

Statement of Financial Accounting Standards No. 121

Note: This Statement has been completely superseded

[FAS121 Status Page](#)
[FAS121 Summary](#)

Accounting for the Impairment of
Long-Lived Assets and for Long-Lived
Assets to Be Disposed Of

March 1995



Financial Accounting Standards Board
of the Financial Accounting Foundation
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Statement of Financial Accounting Standards No. 121

Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of

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CONTENTS

	Paragraph Numbers
Introduction	1–2
Standards of Financial Accounting and Reporting:	
Scope	3
Assets to Be Held and Used	4–14
Recognition and Measurement of Impairment	4–11
Goodwill	12
Reporting and Disclosure	13–14
Assets to Be Disposed Of	15–19
Recognition and Measurement	15–17
Reporting and Disclosure	18–19
Amendments to Existing Pronouncements	20–33
Effective Date and Transition	34–35
Appendix A: Background Information and Basis for Conclusions	36–146
Appendix B: References to Pronouncements	147

FAS 121: Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of

FAS 121 Summary

This Statement establishes accounting standards for the impairment of long-lived assets, certain identifiable intangibles, and goodwill related to those assets to be held and used and for long-lived assets and certain identifiable intangibles to be disposed of.

This Statement requires that long-lived assets and certain identifiable intangibles to be held and used by an entity be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In performing the review for recoverability, the entity should estimate the future cash flows expected to result from the use of the asset and its eventual disposition. If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the asset, an impairment loss is recognized. Otherwise, an impairment loss is not recognized. Measurement of an impairment loss for long-lived assets and identifiable intangibles that an entity expects to hold and use should be based on the fair value of the asset.

This Statement requires that long-lived assets and certain identifiable intangibles to be disposed of be reported at the lower of carrying amount or fair value less cost to sell, except for assets that are covered by APB Opinion No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*. Assets that are covered by Opinion 30 will continue to be reported at the lower of carrying amount or net realizable value.

This Statement also requires that a rate-regulated enterprise recognize an impairment for the amount of costs excluded when a regulator excludes all or part of a cost from the enterprise's rate base.

This Statement is effective for financial statements for fiscal years beginning after December 15, 1995. Earlier application is encouraged. Restatement of previously issued financial statements is not permitted. Impairment losses resulting from the application of this Statement should be reported in the period in which the recognition criteria are first applied and met. The initial application of this Statement to assets that are being held for disposal at the date of adoption should be reported as the cumulative effect of a change in accounting principle.

INTRODUCTION

1. This Statement establishes accounting standards for the impairment of long-lived assets, certain identifiable intangibles, and goodwill related to those assets to be held and used and for long-lived assets and certain identifiable intangibles to be disposed of.
2. Long-lived assets such as plant and equipment generally are recorded at cost, which is usually fair value at the date of acquisition. The original cost usually is reduced over time by depreciation (amortization) so that the cost of the asset is allocated to the periods in which the asset is used. That practice has been modified in some circumstances when an asset has been determined to be impaired, in which case the asset has been written down to a new carrying amount that is less than the remaining cost and a loss has been recognized. Accounting standards generally have not addressed when impairment losses should be recognized or how impairment losses should be measured. As a result, practice has been diverse.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Scope

3. This Statement applies to long-lived assets, certain identifiable intangibles, and goodwill related to those assets to be held and used and to long-lived assets and certain identifiable intangibles to be disposed of. The Statement applies to all entities. This Statement does not apply to financial instruments, long-term customer relationships of a financial institution (for example, core deposit intangibles and credit cardholder intangibles), mortgage and other servicing rights, deferred policy acquisition costs, or deferred tax assets. It also does not apply to assets whose accounting is prescribed by:
 - a. FASB Statement No. 50, *Financial Reporting in the Record and Music Industry*
 - b. FASB Statement No. 53, *Financial Reporting by Producers and Distributors of Motion Picture Films*
 - c. FASB Statement No. 63, *Financial Reporting by Broadcasters*
 - d. FASB Statement No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed*
 - e. FASB Statement No. 90, *Regulated Enterprises—Accounting for Abandonments and Disallowances of Plant Costs*.

Appendix B contains a list of certain pronouncements that refer to impairment or disposal of assets and indicates which pronouncements are amended by this Statement and which pronouncements remain as authoritative literature. All references to an asset in this Statement

also refer to groups of assets representing the lowest level of identifiable cash flows as described in paragraph 8.

Assets to Be Held and Used

Recognition and Measurement of Impairment

4. An entity shall review long-lived assets and certain identifiable intangibles to be held and used for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

5. The following are examples of events or changes in circumstances that indicate that the recoverability of the carrying amount of an asset should be assessed:

- a. A significant decrease in the market value of an asset
- b. A significant change in the extent or manner in which an asset is used or a significant physical change in an asset
- c. A significant adverse change in legal factors or in the business climate that could affect the value of an asset or an adverse action or assessment by a regulator
- d. An accumulation of costs significantly in excess of the amount originally expected to acquire or construct an asset
- 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 an asset used for the purpose of producing revenue.

6. If the examples of events or changes in circumstances set forth in paragraph 5 are present or if other events or changes in circumstances indicate that the carrying amount of an asset that an entity expects to hold and use may not be recoverable, the entity shall estimate the future cash flows expected to result from the use of the asset and its eventual disposition. Future cash flows are the future cash inflows expected to be generated by an asset less the future cash outflows expected to be necessary to obtain those inflows. If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the asset, the entity shall recognize an impairment loss in accordance with this Statement. Otherwise, an impairment loss shall not be recognized; however, a review of depreciation policies may be appropriate.¹

7. An impairment loss recognized in accordance with paragraph 6 shall be measured as the amount by which the carrying amount of the asset exceeds the fair value of the asset. The fair value of an asset is the amount at which the asset could be bought or sold in a current transaction between willing parties, that is, other than in a forced or liquidation sale. Quoted market prices in active markets are the best evidence of fair value and shall be used as the basis for the measurement, if available. If quoted market prices are not available, the estimate of fair value

shall be based on the best information available in the circumstances. The estimate of fair value shall consider prices for similar assets and the results of valuation techniques to the extent available in the circumstances. Examples of valuation techniques include the present value of estimated expected future cash flows using a discount rate commensurate with the risks involved, option-pricing models, matrix pricing, option-adjusted spread models, and fundamental analysis.

8. In estimating expected future cash flows for determining whether an asset is impaired (paragraph 6), and if expected future cash flows are used in measuring assets that are impaired (paragraph 7), assets shall be grouped at the lowest level for which there are identifiable cash flows that are largely independent of the cash flows of other groups of assets.

9. Estimates of expected future cash flows shall be the best estimate based on reasonable and supportable assumptions and projections. All available evidence should be considered in developing estimates of expected future cash flows. The weight given to the evidence should be commensurate with the extent to which the evidence can be verified objectively. If a range is estimated for either the amount or timing of possible cash flows, the likelihood of possible outcomes shall be considered in determining the best estimate of future cash flows.

10. In limited circumstances, the test specified in paragraph 6 will be applicable at only the entity level because the asset being tested for recoverability does not have identifiable cash flows that are largely independent of other asset groupings. In those instances, if the asset is not expected to provide any service potential to the entity, the asset shall be accounted for as if abandoned or held for disposal in accordance with the provisions of paragraph 15 of this Statement. If the asset is expected to provide service potential, an impairment loss shall be recognized if the sum of the expected future cash flows (undiscounted and without interest charges) for the entity is less than the carrying amounts of the entity's assets covered by this Statement.

