# Impact of COVID-19: Goodwill impairment considerations

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Given the downturn in the economy as a result of the effects of COVID-19 (e.g., increases in unemployment, disruptions of global supply chains and lower overall economic activity), we expect many companies will be required to perform interim goodwill impairment tests during the 2020 calendar year. Expectations for many companies are below what they initially planned or budgeted for at the beginning of the year, and the timeline for recovery is uncertain. The pandemic may result in a change in circumstances that would more likely than not reduce the fair value of a reporting unit below its carrying amount, which is sometimes referred to as a triggering event.[1] Therefore, to the extent companies are negatively impacted by COVID-19, they may be required to review and test their goodwill for impairment.

## Evaluating indicators of impairment

Regardless of whether they are publicly or privately held, all companies are required to test goodwill for impairment when a triggering event occurs. As noted in Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) paragraph 350-20-35-30, "Goodwill of a reporting unit shall be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount." A summary and examples of such events or circumstances noted in ASC 350 (which are not all-inclusive) follow.

[1] A reporting unit is the unit of accounting for goodwill impairment testing. For companies that apply the Private Company Council goodwill accounting alternative, they may elect to test goodwill for impairment at the reporting unit level or the entity level.

## External or market triggering events

| Triggering event | Examples in COVID-19 economy |
|---|---|
| **Economy:** Macroeconomic conditions, such as a deterioration in general economic conditions, limitations on accessing capital, fluctuations in foreign exchange rates, or other developments in equity and credit markets | Restrictions imposed by government or health agencies<br><br>Increased unemployment and lower consumer spending<br><br>Supply and demand variances<br><br>Foreign investment reduction and lower cross-border capital financing |
| **Industry:** Industry and market considerations, such as a deterioration in the environment in which an entity operates, an increased competitive environment, a decline in market-dependent multiples or metrics (in absolute terms and relative to peers), a change in the market for an entity's products or services, or a regulatory or political development | Local government orders or changes in laws that adversely affect the ability to operate<br><br>Decrease in demand for products or services<br><br>Decrease in transaction prices or multiples as investors have "priced in" increased risk in advance of financial information being available |
| **Share price:** A sustained decrease in share price (consider in both absolute terms and relative to peers) | Through the date of this paper, capital markets showed a steep decline in March and higher volatility shortly thereafter.<br><br>Major stock indices have generally recovered, but the recovery has varied by industry and certain components of the indices have contributed to a large portion of the market gain. |

## Internal or company-specific triggering events

| Triggering event | Examples in COVID-19 economy |
|---|---|
| **Cost:** Factors such as increases in raw materials, labor, or other costs that have a negative effect on earnings and cash flows | Volatility in commodity pricing |
| **Cash flow:** Overall financial performance, such as negative or declining cash flows or a decline in actual or planned revenue or earnings compared with actual and projected results of relevant prior periods | Customer disruption or loss<br><br>Supply chain disruption<br><br>Temporary business closures<br><br>Decline in revenue growth rates and profitability due to change in delivery of products or services |
| **Entity-specific:** Other relevant entity-specific events, such as changes in management, key personnel, | Restructuring that causes decrease in operations, services or products |

| Triggering event | Examples in COVID-19 economy |
|---|---|
| strategy, or customers; contemplation of bankruptcy; or litigation | Similar disruptions (supply chain, customer, business closures) noted above<br><br>Lack of access to liquidity given size, credit quality or increased leverage position<br><br>Debt covenant violations |
| **Other:** Events affecting a reporting unit, such as a change in the composition or carrying amount of its net assets; a more-likely-than-not expectation of selling or disposing of all, or a portion, of a reporting unit; the testing for recoverability of a significant asset group within a reporting unit; or recognition of a goodwill impairment loss in the financial statements of a subsidiary that is a component of a reporting unit. | Selling an asset group<br><br>Discontinuing or selling assets<br><br>Write down on other assets |

