Impairment: Nonfinancial assets

Executive summary

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Roadmap to impairment

Testing nonfinancial assets for impairment can be challenging – made more so by the need to navigate different impairment models: goodwill under Subtopic 350-20, indefinite-lived intangible assets under Subtopic 350-30, and long-lived assets under Topic 360.

Each impairment model has its own complexities in determining the unit of account, knowing when to test for impairment, and calculating the amount of any impairment loss.

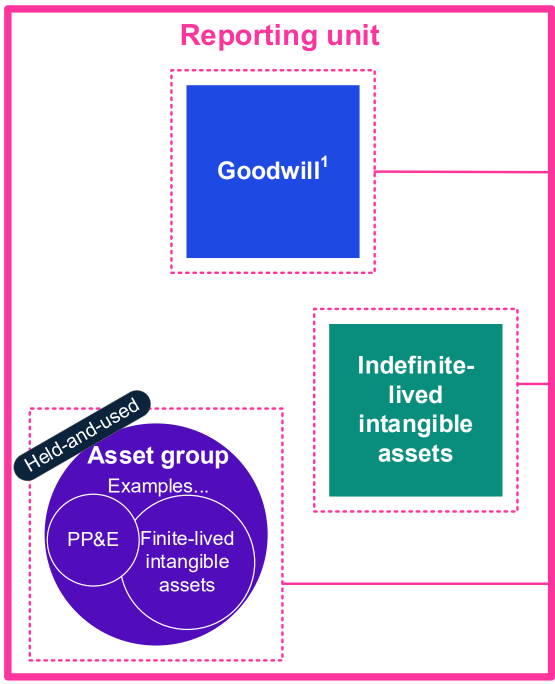
While each model is independent, they are also inextricably linked – containing overlapping concepts and requiring a specific sequence in impairment testing.

This Executive Summary provides an overview of the three impairment models used to test nonfinancial assets for impairment. We have organized the content to help you compare and contrast the different models.

Our related Handbook, Impairment: Nonfinancial assets, explains the relationship between the impairment models, and helps you navigate the challenges of impairment testing through in-depth interpretive guidance and examples.

Overview of models

The following diagram is an overview of the different models for the impairment of nonfinancial assets: goodwill under Subtopic 350-20, indefinite-lived intangible assets under Subtopic 350-30, and long-lived assets (that are classified as held-and-used) under Topic 360. While the models must be applied in a specific sequence and share some concepts, they otherwise operate independent of each other. The following diagram also highlights the key aspects of each model in a tabular format to facilitate comparing and contrasting the different models. Each of these key aspects is explored further in this Executive Summary.



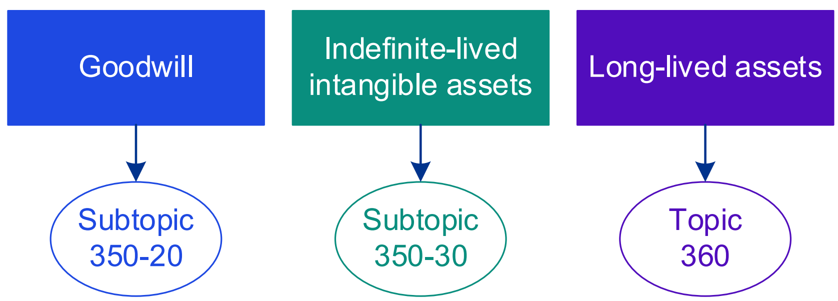
Impairment model	Unit of account	Measurement	Recognition	Allocation
Subtopic 350-20: • One-step model with optional qualitative assessment • Annual testing requirement	Reporting unit	Fair value	Excess of carrying amount over fair value (considering tax effects)	Reduce goodwill assigned to reporting unit (but not below zero)
Subtopic 350-30: • One-step model with optional qualitative assessment • Annual testing requirement	Generally, single asset	Fair value	Excess of carrying amount over fair value	Reduce carrying amount of intangible asset
Topic 360: Event-driven two-step model	Asset group	Step 1: Undiscounted cash flows Step 2: Fair value	Excess of carrying amount over fair value	Reduce carrying amount of assets in scope on pro rata basis (subject to fair value limitation)

Note 1: Assumes the entity has not elected the goodwill amortization accounting alternative available to private companies and NFPs.

