management's judgments and assumptions relating to market rent of comparable properties of recently negotiated leases involved obtaining recently negotiated leases to evaluate whether the fair market monthly rent used in the method was consistent with the executed agreements. Evaluating management's assumptions relating to the market comparable properties based on asset group's projected sales for fiscal years 2021 through 2023 sales involved evaluating whether the assumptions used by management were reasonable considering current and past performance of the asset group, industry data and whether these assumptions were consistent with evidence obtained in other areas of the audit. Professionals with specialized skill and knowledge were used to assist in the evaluation of the Company's market participant approach methods and the discount rate assumption.

Carrying Amount

In step 1, the undiscounted cash flows discussed above are compared to the carrying value of the asset group. The carrying value of an asset group is the amount recorded in the entity's financial statements at the date of the recoverability test. Limited guidance on determining the carrying amount of the asset group is provided in FASB ASC 360-10. FASB ASC 360-10-35-26 indicates that goodwill should be included in an asset group to be tested for impairment only if the asset group is or includes a reporting unit. Goodwill should not be included in a lower-level asset group that includes only part of a reporting unit. Estimates of future cash flows used to test that lower-level asset group for recoverability should not be adjusted for the effect of excluding goodwill from the group.

FASB ASC 360-10-35-27 indicates that other than goodwill, the carrying amounts of any assets (such as accounts receivable and inventory) and liabilities (such as accounts payable, long-term debt, and asset retirement obligations) not covered by the impairment subtopic in FASB ASC 360-10 that are included in an asset group should be adjusted in accordance with other U.S. GAAP before testing the asset group for recoverability.

Practice Note. Proper ordering of impairment tests is an important point. Assets and liabilities should be adjusted first in accordance with U.S. GAAP applicable to those assets and liabilities. Otherwise, the recoverability test may start with incorrect carrying amounts.

FASB ASC 360-10-35-18 indicates that the carrying amount of the asset group should include amounts of capitalized asset retirement costs. However, estimated future cash flows related to the liability for an asset retirement obligation that has been recognized in the financial statements should be excluded from the recoverability test.

Clarifying What Liabilities Are Included in the Carrying Amount

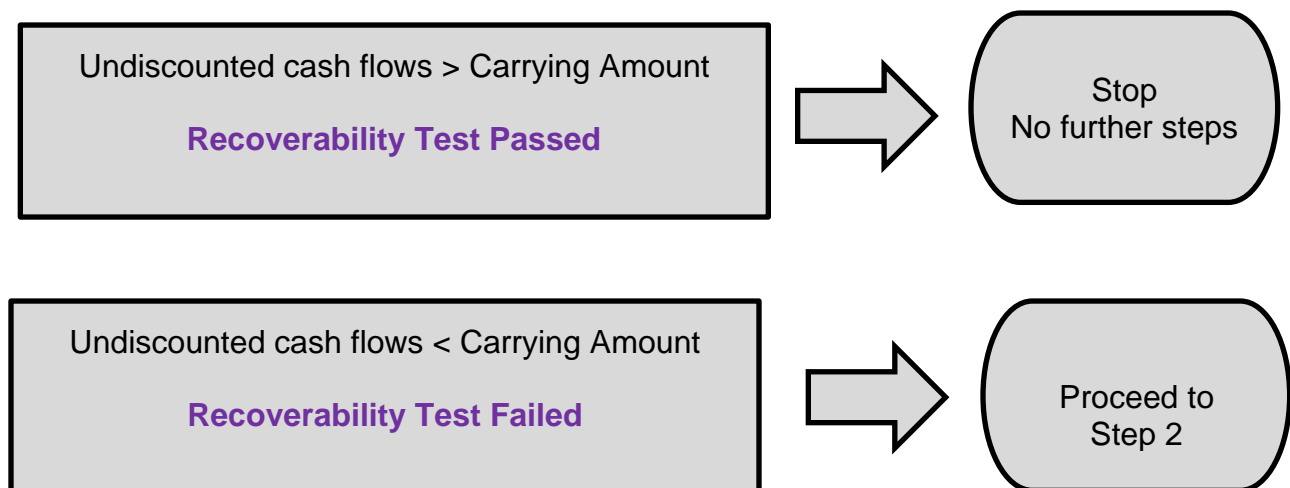
As indicated above, the carrying value of an asset group often includes related liabilities. Generally, operating liabilities are included in the carrying amount and nonoperating liabilities are not included. Therefore, generally, debt obligations are excluded from the carrying value of asset groups.