If a triggering event occurred, entities must consider the impact it has on the fair value and carrying amount of their reporting units to determine whether interim impairment testing is required as of the date of the triggering event. Any offsetting positive and mitigating events and circumstances should also be considered to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. Mitigating events may include but are not limited to: (a) the amount by which a reporting unit passed its most recent quantitative goodwill impairment test; (b) positive outlook for the related industry due to the pandemic; and, (c) a market participant would consider the outlook for Company or RU to have less downside risk relative to industry or peers. It is important to note, while there may be mitigating events, the assessment of triggering events should be looked at holistically and mitigating events alone would not indicate that there is no impairment or no impairment testing procedures are required. The amount of analysis and documentation required will depend on specific facts and circumstances.

When testing goodwill for impairment, entities have the option to first assess qualitative factors to determine whether it is necessary to perform the quantitative impairment test.[2] An entity electing to perform a qualitative assessment is not required to calculate the fair value of a reporting unit (and perform the quantitative impairment test) unless the entity determines, based on the qualitative assessment, that it is more likely than not that the fair value of the reporting unit is less than its carrying amount.

While the decline in economic conditions has been swift, there is no general consensus as to the recovery timeline. For different industries, companies and geographic regions, the recovery will be highly dependent on the severity of and response to the COVID-19 outbreak. Due to the number of economic factors that the virus has impacted, caution should be used in the application of the qualitative assessment. Accordingly, in most cases, a quantitative approach would be highly recommended to determine if impairment should be recognized.

[2] FASB Accounting Standards Update 2011-08, Intangibles—Goodwill and Other (Topic 350): Testing Goodwill for Impairment

## Timing of a triggering event

Many companies that only issue financial statements annually may question when to test for impairment as a result of a triggering event. As identified above, there is no blanket rule for when a triggering event occurs. A triggering event will vary based upon the company's facts and circumstances, economy and industry in which it operates. Generally speaking, when events have become known or knowable that resulted in a reduction of the value of a reporting unit, the company should explore whether a trigging event has occurred. For additional related discussions on trigger event timing, see Goodwill impairment testing when carrying amount is trending downward and Qualitative assessment of goodwill impairment upon triggering event.

## Calibration

Calibration is a fundamental consideration in fair value measurements and particularly useful in light of the impact of COVID-19. Fundamentally, calibration helps explain the changes in assumptions or conclusions from a prior valuation or observable transaction. As unobservable inputs and market participant assumptions are calibrated to prior observable data points, this tool provides a bridge from the observable market data of a prior transaction to the current entity performance and economic conditions. Where COVID-19 has made it difficult to update projections and interpret significant swings in stock prices, calibration provides a much-needed foundation for anchoring valuations.

ASC 820-10-35-24c states:

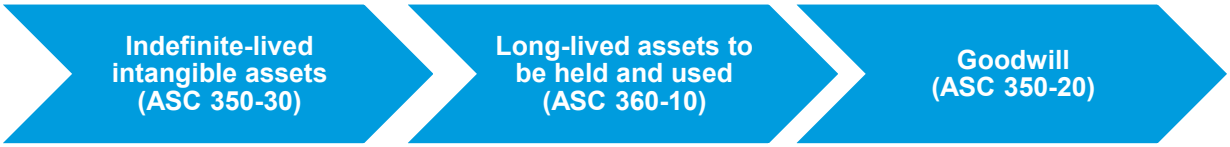
> If the transaction price is fair value at initial recognition and a valuation technique that used unobservable inputs will be used to measure fair value in subsequent periods, the valuation technique shall be calibrated so that at initial recognition the result of the valuation technique equals the transaction price. Calibration ensures that the valuation technique reflects current market conditions, and it helps a reporting entity determine whether an adjustment to the valuation technique is necessary…After initial recognition, when measuring fair value using a valuation technique or techniques that use unobservable inputs, a reporting entity shall ensure that those valuation techniques reflect observable market data…at the measurement date.