Scope of impairment models

Nonfinancial assets include assets such as land, buildings, equipment, right-of-use leasing assets, both finite- and indefinite-lived intangible assets and goodwill. An entity typically has a number of different types of nonfinancial assets and is required to evaluate each asset for impairment either on an annual basis and/or on the occurrence of certain impairment triggers (a trigger-based model).

Different Subtopics of the Codification apply to different types of nonfinancial assets, and the impairment models are different.



The nature of an intangible asset drives the applicable impairment model. The impairment model under Topic 360 applies to long-lived assets, including finite-lived intangible assets. Subtopic 350-30 applies to indefinite-lived intangible assets (other than goodwill). Therefore, to test an intangible asset for impairment, an entity first needs to determine whether it is a finite-lived or an indefinite-lived intangible asset.

For long-lived assets, this Executive Summary focuses on the impairment model for those that are classified as held-and-used. This classification is appropriate for an asset the entity:

- uses in operations and does not plan to sell;
- plans to sell but does not yet satisfy the necessary conditions to be classified as held-for-sale; or
- plans to abandon, dispose of in an exchange measured at its recorded amount, or distribute to owners in a spinoff.

Long-lived assets classified as held-for-sale are subject to a different impairment model. The held-for-sale criteria and related accounting requirements are discussed in chapter 4 of KPMG Handbook, Discontinued operations and held-for-sale disposal groups.

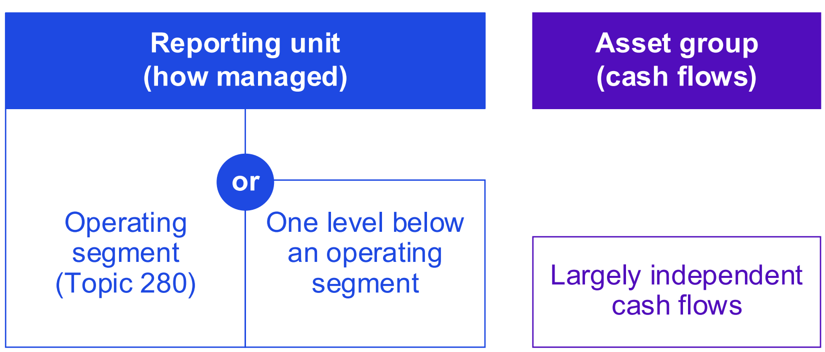
The unit of account

The level at which nonfinancial assets are tested for impairment (i.e. the unit of account) differs under the three impairment models. For each type of nonfinancial asset, the following diagram shows the unit of account followed by a description.

Goodwill	Indefinite-lived intangible assets	Long-lived assets
Reporting unit	Generally, single asset	Asset group
An operating segment or a component of an operating segment	Or a group of indefinite-lived intangible assets if certain criteria are met	A group of assets and liabilities whose cash flows are largely independent

A reporting unit must also constitute a business for which discrete financial information is available and the operating results are regularly reviewed by segment management.

The following diagram shows a typical relationship between an asset group and a reporting unit.



While an asset group is often at a level lower than a reporting unit (as illustrated above), it can be at the same level in certain circumstances.

Reporting units and asset groups are not static. An entity reassesses reporting units when its reporting structure changes, and reassesses asset groups if it experiences a significant change in facts and circumstances. Events such as reorganizations and disposal transactions may cause a reassessment.

When to test

When to test for impairment is dictated by the nature of the asset. The timing of an impairment test may be event-driven due to the existence of impairment indicators (e.g. operating losses) or may be performed on an annual basis as required by the relevant Subtopic.