11. After an impairment is recognized, the reduced carrying amount of the asset shall be accounted for as its new cost. For a depreciable asset, the new cost shall be depreciated over the asset's remaining useful life. Restoration of previously recognized impairment losses is prohibited.

Goodwill

12. If an asset being tested for recoverability was acquired in a business combination accounted for using the purchase method, the goodwill that arose in that transaction shall be included as part of the asset grouping (paragraph 8) in determining recoverability. If some but not all of the assets acquired in that transaction are being tested, goodwill shall be allocated to the assets being tested for recoverability on a pro rata basis using the relative fair values of the long-lived assets and identifiable intangibles acquired at the acquisition date unless there is evidence to suggest that some other method of associating the goodwill with those assets is more appropriate. In instances where goodwill is identified with assets that are subject to an

impairment loss, the carrying amount of the identified goodwill shall be eliminated before making any reduction of the carrying amounts of impaired long-lived assets and identifiable intangibles.

Reporting and Disclosure

13. An impairment loss for assets to be held and used shall be reported as a component of income from continuing operations before income taxes for entities presenting an income statement and in the statement of activities of a not-for-profit organization. Although there is no requirement to report a subtotal such as "income from operations," entities that present such a subtotal must include the impairment loss in that subtotal.

14. An entity that recognizes an impairment loss shall disclose all of the following in financial statements that include the period of the impairment write-down:

- a. A description of the impaired assets and the facts and circumstances leading to the impairment
- b. The amount of the impairment loss and how fair value was determined
- c. The caption in the income statement or the statement of activities in which the impairment loss is aggregated if that loss has not been presented as a separate caption or reported parenthetically on the face of the statement
- d. If applicable, the business segment(s) affected.

Assets to Be Disposed Of

Recognition and Measurement

15. APB Opinion No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*, requires that certain assets to be disposed of be measured at the lower of carrying amount or net realizable value.² All long-lived assets and certain identifiable intangibles to be disposed of that are not covered by that Opinion and for which management, having the authority to approve the action, has committed to a plan to dispose of the assets, whether by sale or abandonment, shall be reported at the lower of carrying amount or fair value less cost to sell. The fair value of the assets to be disposed of shall be measured in accordance with paragraph 7 of this Statement.

16. Cost to sell an asset to be disposed of generally includes the incremental direct costs to transact the sale of the asset such as broker commissions, legal and title transfer fees, and closing costs that must be incurred before legal title can be transferred. Costs generally excluded from cost to sell an asset to be disposed of include insurance, security services, utility expenses, and other costs of protecting or maintaining an asset. However, if a contractual agreement for the sale of an asset obligates an entity to incur costs in the future to effect the ultimate sale, those

costs shall be included as adjustments to the cost to sell an asset to be disposed of. If the fair value of an asset is measured by the current market value or by using the current selling price for a similar asset, that fair value shall be considered to be a current amount and that fair value and cost to sell shall not be discounted. If the fair value of an asset is measured by discounting expected future cash flows and if the sale is expected to occur beyond one year, the cost to sell also shall be discounted. Assets to be disposed of covered by this Statement shall not be depreciated (amortized) while they are held for disposal.

17. Subsequent revisions in estimates of fair value less cost to sell shall be reported as adjustments to the carrying amount of an asset to be disposed of, provided that the carrying amount of the asset does not exceed the carrying amount (acquisition cost or other basis less accumulated depreciation or amortization) of the asset before an adjustment was made to reflect the decision to dispose of the asset.

Reporting and Disclosure

18. An entity that holds assets to be disposed of that are accounted for in accordance with paragraphs 15-17 of this Statement shall report gains or losses resulting from the application of those paragraphs as a component of income from continuing operations before income taxes for entities presenting an income statement and in the statement of activities of a not-for-profit organization. Although entities are not required to report a subtotal such as "income from operations," entities that present such a subtotal must include the gains or losses resulting from the application of paragraphs 15-17 in that subtotal.

19. An entity that accounts for assets to be disposed of in accordance with paragraphs 15-17 shall disclose all of the following in financial statements that include a period during which those assets are held:

- a. A description of assets to be disposed of, the facts and circumstances leading to the expected disposal, the expected disposal date, and the carrying amount of those assets
- b. If applicable, the business segment(s) in which assets to be disposed of are held
- c. The loss, if any, resulting from the application of paragraph 15 of this Statement
- d. The gain or loss, if any, resulting from changes in the carrying amounts of assets to be disposed of that arises from application of paragraph 17 of this Statement
- e. The caption in the income statement or statement of activities in which the gains or losses in (c) and (d) are aggregated if those gains or losses have not been presented as a separate caption or reported parenthetically on the face of the statement
- f. The results of operations for assets to be disposed of to the extent that those results are included in the entity's results of operations for the period and can be identified.

Amendments to Existing Pronouncements

20. Paragraph 88(d) of APB Opinion No. 16, *Business Combinations*, is replaced by the following:

d. Plant and equipment: (1) to be used, at the current replacement cost for similar capacity¹¹ unless the expected future use of the assets indicates a lower value to the acquirer, and (2) to be sold, at fair value less cost to sell.

21. The following sentence is added to the beginning of paragraph 31 of APB Opinion No. 17, *Intangible Assets*, immediately following the heading:

Identifiable intangible assets not covered by FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*, and goodwill not identified with assets that are subject to an impairment loss shall be evaluated as follows.

22. In the first sentence of paragraph 19(h) of APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, the phrase *the same as a loss in value of other long-term assets* is deleted.

23. The last question and its interpretation of AICPA Accounting Interpretation 1, "Illustration of the Application of APB Opinion No. 30," are superseded by this Statement.

24. FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings*, is amended as follows:

a. The following sentence is added after the first sentence in paragraph 28:

A creditor that receives long-lived assets that will be sold from a debtor in full satisfaction of a receivable shall account for those assets at their fair value less cost to sell, as that term is used in paragraphs 15-17 of FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*.

b. The last sentence of paragraph 28 is replaced by the following:

The excess of (i) the recorded investment in the receivable¹⁷ satisfied over (ii) the fair value of assets received (less cost to sell, if required above) is a loss to be recognized. For purposes of this paragraph, losses, to the extent they are not offset against allowances for uncollectible amounts or other valuation accounts, shall be included in measuring net income for the period.

c. In the second sentence of paragraph 33, *at their fair values* is deleted and *less cost to sell* is inserted after *reduced by the fair value*.

25. The following new paragraph and heading are added after paragraph 62 of FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*:

Impairment Test for Proved Properties and Capitalized Exploration and Development Cost

The provisions of FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*, are applicable to the costs of an enterprise's wells and related equipment and facilities and the costs of the related proved properties. The impairment provisions relating to unproved properties referred to in paragraphs 12, 27-29, 31(b), 33, 40, 47(g), and 47(h) of this Statement remain applicable to unproved properties.

26. The following sentence is added to the end of paragraph 19 of FASB Statement No. 34, *Capitalization of Interest Cost*:

The provisions of FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*, apply in recognizing impairment of assets held for use.

27. The first two sentences of paragraph 14 of FASB Statement No. 51, *Financial Reporting by Cable Television Companies*, are replaced by the following:

Capitalized plant and certain identifiable intangible assets are subject to the provisions of FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*.

28. FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises*, is amended as follows:

- a. In the first sentence of paragraph 48, *and an allowance for any impairment in value* is deleted.
- b. In the last sentence of paragraph 48, *Changes in the allowance for any impairment in value relating to real estate investments* is replaced by *Reductions in the carrying amounts of real estate investments resulting from the application of FASB Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*.

29. FASB Statement No. 61, *Accounting for Title Plant*, is amended as follows:

- a. In the first and second sentences of paragraph 6, *value* is replaced by *carrying amount*.
- b. The last sentence of paragraph 6 is replaced by the following:

Those events or changes in circumstances, in addition to the examples in paragraph 5

of FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*, indicate that the carrying amount of the capitalized costs may not be recoverable. Accordingly, the provisions of Statement 121 apply.

30. Footnote 5 to paragraph 21 of FASB Statement No. 66, *Accounting for Sales of Real Estate*, is replaced by the following:

Paragraph 24 of FASB Statement No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects*, as amended by FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*, specifies the accounting for property that has not yet been sold but is substantially complete and ready for its intended use.

31. FASB Statement No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects*, is amended as follows:

- a. In paragraph 3, *costs in excess of estimated **net realizable value*** is replaced by *reductions in the carrying amounts of real estate assets prescribed by FASB Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*.
- b. Paragraph 16 is deleted.
- c. The first and second sentences of paragraph 24 are replaced by the following:

A real estate project, or parts thereof, that is substantially complete and ready for its intended use* shall be accounted for at the lower of carrying amount or fair value less cost to sell as prescribed in paragraphs 15-17 of Statement 121. The recognition and measurement principles contained in paragraphs 4-7 of that Statement shall apply to real estate held for development and sale, including property to be developed in the future as well as that currently under development. Determining whether the carrying amounts of real estate projects require write-downs shall be based on an evaluation of individual projects.

*Refer to footnote 5.

- d. Paragraph 25 is replaced by the following:

Paragraph 5 of Statement 121 provides examples of events or changes in circumstances that indicate that the recoverability of the carrying amount of an asset should be assessed. Insufficient rental demand for a rental project currently under construction is an additional example that indicates that the recoverability of the real estate project

should be assessed in accordance with paragraph 6 of Statement 121.

e. In paragraph 28, the term *net realizable value* and its definition are deleted.

32. FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*, is amended as follows:

a. The following sentence is added to the end of paragraph 9:

If at any time the incurred cost no longer meets the above criteria, that cost shall be charged to earnings.

b. Paragraph 10 is amended as follows:

(1) The second and third sentences are replaced by:

If a regulator excludes all or part of a cost from allowable costs, the carrying amount of any asset recognized pursuant to paragraph 9 of this Statement shall be reduced to the extent of the excluded cost.

(2) In the fourth sentence, *the asset has* is replaced by *other assets have* and the following phrase is added to the end of that sentence after the footnote added by FASB Statement No. 90, *Regulated Enterprises—Accounting for Abandonments and Disallowances of Plant Costs*:

and FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*, shall apply.

c. The following new paragraph is added after paragraph 10:

If a regulator allows recovery through rates of costs previously excluded from allowable costs, that action shall result in recognition of a new asset. The classification of that asset shall be consistent with the classification that would have resulted had those costs been initially included in allowable costs.

33. The following phrase is added to the end of the third sentence of paragraph 6 of FASB Statement No. 101, *Regulated Enterprises—Accounting for the Discontinuation of Application of FASB Statement No. 71*:

and FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*, shall apply, except for the provisions for income statement reporting in paragraph 13 of that Statement.

Effective Date and Transition

34. This Statement shall be effective for financial statements for fiscal years beginning after December 15, 1995. Earlier application is encouraged. Restatement of previously issued financial statements is not permitted. Impairment losses resulting from the application of this Statement shall be reported in the period in which the recognition criteria are first applied and met.

35. The initial application of this Statement to assets that are being held for disposal at the date of adoption shall be reported as the cumulative effect of a change in accounting principle, as described in APB Opinion No. 20, *Accounting Changes*. A business enterprise shall report the amount of the cumulative effect in the income statement between the captions "extraordinary items," if any, and "net income" (Opinion 20, paragraph 20). A not-for-profit organization shall report the cumulative effect of a change in accounting on each class of net assets in the statement of activities between the captions "extraordinary items," if any, and "change in unrestricted net assets," "change in temporarily restricted net assets," and "change in permanently restricted net assets." The pro forma effects of retroactive application (Opinion 20, paragraph 21) are not required to be disclosed.

**The provisions of this Statement need
not be applied to immaterial items.**

This Statement was adopted by the affirmative votes of five members of the Financial Accounting Standards Board. Messrs. Anania and Northcutt dissented.

Messrs. Anania and Northcutt disagree with this Statement's conclusion in paragraph 7 that an impairment loss should be measured as the amount by which the carrying amount of an asset exceeds the asset's fair value. The Board concluded that a decision to continue to operate rather than sell an impaired asset is economically similar to a decision to invest in that asset and, therefore, the impaired asset should be measured at its fair value. Messrs. Anania and Northcutt do not agree with the rationale of that conclusion. In their view, fair value, which is predicated on the concept of an exchange in a current transaction between willing parties, is not an appropriate measure of impairment because (1) there has been no exchange transaction with an independent party and (2) the asset will continue to be used in operations.

Mr. Anania believes that an impaired asset should be measured at its recoverable cost including the time value of money. In Mr. Anania's view, that approach is the appropriate improvement within the historical cost model to resolve the inconsistent accounting practices that currently exist. Mr. Anania would accept an incremental borrowing rate to determine the present value of estimated future cash flows from an impaired asset that does not have a quoted market price. However, he also would support a discount rate based on rates of return on high-quality, fixed-income investments, with cash flows matching the timing of the asset's

expected cash flows. Mr. Anania believes that use of the latter rate would provide greater comparability when similar assets are owned by different entities that have different debt capacities. The recoverable cost including interest approach is discussed in paragraphs 82-85.

In addition, Mr. Anania believes that a forecast of expected cash flows will be the only available information to determine fair value for assets of an entity-specific nature, such as special-purpose structures and customized equipment. In Mr. Anania's view, the requirement to discount those cash flows at a rate commensurate with the risks involved, as discussed in paragraphs 92 and 93, imposes an unnecessary burden to determine that rate when there is clearly no plan or intent to sell the asset.

Mr. Northcutt believes that this Statement's requirement to measure an impaired asset at fair value is a precedent-setting departure from the transaction-based historical cost model. In Mr. Northcutt's view, the requirement to recognize an impairment loss is not an event or transaction that warrants the adoption of a new basis of accounting at fair value. He does not believe that a fair value measure provides the most relevant and reliable information for users of financial statements, and he finds little relevance in using that measure for an impaired asset that will continue to be held and used. Further, Mr. Northcutt believes that using fair value to measure an impaired asset fails to recognize the nature of that asset, permits "fresh-start" accounting based on management's decision to keep an asset rather than sell it, and usually results in an excessive loss in the current period and an excessive profit in future periods.

Under the present accounting model, a long-lived asset is initially recognized and measured at cost, which is also presumed to be fair value. All subsequent measurements of that asset are the result of a process of allocation through depreciation or amortization. The carrying amount of the asset never purports to reflect anything other than the unallocated balance of the asset's original cost. Mr. Northcutt agrees with the impairment recognition test in paragraph 6 of this Statement and believes that when the carrying amount of an asset cannot be recovered through future operations, an impairment loss should be recognized. However, he believes that an impairment loss should reflect the cost of the asset that will not be recovered from the future operation and subsequent disposal of the asset. Thus, an impaired asset should be written down to its recoverable cost excluding interest. Mr. Northcutt views interest cost as a period cost. For the same reasons as those cited in the dissent to FASB Statement No. 34, *Capitalization of Interest Cost*, he believes that interest cost should not be included as part of an impairment loss regardless of whether the interest is an accrual of actual debt costs or the result of discounting expected future cash flows at some debt rate.