However, in situations where the asset group includes all the assets and liabilities of an entity (see previous asset grouping discussion) because they represent the lowest level of identifiable cash flows, nonoperating liabilities such as debt, asset retirement obligations, and capital lease obligations would be included in the carrying value of the asset group. In this situation, the inclusion of the nonoperating liabilities in the carrying value is necessary to be consistent with the cash flows being used. Put another way, it would be appropriate to reduce the cash flows for payments on nonoperating liabilities since the carrying value has been reduced by the nonoperating liabilities.

CPEA Observation: The question of inclusion of non-operating liabilities in carrying value depends on whether they are included in the lowest level of identifiable cash flows. However, it is more important that the cash flows used in Step 1 are consistent with the determination regarding inclusion/exclusion of non-operating liabilities in carrying value.

Calculating and Recording an Impairment Loss (Step 2)

If the carrying amount of the asset group exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset group, it is not recoverable and the entity must perform step 2 in the impairment analysis of measuring and recording an impairment loss.



Step 2 involves measuring the fair value of the asset group and comparing it to the carrying amount of the asset group. If the carrying value of the asset group exceeds the

fair value of the asset group, an impairment loss is recorded in the income statement and the asset group is written down on the balance sheet. An impairment loss should be measured as the amount by which the carrying amount of the asset group exceeds its fair value. As indicated earlier in this report, a valuation expert may be necessary in determining the fair value of an asset group.

Key Differences Between Step 1 and Step 2. The recoverability test in Step 1 is performed from the perspective of the entity. The model considers the plans of the entity. The measurement of the asset group's fair value in step 2 is performed from a market participant's perspective. Market participants may view the entity and the use of the asset group differently than management. Step 2 measures the asset group based on the "highest and best" use of the asset group by market participants. Also, in step 1, cash flows are not discounted. In step 2, cash flows are discounted.

Since fair value is the measurement objective associated with recognizing impairment losses, the guidance in FASB ASC 820, *Fair Value Measurement*, is important here, although the guidance in FASB ASC 360-10-35-36 is clear in that, for long-lived assets that have uncertainties both in timing and amounts of cash flows, an expected present value technique often will be the appropriate technique with which to estimate fair value.

Pursuant to the provisions of FASB ASC 820-10-55-5, use of present value techniques in determining fair value measurements of assets or liabilities should capture all the following elements from the perspective of market participants as of the measurement date:

- Estimates of future cash flows for the assets or liabilities being measured
- Expectations about possible variations in amounts and timing of the cash flows representing uncertainties inherent in the cash flows
- The time value of money, represented by the rate on risk-free monetary assets that have maturity dates or durations coinciding with the period covered by the cash flows and pose neither uncertainty in timing nor risk of default to the holder (i.e., a risk-free interest rate); for present value computations denominated in nominal U.S. dollars, the yield curve for U.S. Treasury securities determines the appropriate risk-free interest rate
- The price for bearing uncertainties inherent in the cash flows (i.e., risk premiums)
- Other factors that other market participants would take into account in the circumstances
- For liabilities, the nonperformance risks related to the liabilities, including the credit risk of the reporting entity (i.e., the obligor)

Using present value techniques for purposes of fair value measurements constitute applying an income approach to determining the measurements. The income approach

incorporates valuation techniques that convert future amounts (e.g., cash flows or income and expenses) to a single current (i.e., discounted) amount. The fair value measurements are determined on the basis of the value indicated by current market expectations about those future amounts.