Since the initial recognition of goodwill stems from an observable transaction, calibration can be used to bridge the acquisition price forward to testing for impairment at subsequent measurement dates by reference to changes in market valuations and entity-specific changes. Calibration is flexible and can be used on a broad basis at the enterprise-value or equity-value levels, or it can be used to home in on specific inputs, such as the weighted-average cost of capital, company-specific risk premium, long-term growth rate and valuation multiple.

Calibration can also be used to analyze the impact of pre-event trends on post-event value. For example, an entity that was performing poorly prior to a significant external event may see these trends accelerate, whereas a stronger performer may see less of an impact. With COVID-19, we have seen this through the wide-ranging impacts experienced by industry, with some industries impacted more extensively than others.

## Impairment testing order

U.S. generally accepted accounting principles (GAAP) identifies which assets should be tested and in what order as follows.



The accounting literature includes guidance on impairment testing in the relevant ASC subtopics, with differences with respect to many details, including private company alternatives, testing frequency, unit of account, number of steps required and the impairment threshold. For more information on these subtopics and details on the impairment testing order, see Snapshot: Accounting for the impairment of goodwill and other long-lived assets.

## Goodwill

Although goodwill is the last asset to be tested for impairment, it is frequently considered first in the initial conversations about impairment of assets. This is because any impairment is often first identified in the goodwill asset. The following sections describe key valuation issues in the current economic environment.

### Market prices as evidence of fair value

Current economic conditions have resulted in volatility in capital markets, share prices and asset valuations. However, a key consideration in a fair value measurement is whether the market data represents a market participant's assumption for the unit of account to be valued. ASC 350-20 addresses the fair value of a reporting unit, noting, in summary, that the market capitalization need not be the sole basis of fair value for impairment testing.[3]

Consistent with this guidance, market capitalization (if the entity is publicly traded) may not be representative of the fair value of a reporting unit as a whole. Therefore, a reconciliation between the fair value of the reporting units and the market capitalization may result in an implied control premium. The magnitude of an appropriate control premium is highly dependent on an entity's specific facts and circumstances. A control premium should not be determined generically based on rules of thumb or general references to industry standards. Further, the level of evidence and documentation required to support the control premium utilized by an entity should be commensurate with the control premium percentage. In other words, the greater the control premium utilized, the greater the level of evidence required to support that premium. It is worth noting that in 2017 the Appraisal Foundation issued Valuations in Financial Reporting Valuation Advisory #3: *The Measurement and Application of Market*

[3] ASC 350-20-35- 22 to 23 states, "…the market price of an individual equity security (and thus the market capitalization of a reporting unit with publicly traded equity securities) may not be representative of the fair value of the reporting unit as a whole…. Substantial value may arise from the ability to take advantage of synergies and other benefits that flow from control over another entity. Consequently, measuring the fair value of a collection of assets and liabilities that operate together in a controlled entity is different from measuring the fair value of that entity's individual equity securities. An acquiring entity often is willing to pay more for equity securities that give it a controlling interest than an investor would pay for a number of equity securities representing less than a controlling interest. That control premium may cause the fair value of a reporting unit to exceed its market capitalization. The quoted market price of an individual equity security, therefore, need not be the sole measurement basis of the fair value of a reporting unit."

*Participant Acquisition Premiums* (the "MPAP Guide"), which addresses these topics in detail from a valuation perspective.[4,5]

Specifically, the COVID-19 pandemic has created a new economic crisis. While the root causes are fundamentally different, the impact to asset prices can be viewed as similar to the economic crisis that occurred in 2008. The MPAP Guide states:

> In 2008, during the economic crisis, the market for and fair value of many assets and companies declined and the level of difficulty for measuring value increased. In particular, the SEC staff indicated that they would expect objective evidence to support the reasonableness of implied transaction premiums, whether a quantitative or qualitative analysis (or both) was used. The SEC staff also indicated that while judgment may result in a range of reasonably possible premiums, they expect the rigor of documentation to increase as the magnitude of the premium increases.