For each type of nonfinancial asset, the following diagram highlights the number of steps in the impairment model and the frequency of testing.

Goodwill	
One-step model with optional qualitative assessment	• Test annually • Test when trigger exists with some relief for private companies and NFPs

Indefinite-lived intangible assets	
One-step model with optional qualitative assessment	• Test annually • Test when trigger exists

Long-lived assets	
Two-step model	Test when trigger exists

Regardless of why an impairment test is performed, the testing sequence is based on the nature of the asset as shown in the following diagram.

Step 1	→	Step 2	→	Step 3	→	Step 4
Adjust carrying amounts of assets not in scope	→	Test indefinite-lived intangible assets	→	Test long-lived assets	→	Test goodwill

Carrying amount

The impairment models for nonfinancial assets require determination of the unit of account's carrying amount. While determining the carrying amount of indefinite-lived intangible assets is straightforward, the same cannot always be said about reporting units and asset groups.

For each type of nonfinancial asset, the following diagram shows the unit of account and discusses the assets and liabilities (as appropriate) included in the unit of account's carrying amount.

Goodwill	Indefinite-lived intangible assets	Long-lived assets
Reporting unit	Generally, single asset	Asset group
The carrying amount of the assets and liabilities that: • will be employed in (assets) or relates to (liabilities) a reporting unit's operations; and • will be considered in determining a reporting unit's fair value.	The carrying amount of the indefinite-lived intangible asset or the aggregate carrying amount of a group of indefinite-lived intangible assets when certain criteria are met.	The carrying amount of the assets and liabilities that result in symmetry with the cash flows used to test the asset group for impairment (i.e. the carrying amount and future estimated cash flows are on a like-for-like basis).

Qualitative assessment

Applies to: goodwill and indefinite-lived intangible assets.

An entity may elect to perform a qualitative assessment to determine if it's not more likely than not that a reporting unit (or indefinite-lived intangible asset) is impaired. As such, the optional qualitative assessment acts as a screen for determining if it is necessary to perform the quantitative test.

If the qualitative assessment is elected, we recommend following a systematic approach, such as the following model.

Step 1	**Develop a framework** to determine when the entity will perform a qualitative assessment and when it will proceed directly to the quantitative test.
Step 2	If a qualitative assessment will be performed, consider the **most recent fair value measurement** and when that measurement was determined.
Step 3	Identify the **significant drivers of fair value**.
Step 4	Determine what **events and circumstances** have occurred that may have affected those drivers of fair value, including positive and mitigating events and circumstances.
Step 5	Assess the **likely impact of the factors identified** in the previous steps on the fair value.
Step 6	Consider any **transactions or events** that significantly affected the carrying amount.
Step 7	Prepare an analysis based on the events, circumstances and factors identified and **document the assessment** of whether it is more likely than not that fair value is less than the carrying amount.

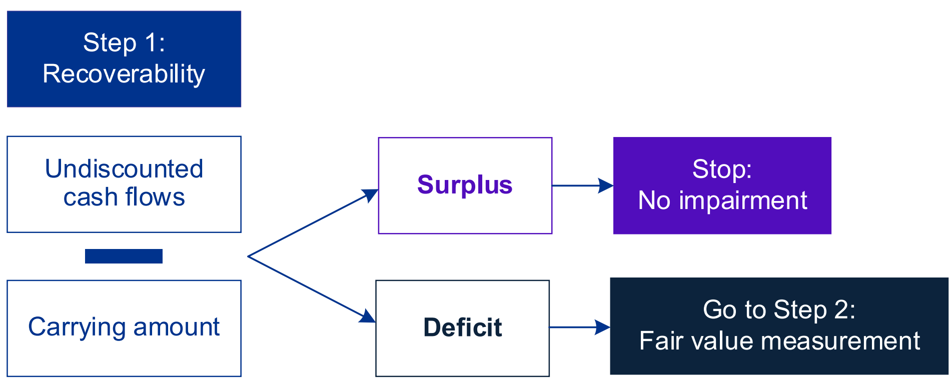
Recoverability test

Applies to: long-lived assets.