When using present value techniques to approximate fair values, the following general principles govern:

- Cash flows and discount rates should reflect assumptions that market participants would use in pricing the assets or liabilities
- Cash flows and discount rates should consider only factors attributed to the assets or liabilities being measured
- To avoid double-counting or omitting the effects of risk factors, discount rates should reflect assumptions that are consistent with those inherent in the cash flows
- Assumptions about cash flows and discount rates should be internally consistent
- Discount rates should be consistent with the underlying economic factors of the currency in which the cash flows are denominated

Use of Appraisals under USPAP. In many cases, clients will have property appraisals for long-lived assets that have been obtained for financing or insurance. These appraisals generally are conducted under the Uniform Standards for Professional Appraisal Practice (USPAP). While USPAP has some similarities to fair value under FASB ASC 820, differences can exist. Certain concepts in FASB ASC 820 such as, but not limited to, exit price, principal or most advantageous market, and market participant assumptions may not be reflected in a USPAP property appraisal. Accordingly, caution should be exercised if a USPAP property appraisal is presented as audit evidence without any consideration of the application of FASB ASC 820.

COVID-19 Impact on Discount Rate. Discount rates that are commensurate with risks inherent in the expected cash flows should be used. Assumptions related to the determination of discount rates should reflect recent impacts attributable to the economic consequences of the pandemic. For example, the risk-free rate has declined for all companies while any changes to the cost of debt will depend on the circumstances of the specific entity.

Allocation of Impairment Loss

In accordance with FASB ASC 360-10-35-28, an impairment loss for an asset group should reduce only the carrying amounts of a long-lived asset or assets of the group. The loss should 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 should not reduce the carrying amount of that

asset below its fair value whenever that fair value is determinable without undue cost and effort. See Example 1 in FASB ASC 360-10-55-20 for an illustration of this guidance.

New Cost Basis for Long-Lived Asset

In accordance with FASB ASC 360-10-35-20, if an impairment loss is recognized, the adjusted carrying amount of a long-lived asset should be its new cost basis. For a depreciable long-lived asset, the new cost basis should be depreciated (amortized) over the remaining useful life of that asset. Restoration of a previously recognized impairment loss is prohibited.

Updating Useful Lives of Long-Lived Assets

The effects of the COVID-19 pandemic may necessitate a change in the useful life of a long-lived asset if an entity changes the way it uses or plans to use the asset. The change would be accounted for in accordance with FASB ASC 250, *Accounting Changes and Error Corrections*, specifically the guidance on changes in accounting estimates in FASB ASC 250-10-45-17 through 20.

Disclosure Requirements and Illustrations

FASB ASC 360-10-50-2 requires the following information to be disclosed in the notes to financial statements that include the period in which an impairment loss is recognized:

- A description of the impaired long-lived asset (asset group) and the facts and circumstances leading to the impairment
- 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
- The method or methods for determining fair value (whether based on a quoted market price, prices for similar assets, or another valuation technique)

Illustrative disclosures of COVID-19 related asset impairments can be found in our [CPEA report](#), *COVID-19 Related Illustrative Disclosures*.

APPENDIX: Illustrative Example

Singular Seafood operates 15 restaurants across 5 states. Due to the COVID-19 pandemic and the orders and guidance from governmental authorities, the Company temporarily closed the dining rooms in all restaurants and operated with pick-up or delivery only. All the dining rooms were subsequently reopened but operate at reduced capacity. Singular Seafood's operating results substantially depend upon its ability to drive traffic to its restaurants and serve guests in its dining rooms. Management cannot currently estimate the duration of the impact of the COVID-19 pandemic on its business; neither are they able to predict how the pandemic will evolve nor how various government entities will respond to its evolution. Even without government orders, customers may choose to reduce or eliminate in-restaurant dining.