Similar to 2008, in the current economic environment it is expected that auditors and regulators will have additional scrutiny of, and require more robust documentation related to, market-participant acquisition premiums. Therefore, to enhance supporting documentation for these premiums, it is recommended to consider the factors referenced in reconciling fair value to the market capitalization in Paragraph 4.83 of the AICPA Accounting and Valuation Guide, *Testing Goodwill for Impairment* (the "AICPA Goodwill Guide"). These factors include:

- Control synergies
- Asymmetric data
- Tax consequences
- Entity-specific vs. market-participant capital structure
- Excessive short positions
- Controlling or large block interests

However, there may be challenges related to the availability of quality data to assess each of these factors, especially in the current environment. Further consideration and diligence is recommended, and it

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[4] Paragraph 1.15 and footnotes 5 and 6 of the AICPA Accounting & Valuation Guide, *Testing Goodwill for Impairment (2013)*, state:

> "Control premiums[5, 6] may also need to be considered.
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> [5] As of the writing of this guide, the Appraisal Foundation is working on a project regarding the assessment and measurement of control premiums in valuations for financial reporting. The purpose of this project is to present views on how to approach and apply certain aspects of the valuation process appropriate for measuring the fair value of controlling interests in business enterprises for financial reporting purposes. Please refer to the Appraisal Foundation's website at http://www.appraisalfoundation.org for further information about this project and its status.
>
> [6] Control premiums are also frequently referred to as acquisition premiums."

[5] The Appraisal Foundation noted in its guidance, "In fulfilling its mandate to provide best practices in the context of measuring fair value for financial reporting purposes, the Working Group has elected to introduce the term Market Participant Acquisition Premium (MPAP). The purpose of introducing this new term is twofold:

> (1) to emphasize the importance of the market participants' perspective when measuring fair value; and
>
> (2) to distinguish this premium from the more general (and occasionally controversial) notion of the control premium."

is of greater importance to consider multiple factors in supporting market-participant acquisition premiums.

The following factors should be considered in the current environment:

- Given the uncertainty in the market, forecasting cash flows and identifying potential control synergies and asymmetric data could be challenging. Consideration should be given to the impact to revenue, expenses and the working capital cycle caused by the disruption to businesses because of social distancing and stay-at-home orders.
- Current market data on capital structures may be significantly distorted from normalized market participant perspectives and may not be indicative of optimal capital structures. In comparing the entity-specific vs market-participant capital structure, it is recommended to consider the long-term normalized capital structure rather than solely using current market-participant capital structures.
- Reviewing excessive short positions may pose challenges as it may be unclear whether the increase in a stock's short interest leading up to the valuation date of the impairment analysis is indicative of a negative sentiment toward the company's prospects or a hedge against current overall market conditions. It also could be elements of both. It is recommended to place less weight on this factor as the current environment likely will create uncertainty as to what any excessive short positions are indicating.
- There is likely less availability of security analysts' expectations and estimates for companies or industries they cover and, given the suddenness of the economic slowdown and unprecedented unemployment, there may be less reliability in analysts' estimates that are available. The estimates either use forecasts that involve speculative information due to the uncertainty in the market or may not reflect updated forecasted information. Therefore it is critical to consider whether any estimates or forecasts may reflect stale or pre-COVID information.

## Valuation methodology considerations

As defined in both ASC 820 and general valuation guidance, there are three approaches to valuation: income, market and cost. The market approach is particularly difficult to apply in the current economic environment. The capital markets have priced a level of uncertainty regarding future performance into securities in general. More importantly, the market approach is less reliable in a period where operating metrics, such as revenue or EBITDA, are experiencing a sudden decrease and a potential protracted recovery. However, as explained in paragraph 1.08 of the AICPA Goodwill Guide:

> Each of the three approaches can be used to measure fair value of a reporting unit for goodwill impairment testing. As provided in FASB ASC 820-10-35-24B:
>
> > [i]n some cases, a single valuation technique will be appropriate . . . In other cases, multiple valuation techniques will be appropriate (for example, that might be the case when valuing a reporting unit). If multiple valuation techniques are used to measure fair value, the results (that is, respective indications of fair value) shall be evaluated considering the reasonableness of the range of values indicated by those results. A fair value measurement is the point within that range that is most representative of fair value in the circumstances.
>
> Paragraph 1.27, "Apply the Appropriate Valuation Approaches," of the AICPA Goodwill Guide indicates:
>
> > … when measuring the fair value of a reporting unit the income, market, and asset approaches would be considered and the approach or approaches that are appropriate under the circumstances should be selected. Under each approach, various valuation techniques can be used to measure fair value, and entities may need to consider multiple valuation techniques. In some cases, the fair value measurements related to reporting units will require a greater level of judgment and subjectivity due to the lack of existing markets and observable inputs. Entities would need to document the key assumptions made and techniques used when measuring the fair value of a reporting unit.

While valuation methodologies have not changed, ASC 820-10-35-25 notes that a change in valuation technique or its application (e.g., a change in its weighting when multiple valuation techniques are used or a change in an adjustment applied to a valuation technique) is appropriate if the change results in a measurement that is equally or more representative of fair value in the circumstances. As a result, management should review which valuation methodologies are most appropriate in the current environment, and it may be appropriate to utilize multiple methodologies.

ASC 820-10-35-54F notes that when weighting indications of fair value resulting from the use of multiple valuation techniques, a reporting entity shall consider the reasonableness of the range of fair value measurements. The objective is to determine the point within the range that is most representative of fair value under current market conditions. For example, a discounted cash flow method may result in a measurement that is more representative of fair value, as this model has more flexibility to address both the current shock to demand and supply as well as recovery and post-recovery assumptions. However, there may be challenges related to the availability of quality data to assess these assumptions.

### Changes to inputs and assumptions

Certain inputs and assumptions used in applying the methodologies may need to be revised from prior analyses and should be given additional consideration. Examples of such inputs and assumptions include (but are not limited to):

- Expected revenue in 2020 resulting from the impact of the pandemic
- Expected revenue beyond the short term and during the recovery period
- Expense structure considering the impact of the pandemic
- Net working capital needs that may increase if customers stretch payment terms
- Future capital expenditures considering changes in projected revenue
- Consideration of different valuation multiples that could be more applicable

Regardless of the method used, valuation typically comes down to expected growth and financial performance, and the inherent risk in achieving the prospective financial information, as well as the level of interest in the reporting unit and its industry by market participants. The following factors should be considered:

- **Economic and industry:** The financial and economic consequences of the pandemic and related measures taken. COVID-19 is not impacting all industries equally. It is important to factor in the liquidity of the reporting unit's customers, as well as its suppliers, and how they could be impacted by the current market environment. The current market is one where customer or supplier concentration can certainly have a significant impact on the reporting unit's financial performance.
- **Size and liquidity:** The size of the reporting unit and its access to liquidity. These can be significant contributors to how well the reporting unit will weather the storm. Typically, the larger the reporting unit, or the better its access to liquidity, the more resilient it will be. Thus, consideration should be given to the size and credit quality of the reporting unit's customers, suppliers and lenders.
- **Customers and suppliers:** The enforceability of contracts that a reporting unit has with customers, as well as suppliers.
- **Financial risks:** In developing valuation assumptions and inputs, the financial condition of a reporting unit, including its leverage level and its ability to draw on credit lines for liquidity.
- **Prospective financial information:** The need to scale down forecasts and (or) change forecast assumptions. Certain assumptions in the prospective financial information, such as the impact on revenue caused by social distancing and stay-at-home orders, potential interruptions in the supply

chain, and risk of an increase to the day's sales outstanding ratio, among others, should be considered as part of estimating the impact of the pandemic on financial projections.