Mr. Northcutt further believes that the use of a fair value measurement, which is based on the notion of an exchange transaction between a willing buyer and a willing seller, fails to consider the nature of the asset in question. He believes that measurement at fair value is not operational. Clearly, the test for recoverability in paragraph 6 of this Statement is an entity-specific test. The estimate of future cash flows expected to result from the use of the asset reflects many aspects that are unique to the specific plans and operations of the entity. That estimate depends on assumptions about many variables, such as the efficiency of the entity's work force, the effectiveness of its marketing efforts, the creativity of its engineers, and management's willingness to invest additional capital. Estimating expected future cash flows is a very subjective process at best, but is probably within the capabilities of an entity's management

if it is in the context of that entity's specific plans and operations.

Mr. Northcutt believes that while it may be possible to estimate the timing of expected future cash flows and then discount those cash flows at a rate "commensurate with the risks," it is presumptuous to believe that the result approximates fair value, as defined. In paragraph 70, the Board argues that the decision to continue to use rather than sell an impaired asset is presumably based on a comparison of expected future cash flows from alternative courses of action and is essentially a capital investment decision. The Board further presumes that no entity would decide to continue to use an asset unless that alternative was expected to produce more in terms of expected future cash flows or service potential than the alternative of selling it and reinvesting the proceeds. Mr. Northcutt believes that the Board's rationale demonstrates that the entity-specific cash flows are not the same as the market-based cash flows used to estimate fair value and that both sets of cash flows must be determined.

Mr. Northcutt believes that due to the nature of the long-lived assets subject to this Statement, quoted market prices in active markets will rarely be available and that the use of other valuation techniques will be required. Prices of similar assets, rental cash flows, and appraisals may produce reasonable fair value estimates for certain assets, such as an office building, but are unavailable for unique assets, such as manufacturing facilities or industrial equipment. Mr. Northcutt believes that cash flows used to estimate fair value must be based on some notion of "market" cash flows. He doubts the operability of this Statement when the only available information is an entity's own cash flows expected from an asset's use and disposition. In Mr. Northcutt's view, a measure that uses entity-specific assumptions about an asset's expected future cash flows does not represent fair value.

Mr. Northcutt disagrees with the use of a fair value measurement that will yield variable results for identical assets. For example, consider two identical assets subject to different depreciation methods that result in different carrying amounts. It is possible that one asset could fail the impairment test in paragraph 6 of this Statement, whereas the other asset could pass, with the difference attributed solely to management's choice of a depreciation method. One asset would be written down to its fair value in accordance with paragraphs 7-11, whereas the other asset would remain at its carrying amount. Mr. Northcutt does not believe that those significantly different outcomes for the two assets, solely based on the depreciation method that was selected, produce decision-useful information for comparing the performance of different entities. In Mr. Northcutt's view, an asset's depreciation method does not influence management's decision to continue to use the asset or to dispose of the asset. He believes that if the recoverable cost approach was permitted, the resulting write-down would appropriately reflect a depreciation "catch-up" adjustment and that future depreciation would be based on the asset's new recoverable cost.

Mr. Northcutt also disagrees with this Statement's requirement that long-lived assets to be disposed of that are not covered by Opinion 30 be measured at the lower of carrying amount or fair value less cost to sell. Consistent with his view on assets to be held and used, Mr. Northcutt believes that a long-lived asset to be disposed of also should be written down to its recoverable cost—its net realizable value. In his view, net realizable value is a market value notion because it represents the net proceeds expected to be received when an asset is sold. The only difference between the fair value less cost to sell measure and the net realizable value measure is the

consideration of the time value of money. The fair value less cost to sell measure requires that the expected net proceeds be discounted.

The Board decided to include assets to be disposed of in the scope of this Statement to preclude an entity from avoiding recognition of a larger fair value impairment loss by declaring an impaired asset as held for disposal and writing it down to its net realizable value. That decision illustrates that the measurements of impaired assets and assets to be disposed of are interrelated. Mr. Northcutt agrees that the measurements are interrelated but believes that the appropriate measure for an impaired asset is recoverable cost and, therefore, the appropriate measure for an asset to be disposed of is net realizable value.

Furthermore, Mr. Northcutt believes that measuring assets to be disposed of at the lower of carrying amount or fair value less cost to sell will not produce the best decision-useful information for users of financial statements because that measure usually results in a higher current-period loss and higher future-period income. According to paragraph 17, the carrying amount of an asset to be disposed of must be adjusted each reporting period for all revisions to the estimate of fair value less cost to sell. If the estimate of future net proceeds does not change, the passage of time will result in the carrying amount of the asset being adjusted to reflect the time value of money by a credit to income. Mr. Northcutt believes that a present decision to dispose of an asset at a loss should not result in income in future periods.

Members of the Financial Accounting Standards Board:

Dennis R. Beresford, *Chairman*
Joseph V. Anania
Anthony T. Cope
John M. Foster
James J. Leisenring
Robert H. Northcutt
Robert J. Swieringa

Appendix A

BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

CONTENTS

	Paragraph Numbers
Introduction.....	36–37
Background Information.....	38–46
Scope.....	47–55
When to Test for Impairment.....	56–58
Recognition of an Impairment Loss.....	59–68
Measurement of an Impairment Loss	69–75
Alternative Measures of an Impairment Loss.....	76–85
Recoverable Cost	77–81
Recoverable Cost including Interest	82–85
Different Measures for Different Impairment Losses	86
Cash Flows.....	87–91
Discount Rate.....	92–94
Grouping for Recognition and Measurement of an Impairment Loss	95–104
Restoration of Impairment Losses	105
Goodwill	106–107
Reporting and Disclosure of Impairment Losses.....	108–111
Early Warning Disclosures	110–111
Assets to Be Disposed Of	112–123
Depreciation of Assets to Be Disposed Of	121–122
Goodwill Related to Assets to Be Disposed Of	123
Real Estate Development.....	124–126
Regulated Enterprises	127–135
Loan Impairment.....	136–138
Benefits and Costs	139–142
Effective Date and Transition	143–146

Appendix A: BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

Introduction

36. This appendix summarizes considerations that Board members deemed significant in reaching the conclusions in this Statement. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

37. Accounting standards generally have not addressed when impairment losses for long-lived assets, identifiable intangibles, and goodwill related to those assets should be recognized or how those losses should be measured. As a result, practice has been diverse. This Statement provides accounting guidance for the recognition and measurement of impairment losses for long-lived assets, certain identifiable intangibles, and goodwill related to those assets to be held and used. This Statement also addresses the accounting for long-lived assets and certain identifiable intangibles to be disposed of.

Background Information

38. In July 1980, the Accounting Standards Executive Committee of the AICPA (AcSEC) sent the Board the AICPA Issues Paper, *Accounting for the Inability to Fully Recover the Carrying Amounts of Long Lived Assets*. AcSEC urged the Board to consider issues raised in the Issues Paper and to provide specific accounting guidance for the impairment of assets.

39. In 1980, the Financial Accounting Standards Advisory Council (FASAC) also discussed accounting for impairment of long-lived assets and advised the Board to continue its work on the conceptual framework project and other agenda topics before adding a project on impairment of assets. The Board agreed and in November 1980 decided not to add a project on impairment of assets to its agenda.