These events and changes in circumstances clearly indicate that the carrying amount of the Company's asset groups may not be recoverable (triggering event). Singular Seafood identifies each of its restaurants as an asset group and determines that the triggering event impacts all restaurants. Therefore, the Company would need to perform a recoverability test (step 1) on each of its 15 asset groups (restaurants). The continuation of the example below reflects the impairment testing for 1 asset group (restaurant).

Singular Seafood has developed cash flow estimates related to the restaurant assuming 15%, 20%, and 30% declines in revenues and cash flows. Cash flow estimates have been made over a 5-year period, which is the remaining useful life of the primary asset of the group – leasehold improvements (building is rented under an operating lease). The company has decided to project cash flows related to recoverability of assets using a range of cash flows that encompasses all three of the potential percentage declines. The restaurant has been generating cash flows at a level that would indicate that \$2 million in undiscounted net cash flows would be generated over the next 5 years.

Singular Seafood believes there is a 60% probability that revenues and cash flows will decline by 15% (to \$1.7 million), a 20% probability that revenues and cash flows will decline by 20% (to \$1.6 million), and a 20% probability that revenues and cash flows will decline by 30% (to \$1.4 million). As a result of this analysis, the Company has projected a weighted-average undiscounted net cash flow associated with the restaurant as follows:

60%	X	\$1,700,000	=	\$1,020,000
20%	X	\$1,600,000	=	320,000
20%	X	\$1,400,000	=	<u>280,000</u>
				\$1,620,000

If the carrying value of the asset group (restaurant) exceeds \$1,620,000, the carrying value is not recoverable. At that point, Singular Seafood would proceed to step 2 of the impairment analysis and determine if there is an impairment loss. If there is a loss, it would equal the amount by which the carrying amount of the asset group exceeds its fair value. FASB ASC 360-10-35-36 indicates that for long-lived asset groups that have uncertainties both in timing and amount, an expected present value technique will often be the appropriate technique with which to estimate fair value. Singular Seafood applies the principles in FASB ASC 820 and determines fair value through the use of an income approach. Other approaches that might be considered include the market approach and the cost approach, as described in FASB ASC 820.

In accordance with FASB ASC 820, a fair value measurement of a nonfinancial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use. The highest and best use of a nonfinancial asset establishes the valuation premise used to measure the fair value of the asset. See paragraphs 10A through 14 of FASB ASC 820-10-35 for detailed guidance.

Assumption No. 1: Fair value of the asset group has been determined to be \$550,000. The asset group has a carrying value of \$950,000. And, the estimated undiscounted cash flows (UCF) are \$1,620,000. Since the UCF exceed the carrying value of the asset group, no impairment loss needs to be recognized even though the fair value of the asset group is significantly less than its carrying value. In this case, the fair value is depressed due to current unfavorable market conditions.

Auditing Note. Auditors should consider the reasonableness of the causes underlying situations where the UCF exceeds an asset group's carrying value and yet the fair value of the asset group is below its carrying value.

Practice Note: Before performing an extensive cash flow analysis related to an asset group, if the fair value associated with the asset group easily is determined to be in excess of the carrying value of the asset group, there is no need to perform the cash flow analysis since, even if there is a gross cash flow deficiency, no impairment loss would be recognized.

Assumption No. 2: Fair value of the asset group has been determined to be \$550,000. The asset group has a carrying value of \$1,800,000. Projected UCF is \$1,620,000. Since the UCF are less than the carrying value of the asset group, an impairment loss must be recognized for the difference between the carrying value and the fair value of the asset group ($\$1,800,000 - \$550,000 = \$1,250,000$). Notice that even though the difference in the carrying value of the asset group and the projected UCF = \$180,000 [$\$1,800,000 - \$1,620,000$], the impairment loss to be recognized is the

difference between the carrying value of the assets [\$1,800,000] and the fair value of the assets [\$550,000] = \$1,250,000.

Practice Note: This “cliff effect” can result in the recognition of significant impairment losses when there only exists a slight cash flow deficiency associated with asset groups.

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