- **Market volatility:** Market pricing and volatility in advance of supporting underlying data. The recent market volatility demonstrates that, to assess longer term trends, investors already have "priced in" an expectation regarding an increase in discount rates and decrease in valuation multiples, even in advance of revised financial data being available. However, adjustments should be considered to reflect the impact that could be reasonably estimated in the short to medium term. It is important not to "double dip" by applying lower market multiples (or higher discount rates) when additional data about economic performance becomes more evident.

While it generally is acknowledged that there is a greater level of uncertainty and risk (in comparison to recent history) to consider in the discount rate, that risk premium is difficult to estimate. An alternative that is theoretically preferred is to incorporate risk directly into the cash flows. This typically is accomplished by using multiple scenarios. Given the uncertainty regarding the expected shape (such as "V," "U," "L" or "W") of the recovery, expected duration of suppressed performance, and effects of these assumptions on revenue, earnings and cash flow, an analysis with multiple cash-flow projection scenarios might be a better representation of fair value in the current environment than a single model with an arbitrary increase to the risk premium.

## Conclusion

The COVID-19 virus likely will continue to have a significant adverse impact on the global economy and the financial results of many entities. Management teams should continuously assess the changing conditions on their business and be in regular communication with their auditors to identify areas of concern. Companies should continue to monitor the latest in the economy via RSM Middle Market Economics information and the RSM Coronavirus Resource Center.

## Appendix 1: Long-lived assets to be held and used

Long-lived assets to be held and used include those long-lived assets within the scope of ASC 360-10-15, such as property, plant and equipment, amortizable intangible assets, internal use software and long-term prepaid assets. For these assets it is important to understand that testing considerations under ASC 360 are based on the asset group level (lowest level of independent cash flows) and as such may be a different level of testing than under ASC 350. This is especially the case for those companies that have elected the private company accounting alternative for goodwill, which allows companies to choose to test goodwill for impairment at either the entity level or the reporting unit level. ASC 360 testing, on the other hand, is performed at the lowest level of identifiable cash flows that are largely independent of the cash flows of other groups of assets and liabilities. In addition, under ASC 360, impairment testing for long-lived assets to be held and used is a multi-step process. If indicators of impairment are present that indicate the carrying amount of the asset group may not be recoverable, an entity must first perform a recoverability test to determine whether an impairment loss exists and then determine the fair value of the asset group to measure the impairment.

### Changes to inputs and assumptions

The recoverability test relies on estimated cash flows to be derived from the company's specific use and eventual disposition of the asset or asset group. It does not consider how a market participant would use and dispose of those assets. Given that the recoverability test is on a pre-tax, undiscounted basis, the following specific factors should be considered in evaluating the near- and long-term inputs and assumptions used when estimating cash flows in the current environment.

| Factor | Considerations in COVID-19 economy |
|---|---|
| Revenue, EBITDA | Has the company's profitability and use of the asset or asset group changed?<br><br>Examples: revenue and earnings decline due to closures; loss or bankruptcy of major customer(s); supply chain disruptions, such as reduced delivery of products or services due to social distancing requirements. |
| Capital expenditures | Have the costs to maintain the fixed asset base changed?<br><br>Examples: Increased technology costs due to remote workforce, such as additional bandwidth for virtual meetings; decreased capital needs due to decreased operations. |
| Working capital needs | Have working capital and inventory needs changed?<br><br>Examples: Ability of government stimulus benefits to provide liquidity; changes in payment terms for receivables and payables going forward; inventory turns increase or decrease due to changes in supply chain for delivery of products or services. |

If the recoverability test indicates an impairment, the loss is measured by determining the fair value of the asset group and comparing such fair value to the carrying amount. The amount by which the carrying amount exceeds the fair value is recorded as an impairment loss. If the asset group includes multiple long-lived assets, fair value will need to be determined for each of these underlying assets. This valuation is needed because the impairment loss of an asset group 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.

For more details on this topic, refer to our white paper, Impairment testing for long-lived assets held and used.