40. The FASB Emerging Issues Task Force (EITF) discussed the issue of impairment at its meetings in October 1984, December 1985, and February 1986. EITF members noted that there were divergent measurement practices in accounting for impairment of assets and a significant increase in the size and frequency of write-downs of long-lived assets. However, members were not able to reach a consensus on any of the impairment issues and urged the Board to add a project on impairment of assets to its agenda.

41. In a March 1985 survey about potential new agenda issues, FASAC members cited

impairment of assets as the second most important issue for the Board to address. In September 1986, responding to a similar survey, most FASAC members supported adding a project on impairment to the FASB technical agenda. Many members stated that the problem of large, "surprise" write-downs of assets was significant enough to justify consideration by the Board.

42. Also in September 1986, the Committee on Corporate Reporting of the Financial Executives Institute (FEI) published the results of its "Survey on Unusual Charges," which was conducted at the request of the Board to assist in exploring current accounting practices for impairment of long-lived assets. The study indicated divergent reporting and measurement practices. In 1991, the FEI updated the survey and found that divergent reporting and measurement practices persisted.

43. In May 1987, the Institute of Management Accountants (IMA), formerly the National Association of Accountants, with the encouragement of the Board, approved a research study to examine accounting for impairment of assets. The IMA research report, *Impairments and Writeoffs of Long-Lived Assets*, published in May 1989, noted a variety of disclosure practices and a steady increase in the number of write-downs. The report suggested that authoritative guidance on the accounting for impairment of long-lived assets was needed.

44. The Board added a project to its agenda in November 1988 to address accounting for the impairment of long-lived assets and identifiable intangibles. A task force was formed in May 1989 to assist with the preparation of a Discussion Memorandum and to advise the Board. The FASB Discussion Memorandum, *Accounting for the Impairment of Long-Lived Assets and Identifiable Intangibles*, was issued in December 1990. The Board received 146 comment letters on the Discussion Memorandum, and 20 individuals and organizations presented their views at a public hearing that was held in August 1991. In January 1992, the Board began deliberating the issues at its public meetings. The Board also discussed those issues at a public meeting of the task force.

45. In November 1993, the Board issued an Exposure Draft, *Accounting for the Impairment of Long-Lived Assets*. The Board received 147 comment letters on the Exposure Draft, and 15 individuals and organizations presented their views at a public hearing that was held in May 1994. The Board reconsidered the proposals in the Exposure Draft at its public meetings. The Board also discussed possible revisions to the Exposure Draft at a public meeting of the task force.

46. In November 1994, the results of a field test of the Exposure Draft were published in an FASB Special Report, *Results of the Field Test of the Exposure Draft on Accounting for the Impairment of Long-Lived Assets*. The field test was conducted jointly by the Asset Impairment Subcommittee of the Financial Executives Institute's Committee on Corporate Reporting and the FASB. Ten entities participated in the field test by completing a comprehensive questionnaire. That questionnaire asked participants to detail the accounting policies and procedures used in the recognition and measurement of previous impairment losses and adjustments to the carrying

amounts of assets to be disposed of. The questionnaire also asked what the effects would have been had the provisions of the Exposure Draft been applied to the same losses and adjustments. The field test results were considered by the Board during its redeliberations of the issues addressed by this Statement.

Scope

47. The original scope of the project was limited to accounting for the impairment of long-lived assets and identifiable intangibles. The Discussion Memorandum did not address accounting for goodwill, long-lived assets to be disposed of, or depreciation. It also did not address joint or common costs, cash flow estimation techniques, or discounting. It did, however, invite comments on the tentative decision to exclude goodwill, assets to be disposed of, and depreciation from the scope of the project. Based on comments received, the Board decided to include goodwill related to impaired assets in the scope of the Exposure Draft and this Statement. It concluded that long-lived assets and identifiable intangibles could not be tested for impairment without also considering the goodwill arising from the acquisition of those assets. The Board also decided that accounting for long-lived assets and identifiable intangibles to be disposed of should be included in the scope of the Exposure Draft and this Statement. In the Board's view, if those assets were not addressed, an entity could potentially avoid the recognition of an impairment loss for assets otherwise subject to an impairment write-down by declaring that those assets are held for sale.

48. The Board decided not to expand the scope of the project to include depreciation. The choice of depreciation method and estimates of useful life and salvage value can have an impact on whether an impairment exists and, when it does, the amount. The Board believes that an asset's depreciation method, estimated useful life, and estimated salvage value should be reviewed periodically and should be changed if current estimates are significantly different from previous estimates. Paragraph 32 of Opinion 20 addresses the accounting for changes in the method of depreciation; paragraph 10 of Opinion 20 addresses the accounting for changes in estimates. The Board agreed that a review of depreciation policies is necessary when considering impairment and included reference to that review in paragraph 6 of this Statement.

49. The Board believes that an impairment condition—the inability to recover fully the carrying amount of an asset—is different from the need to review an asset's depreciation method and estimates of useful life and salvage value. As stated in paragraph 5 of ARB No. 43, Chapter 9C, "Emergency Facilities: Depreciation, Amortization and Income Taxes," depreciation accounting is "a system of accounting which aims to distribute the cost or other basic value of tangible capital assets, less salvage (if any), over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner. It is a process of allocation, not of valuation." It is important to recognize that depreciation accounting is used to distribute or allocate asset carrying amounts that are recoverable. Perhaps the period of recovery may be longer or shorter than previously estimated. Perhaps an alternative depreciation method may be more appropriate. Yet, in using depreciation accounting, it is inherently assumed that the

carrying amount of the asset will be recovered.

50. This Statement does not apply to financial instruments, long-term customer relationships of a financial institution (for example, core deposit intangibles and credit cardholder intangibles), mortgage and other servicing rights, deferred policy acquisition costs, or deferred tax assets. Financial instruments (including investments in equity securities accounted for under the cost or equity method), mortgage servicing rights, and other servicing rights are excluded from this Statement because they are under study in other agenda projects. This Statement does not apply to core deposit intangibles and credit cardholder intangibles because they have characteristics that make their measurements similar to measurements that are used for financial instruments.

51. The Board chose not to include accounting for leases in the scope of the Exposure Draft because FASB Statement No. 13, *Accounting for Leases*, discusses leases in detail. Most respondents who commented on the treatment of leases in the Exposure Draft suggested that the scope should include all capital leases of lessees, and the Board agreed to include those leases in this Statement. The Board also agreed that assets of lessors subject to operating leases are within the scope of this Statement. The Board did not include deferred tax assets in the scope of this Statement because they are addressed in FASB Statement No. 109, *Accounting for Income Taxes*.

52. The Exposure Draft would not have applied to assets whose accounting is prescribed by FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises*. In part, Statement 60 addresses the accounting by insurance enterprises for deferred policy acquisition costs and real estate investments. Several respondents questioned whether that scope exclusion applied to both of those types of assets. The Board intended to exclude only deferred policy acquisition costs. Deferred policy acquisition costs are often considered to be related to other assets and liabilities of insurance enterprises, and as a result, the accounting for those costs is unique to the insurance industry. Statement 60 and FASB Statement No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*, address the impairment of those costs. Therefore, the Board concluded that deferred policy acquisition costs, but not real estate investments or other assets covered by Statement 60, should be excluded from the scope of this Statement. The Board also decided to exclude from the scope of this Statement assets addressed in Statements that apply to certain specialized industries, specifically the record and music, motion picture, broadcasting, and software industries.