A recoverability test for long-lived assets is required when the entity concludes that there has been an event or change in circumstances that indicates that the carrying amount of an asset may not be recoverable.

The outcome of the recoverability test (referred to as Step 1) is used to evaluate whether the asset group is impaired.

As shown in the diagram, Step 1 compares the undiscounted estimated future cash flows to the carrying amount of the asset group. If the cash flows exceed the carrying amount, there is no impairment. If the cash flows are less than the carrying amount, the entity proceeds to Step 2 and measures the fair value of the asset group.



Estimating future cash flows for purposes of the recoverability test involves several general principles, including basing those cash flows on:

- the entity's own assumptions about its use of the asset group;
- the asset group's current physical output and cash flow generation capacity; and
- the operation and ultimate disposal of the asset group.

An entity's own assumptions are used to estimate future cash flows for the recoverability test, while a market participant perspective is used when determining fair value based on estimated future cash flows.

Cash flows used in the recoverability test are undiscounted and exclude interest charges that will be recognized as an expense when incurred.

Fair value measurement

For all three impairment models, impairment is calculated by reference to fair value, which is measured in accordance with Topic 820. Fair value is 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 entity's own assumptions are not relevant.

The following summarizes the circumstances that cause an entity to arrive at the need to measure fair value and calculate the amount of any impairment loss.

Goodwill / Indefinite-lived intangible assets	Long-lived assets
• The entity performed a qualitative assessment and concluded it was more likely than not that the asset was impaired – i.e. the entity could not avoid the annual quantitative test; • The entity did not perform a qualitative assessment, and instead proceeded directly to the annual quantitative test; or • Outside of the annual testing, the entity concluded that it was more likely than not that the asset was impaired.	• Based on one or more indicators of impairment, the entity concluded that the carrying amount of an asset group might not be recoverable; and • The entity failed the Step 1 recoverability test.

Under each model, when fair value is less than the carrying amount of the relevant unit of account, that deficit is the amount of the impairment loss – subject to no asset being reduced below zero. When an asset group has failed the undiscounted Step 1 recoverability test, the amount of impairment is measured under Step 2 as the difference between the fair value of the asset group and its carrying amount.

Recognition and allocation

For each type of nonfinancial asset, the following diagram shows how the impairment loss is allocated and the limitations.

Goodwill	Indefinite-lived intangible assets	Long-lived assets
Reporting unit	Generally, single asset	Asset group
Reduce the carrying amount of goodwill, but not below zero	Reduce the carrying amount of the intangible asset	• Reduce the carrying amount of the assets in the scope of the impairment model on a pro rata basis • No individual long-lived asset within the asset group is reduced below its fair value (if determinable without undue cost and effort)

Once recognized, an impairment loss cannot be reversed.

Disclosures

The disclosure requirements related to impairment testing come from three main sources. The following diagram captures those sources, highlights their scope or nature and provides examples.

Topics 350 and 360	Topic 820	Topic 275
Similar disclosures for all impaired nonfinancial assets	Information about the fair value measurement that is the basis for the impairment loss	Disclosures about risks and uncertainties – e.g. potential future impairment
Examples: • Amount of impairment loss • Description of impaired asset • Facts and circumstances that led to impairment	**Examples:** • Description of valuation technique(s) and inputs used • Changes to technique(s) and reasons therefor	**Disclose if:** • reasonably possible of occurring; • would occur in the near term; and • effect would be material to the financial statements

In addition, SEC registrants are expected to make more granular disclosures in MD&A and the financial statements. One example is disclosing the potential for material impairment charges even when the registrant has determined that no impairment charge is necessary for the current reporting period (see KPMG Hot Topic for additional information).

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