## Appendix 2: Indefinite-lived intangible assets

Assuming a triggering event has occurred, if a company has indefinite-lived intangible assets, such as operating rights or certain trade names, it should test those assets for impairment prior to testing long-lived assets or goodwill. In performing an impairment assessment for indefinite-lived intangible assets, consideration should be given to the following factors:

a. The key value drivers for the indefinite-lived intangible asset subject to the impairment test; and

b. The key inputs and assumptions used in the valuation analysis that could impact the fair value conclusion.

For instance, if the indefinite-lived intangible asset is valued under the relief from royalty methodology under the income approach, the primary assumptions typically would include (a) the forecasted annual levels of revenue and cash flows; (b) the royalty rate; and (c) the discount rate.

The changes in operating performance due to the recent downturn in the economy could result in temporary or permanent revisions to the forecasted levels of revenue and cash flows. Those changes could include, but are not limited to:

- Decline in revenue and margins due to the closure of retail stores and manufacturing facilities
- Loss of key customers and (or) customers' inability to make payments
- Increase in product costs due to supply chain and workforce disruptions

If the company does not expect a full recovery and the adverse impact is deemed to be permanent, key inputs and assumptions should be reassessed accordingly. For example, if the operating margins are expected to be significantly lower compared to the expectations as of the acquisition date, the initially selected royalty rate might no longer be supportable by the company's profitability.

The company should also review the useful life of the indefinite-lived intangible assets to determine whether the indefinite useful life classification is still supportable in light of the current events and circumstances. The changes in the economic, legal, regulatory, contractual or other asset-specific factors could result in the limitation to the time period over which the economic benefits from the use of the asset is expected to be generated. If the useful life is no longer indefinite, the subject would be tested for impairment and after the carrying value is adjusted, the asset would be amortized over the new estimated remaining useful life.

## Appendix 3: Impairment under IFRS

Companies that follow International Financial Reporting Standards (IFRS) would be subject to International Accounting Standard (IAS) 36, *Impairment of Assets*. IAS 36 requires entities to test goodwill and indefinite-lived intangible assets for impairment at a minimum annually and other non-financial assets whenever there is an indicator that assets might be impaired. The test is performed at either the asset level or the cash-generating unit (CGU) level when an asset does not generate cash inflows that are largely independent of those from other assets. See U.S. GAAP vs. IFRS: Impairment of long-lived assets.

Impairment testing under IFRS differs from impairment testing under U.S. GAAP in a few key areas. IAS 36 stipulates that the recoverable amount of the asset or CGU is determined as the greater of value in use (VIU) or fair value less cost to sell (FVLCS). If the recoverable amount of the asset or CGU is less than its carrying amount, then the goodwill or asset is impaired by the excess of the asset or CGU's carrying amount over its recoverable amount. If there is additional excess carrying amount over the recoverable amount, then the other assets of the CGU are reduced pro rata based on their carrying amounts.

- VIU is determined based on the present value of the pretax cash flows expected to be derived from an asset or CGU over its remaining useful life. Estimates of the future cash flows that the entity expects to derive from the asset or CGU are discounted to present value using a pre-tax discount rate. The post-tax discount rate may be grossed up by a standard rate of tax to estimate the pre-tax rate.
- FVLCS is the amount obtainable from the sale of the CGU or asset in an arm's length transaction between knowledgeable and willing parties, less the cost of disposal and/or sale. FVLCS may be determined in the following ways, based on the information available:
  - A binding sale agreement in an arm's length transaction, adjusted for incremental costs that would be directly attributable to the disposal of the asset.
  - If the asset is traded in an active market, the asset's market price less the cost of disposal/sale.

- In the absence of a binding sale agreement or an active market for the asset, FVLCS should be estimated based upon the best information available to reflect the amount that the entity could obtain from the disposal of the asset in an arm's length transaction, after deducting the cost of disposal/sale. Under these circumstances, an income approach (discounted cash flow method) often is utilized.

In accordance with IAS 1, *Presentation of Financial Statements,* entities also are required to disclose information about the assumptions made about the future, and other major sources of estimation uncertainty at the end of the reporting period that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

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