53. This Statement applies to long-lived assets and certain identifiable intangibles to be disposed of that are not covered by Opinion 30. The Board decided not to reconsider the conclusions of Opinion 30 because it did not wish to undertake an examination of all of the issues contained in that Opinion.

54. The Board decided to include impairment of regulatory assets in the scope of this Statement. The Board concluded that a distinction should be made between a regulated

enterprise's plant and other fixed assets that any other enterprise would recognize as assets and its regulatory assets that any other enterprise would charge to expense as incurred.

55. Some respondents to the Exposure Draft suggested that not-for-profit organizations should not be included in the scope of the Statement because some assets may not have independent cash flows at a level lower than the total organization. The Board has provided further guidance in paragraph 10 to address those assets, whether held by business enterprises or by not-for-profit organizations. Accordingly, not-for-profit organizations are included in the scope of this Statement.

When to Test for Impairment

56. Respondents to the Discussion Memorandum stressed that requiring a specific periodic impairment test for all assets would be unnecessary and cost prohibitive. They favored limiting impairment testing to when events or changes in circumstances indicate that an impairment test is necessary. They suggested that the impairment indicators contained in the Discussion Memorandum, which had been suggested in the Issues Paper, would be useful examples of events or changes in circumstances that indicate that an impairment assessment is warranted.

57. The Board concluded in the Exposure Draft that management has the responsibility to consider whether an asset is impaired but that to test each asset each period would be too costly. Existing information and analyses developed for management review of the entity and its operations generally will be the principal evidence needed to determine when an impairment exists. Indicators of impairment, therefore, are useful examples of events or changes in circumstances that suggest that the recoverability of the carrying amount of an asset should be assessed. The examples in paragraph 5 of this Statement were derived from the following list in the Issues Paper:

- a. Reduction in the extent to which a plant is used
- b. Dramatic change in the manner in which an asset is used
- c. Substantial drop in the market value of an asset
- d. Change in law or environment
- e. Forecast showing lack of long-term profitability
- f. Costs in excess of amount originally expected to acquire or construct an asset.

58. The Board considered suggestions that the list of impairment indicators should be definitive, that is, the existence of one or more indicators should determine whether an impairment exists. Because Board members were convinced that the list could never be complete, they concluded that it would best serve as examples of events or changes in circumstances that might suggest an impairment loss exists. The Board sought additional examples of impairment indicators in its review of comment letters and public hearing testimony on the Exposure Draft and during meetings with constituent organizations. Some respondents suggested that the list of examples should address events or changes in circumstances that might

suggest an impairment loss exists when past events or changes in circumstances also are considered, such as a current period operating or cash flow loss combined with a history of operating or cash flow losses. Other respondents suggested that an impairment assessment is warranted if a regulator excludes a cost from a regulated enterprise's rate base. The Board agreed and incorporated additional examples into paragraph 5 of this Statement, such as a significant physical change in an asset, an adverse action or assessment by a regulator, and a current period operating or cash flow loss combined with a history of operating or cash flow losses.

Recognition of an Impairment Loss

59. The Board considered the alternative recognition criteria identified and discussed in the Discussion Memorandum and used in practice: economic impairment, permanent impairment, and probability of impairment.

60. The economic criterion calls for loss recognition whenever the carrying amount of an asset exceeds the asset's fair value. It is an approach that would require continuous evaluation for impairment of long-lived assets similar to the ongoing lower-of-cost-or-market measurement of inventory. The economic criterion is based on the measurement of the asset. Using the same measure for recognition and measurement assures consistent outcomes for identical fact situations. However, the economic criterion presupposes that a fair value is available for every asset on an ongoing basis. Otherwise, an event or change in circumstance would be needed to determine which assets needed to be measured and in which period. Some respondents to the Discussion Memorandum indicated that the results of a measurement should not be sufficient reason to trigger recognition of an impairment loss. They favored using either the permanence or probability criterion to avoid recognition of write-downs that might result from measurements reflecting only temporary market fluctuations.

61. The permanence criterion calls for loss recognition when the carrying amount of an asset exceeds the asset's fair value and the condition is judged to be permanent. Some respondents to the Discussion Memorandum indicated that a loss must be permanent rather than temporary before recognition should occur. In their view, a high hurdle for recognition of an impairment loss is necessary to prevent premature write-offs of productive assets. Others stated that requiring the impairment loss to be permanent makes the criterion too restrictive and virtually impossible to apply with any reliability. Still others noted that the permanence criterion is not practical to implement; in their view, requiring management to assess whether a loss is permanent goes beyond management's ability to apply judgment and becomes a requirement for management to predict future events with certainty.

62. The probability criterion, initially presented in the Issues Paper, calls for loss recognition based on the approach taken in FASB Statement No. 5, *Accounting for Contingencies*. Using that approach, an impairment loss would be recognized when it is deemed probable that the carrying amount of an asset cannot be fully recovered. Some respondents to the Discussion

Memorandum stated that assessing the probability that an impairment loss has occurred is preferable to other recognition alternatives because it is already required by Statement 5. Most respondents to the Discussion Memorandum supported the probability criterion because, in their view, it best provides for management judgment.

63. A practical approach to implementing a probability criterion was presented at the public hearing on the Discussion Memorandum. That approach uses the sum of the expected future cash flows (undiscounted and without interest charges) to determine whether an asset is impaired. If that sum exceeds the carrying amount of an asset, the asset is not impaired. If the carrying amount of the asset exceeds that sum, the asset is impaired and the recognition of a new cost basis for the impaired asset is triggered.

64. The Exposure Draft included an undiscounted cash flows recognition criterion, and most respondents supported that criterion. Some respondents expressed concern about situations where small differences in cash flow estimates might result in a large loss being recognized in one instance and no loss being recognized in another. Other respondents suggested that the recognition criteria should be more flexible; management should be able to choose the recognition criteria to be used in impairment situations. Some respondents suggested that fair value be used for both recognition and measurement purposes. Still other respondents suggested using the present value of expected future cash flows discounted at the entity's incremental borrowing rate for both recognition and measurement purposes.

65. The Board affirmed its conclusion that an impairment loss should be recognized whenever the sum of the expected future cash flows (undiscounted and without interest charges) resulting from the use and ultimate disposal of an asset is less than the carrying amount of the asset. The Board believes that the approach is consistent with the definition of an impairment as the inability to fully recover the carrying amount of an asset and with a basic presumption underlying a statement of financial position that the reported carrying amounts of assets should, at a minimum, be recoverable.

66. The Board adopted the recoverability test that uses the sum of the expected future cash flows (undiscounted and without interest charges) as an acceptable approach for identifying when an impairment loss must be recognized. In many cases, it may be relatively easy to conclude that the amount will equal or exceed the carrying amount of an asset without incurring the cost of projecting cash flows.

67. The recognition approach adopted by the Board must be operational in an area of significant uncertainty. The Board's approach requires the investigation of potential impairments on an exception basis. An asset must be tested for recoverability only if there is reason to believe that the asset is impaired as evidenced by events or changes in circumstances. If that test indicates that the sum of the expected future cash flows (undiscounted and without interest charges) to be generated by the asset is insufficient to recover the carrying amount of the asset, the asset is considered impaired. That approach uses information that the Board believes is

generally available to an entity.

68. The Board acknowledges that some object to this approach because they believe that relatively minor changes in cash flow estimates, which may be imprecise, could result in significant differences in the carrying amount of an asset. The Board considered that objection in evaluating whether it was appropriate to use undiscounted cash flows as a recoverability test. The Board concluded that the potential usefulness, from a practical standpoint, of that test was sufficient to overcome that objection.

Measurement of an Impairment Loss

69. An impairment loss is not recognized unless the carrying amount of an asset is no longer recoverable using a test of recoverability—the sum of the expected future cash flows (undiscounted and without interest charges). When an asset's carrying amount is not recoverable using that measure, the Board believes that a new cost basis for the impaired asset is appropriate. The Board concluded that a decision to continue to operate rather than sell an impaired asset is economically similar to a decision to invest in that asset and, therefore, the impaired asset should be measured at its fair value. The amount of the impairment loss should be the amount by which the carrying amount of the impaired asset exceeds the fair value of the asset. That fair value then becomes the asset's new cost basis.

70. When an entity determines that expected future cash flows from using an asset will not result in the recovery of the asset's carrying amount, it must decide whether to sell the asset and use the proceeds for an alternative purpose or to continue to use the impaired asset in its operations. The decision presumably is based on a comparison of expected future cash flows from those alternative courses of action and is essentially a capital investment decision. In either alternative, proceeds from the sale of the impaired asset are considered in the capital investment decision. Consequently, a decision to continue to use the impaired asset is equivalent to a new asset purchase decision, and a new basis of fair value is appropriate.

71. Some respondents to the Exposure Draft disagreed with using fair value to measure impairment. The Board considered those views, but it concluded that the fair value of an impaired asset is the best measure of the cost of continuing to use that asset because it is consistent with management's decision process. Presumably, no entity would decide to continue to use an asset unless that alternative was expected to produce more in terms of expected future cash flows or service potential than the alternative of selling it and reinvesting the proceeds. The Board also believes that using fair value to measure the amount of an impairment loss is not a departure from the historical cost principle. Rather, it is a consistent application of principles practiced elsewhere in the current system of accounting whenever a cost basis for a newly acquired asset must be determined.

72. The Board believes that fair value is an easily understood notion. It is the amount at which an asset could be bought or sold in a current transaction between willing parties. The fair value

measure is basic to economic theory and is grounded in the reality of the marketplace. Fair value estimates are readily available in published form for many assets, especially machinery and equipment. For some assets, multiple, on-line database services provide up-to-date market price information. Estimates of fair value also are subject to periodic verification whenever assets are exchanged in transactions between willing parties.

73. The Exposure Draft included an approach for measuring an asset's fair value that was based on paragraph 13 of FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings*. That approach was not clear about whether the results of valuation techniques could be considered only if selling prices in an active market for similar assets did not exist. Further, some respondents to the Exposure Draft indicated that assumptions developed from selling prices for similar assets are sometimes included in valuation techniques that also consider expected future cash flows. The Board decided to include an approach for measuring the fair value of an asset that would be broadly applicable to other assets in addition to those covered by this Statement.

74. The Board concluded that quoted market prices in active markets are the most objective and relevant measure of an asset's fair value and should be used, if available. If quoted market prices are not available, the estimate of fair value should be based on the best information available in the circumstances. The estimate of fair value should consider prices for similar assets and the results of valuation techniques to the extent available in the circumstances. Valuation techniques for measuring an asset covered by this Statement should be consistent with the objective of measuring fair value and should incorporate assumptions that market participants would use in their estimates of the asset's fair value.

75. The Board recognizes that there may be practical problems in determining the fair value of certain types of assets covered by this Statement that do not have quoted market prices in active markets. While the objective of using a valuation technique is to determine fair value, the Board acknowledges that in some circumstances, the only information available without undue cost and effort will be the entity's expected future cash flows from the asset's use.

Alternative Measures of an Impairment Loss

76. The Board considered approaches other than fair value that also are possible within the historical cost framework for determining the amount of an impairment loss. Those approaches are recoverable cost and recoverable cost including interest.

Recoverable Cost

77. Recoverable cost is measured as the sum of the undiscounted future cash flows expected to be generated over the life of an asset. For example, if an asset has a carrying amount of \$1,000,000, a remaining useful life of 5 years, and expected future cash flows over the 5 years of \$180,000 per year, the recoverable cost would be \$900,000 (5 x \$180,000), and the impairment

loss would be \$100,000 (\$1,000,000 - \$900,000).

78. The Board did not adopt recoverable cost as the measure of an impairment loss. Proponents of the recoverable cost measure believe that impairment is the result of the inability to recover the carrying amount of an asset. They do not view the decision to retain an impaired asset as an investment decision, rather, they view the recognition of an impairment loss as an adjustment to the historical cost of the asset. They contend that recoverable cost measured by the sum of the undiscounted expected future cash flows is the appropriate carrying amount for an impaired asset and the amount on which the impairment loss should be determined.

79. Proponents of the recoverable cost measure do not believe that the fair value of an asset is a relevant measure unless a transaction or other event justifies a new basis for the asset at fair value. They do not view impairment to be such an event.

80. Some proponents of the recoverable cost measure assert that measuring an impaired asset at either fair value or a discounted present value results in an inappropriate understatement of net income in the period of the impairment and an overstatement of net income in subsequent periods. The Board did not agree with that view. Board members noted that measuring an impaired asset at recoverable cost could result in reported losses in future periods if the entity had incurred debt directly associated with the asset.

81. Proponents of the recoverable cost measure view interest cost as a period cost that should not be included as part of an impairment loss regardless of whether the interest is an accrual of actual debt costs or the result of discounting expected future cash flows using a debt rate.

Recoverable Cost including Interest

82. Recoverable cost including interest generally is measured as either (a) the sum of the undiscounted expected future cash flows including interest costs on actual debt or (b) the present value of expected future cash flows discounted at some annual rate such as a debt rate. For example, if an asset has a carrying value of \$1,000,000, a remaining useful life of 5 years, expected future cash flows (excluding interest) over the 5 years of \$180,000 per year, and a debt rate of 6 percent, recoverable cost including interest would be \$758,225 ($4.21236 \times \$180,000$), and the impairment loss would be \$241,775 ($\$1,000,000 - \$758,225$).

83. The Board did not adopt recoverable cost including interest as an appropriate measure of an impairment loss. Proponents of the recoverable cost including interest measure agree that the time value of money should be considered in the measure, but they view the time value of money as an element of cost recovery rather than as an element of fair value. Proponents believe that the measurement objective for an impaired asset should be recoverable cost and not fair value. However, they believe that interest should be included as a carrying cost in determining the recoverable cost. To them, the objective is to recognize the costs (including the time value of money) that are not recoverable as an impairment loss and to measure an impaired asset at the costs that are recoverable.

84. Because of the difficulties in attempting to associate actual debt with individual assets, proponents of the recoverable cost including interest measure believe that the present value of expected future cash flows using a debt rate such as an incremental borrowing rate is a practical means of achieving their measurement objective. They recognize that an entity that has no debt may be required to discount expected future cash flows. They believe that the initial investment decision would have included consideration of the debt or equity cost of funds.

85. The Board believes that use of the recoverable cost including interest measure would result in different carrying amounts for essentially the same impaired assets because they are owned by different entities that have different debt capacities. The Board does not believe that discounting expected future cash flows using a debt rate is an appropriate measure for determining the value of those assets.

Different Measures for Different Impairment Losses

86. The Board also considered but did not adopt an alternative approach that would require different measures for different impairments. At one extreme, an asset might be impaired because depreciation assumptions were not adjusted appropriately. At the other extreme, an asset might be impaired because of a major change in its use. Some believe that the first situation is similar to a depreciation "catch-up" adjustment and that an undiscounted measure should be used. They believe that the second situation is similar to a new investment in an asset with the same intended use and that a fair value measure should be used. The Board was unable to develop a workable distinction between the first and second situations that would support the use of different measures.

Cash Flows

87. The Board recognizes that judgments, estimates, and projections will be required for measuring impaired assets and that precise information about the relevant attributes of those assets seldom will be available. Partly as a result, the Board decided that the measurement guidance provided in this Statement should be general.

88. The Board agreed that one method of obtaining an appropriate measure in some situations is to project expected future cash flows and to discount those cash flows at a current rate that considers the risks inherent in those cash flows. The Board decided not to address issues about how to project cash flows or what interest rate should be associated with those cash flows. The Board currently has a separate project on present-value-based measurements in accounting on its agenda to consider the latter issue.

89. The Board acknowledges that the language in paragraph 9 allows the use of either the single most likely estimate of expected future cash flows or a range that considers the probability of the possible outcomes. The Board concluded that it would be more useful to permit entities to

use cash flow estimation techniques that are currently available and to allow for the use of new techniques that may be developed in the future rather than to prescribe specific techniques in this Statement.

90. The Board considered imposing specific limits on assumptions used to estimate expected future cash flows, such as limiting volume and price assumptions to current levels. The Board decided not to include limits on assumptions because specific limits may be inconsistent with the assumptions that market participants would use in their estimates of an asset's fair value.

91. The Exposure Draft used the term *net* cash flows in certain instances to describe the expected future cash flows used to test the recoverability of an asset in paragraph 6 and to measure an impaired asset in paragraph 7. In this Statement, the reference to *net* cash flows has been eliminated to be consistent with descriptions of cash flows used to determine the fair value of an asset in other pronouncements. The Board's intended meaning of *net*—future cash inflows expected to be generated by an asset should be reduced by the future cash outflows expected to be necessary to obtain those inflows—has been added to paragraph 6 of this Statement.

Discount Rate

92. If quoted market prices for an asset are not available, paragraph 7 of this Statement allows for the consideration of the results of valuation techniques in estimating the fair value of the asset. If such techniques are used, the estimate of fair value may be based on the present value of expected future cash flows using a discount rate commensurate with the risks involved.

93. The discount rate commensurate with the risks involved is a rate that would be required for a similar investment with like risks. That rate is the asset-specific rate of return expected from the market—the return the entity would expect if it were to choose an equally risky investment as an alternative to operating the impaired asset. For some entities that have a well-developed capital budgeting process, the hurdle rate used to make investment decisions might be useful in estimating that rate.

94. Several respondents to the Exposure Draft said that disclosure of the discount rate used to determine the present value of the estimated expected future cash flows should not be required. The Board decided that disclosure of the discount rate without disclosure of the other assumptions used in estimating expected future cash flows generally would not be meaningful to financial statement users. Therefore, this Statement does not require disclosure of the discount rate.

Grouping for Recognition and Measurement of an Impairment Loss

95. The Board concluded that for testing whether an asset is impaired and for measuring the amount of the impairment loss, assets should be grouped at the lowest level for which there are identifiable cash flows that are largely independent of the cash flows generated by other asset

groups. The issue underlying the grouping of assets is when, if ever, it is appropriate to offset the unrealized losses on one asset with the unrealized gains on another. In the Board's view, for determining whether to recognize and how to measure an impairment loss, assets should be grouped when they are used together; that is, when they are part of the same group of assets and are used together to generate joint cash flows.

96. In deciding the appropriate grouping of assets for impairment consideration, the Board reviewed a series of examples that demonstrated the subjectivity of the grouping issue. Varying facts and circumstances introduced in the cases inevitably justified different groupings. Although most respondents to the Discussion Memorandum generally favored grouping at the lowest level for which there are identifiable cash flows for recognition and measurement of an impairment loss, determining that lowest level requires considerable judgment.

97. The Board considered a case that illustrated the need for judgment in grouping assets for impairment. In that case, an entity operated a bus company that provided service under contract with a municipality that required minimum service on each of five separate routes. Assets devoted to serving each route and the cash flows from each route were discrete. One of the routes operated at a significant deficit that resulted in the inability to recover the carrying amounts of the dedicated assets. The Board concluded that the five bus routes would be an appropriate level at which to group assets to test for and measure impairment because the entity did not have the option to curtail any one bus route.

98. The Board concluded that the grouping issue requires significant management judgment within certain parameters. Those parameters are that the assets should be grouped at the lowest level for which there are cash flows that are identifiable and that those cash flows should be largely independent of the cash flows of other groupings of assets.

99. Not-for-profit organizations that rely in part on contributions to maintain their assets may need to consider those contributions in determining the appropriate cash flows to compare with the carrying amount of an asset. Some respondents to the Exposure Draft stated that the recognition criteria in paragraph 6 would be problematic for many not-for-profit organizations because it may be difficult, if not impossible, for them to identify expected future cash flows with specific assets or asset groupings. In other cases, expected future cash flows can be identified with asset groups. However, if future unrestricted contributions to the organization as a whole are not considered, the sum of the expected future cash flows may be negative, or positive but less than the carrying amount of the asset. For example, the costs of administering a museum may exceed the admission fees charged, but the organization may fund the cash flow deficit with unrestricted contributions.

100. Other respondents indicated that similar difficulties would be experienced by business enterprises. For example, the cost of operating assets such as corporate headquarters or centralized research facilities may be funded by revenue-producing activities at lower levels of the enterprise. Accordingly, in limited circumstances, the lowest level of identifiable cash flows

that are largely independent of other asset groups may be the entity level. The Board concluded that the recoverability test in paragraph 6 should be performed at the entity level if an asset does not have identifiable cash flows lower than the entity level. The cash flows used in the recoverability test should be reduced by the carrying amounts of the entity's other assets that are covered by this Statement to arrive at the cash flows expected to contribute to the recoverability of the asset being tested. Not-for-profit organizations should include unrestricted contributions to the organization as a whole that are a source of funds for the operation of the asset.

101. If an impairment write-down is not required, the entity should review the asset's depreciation method, estimated useful life, and estimated salvage value to determine if any adjustments are necessary. However, if the asset does not have any future service potential to the entity, it should be accounted for at the lower of carrying amount or fair value less cost to sell as if the asset had been abandoned or will be disposed of. Paragraph 28 of FASB Concepts Statement No. 6, *Elements of Financial Statements*, defines service potential as "the scarce capacity to provide services or benefits to the entities that use them."

102. The Exposure Draft would have required entities that follow the successful efforts method of accounting prescribed by FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*, to group, for impairment purposes, those capitalized costs of an entity's wells and related equipment and facilities and the costs of related proved properties in the same manner as those costs are grouped, for amortization purposes, under paragraphs 30 and 35 of that Statement. That provision was included in the Exposure Draft so that entities that follow the successful efforts method of accounting would not need to group cash flows at a level lower than the level at which the applicable costs are being amortized. However, many respondents to the Exposure Draft objected to singling out the oil and gas industry for special grouping provisions. Although the Board agreed to delete that requirement in this Statement because there is no reason to provide an exception to the general grouping provision, the Board did not endorse the view of many respondents that oil and gas companies should group their assets in the same manner as those assets are managed or on a country-by-country basis. The Board concluded that all entities should group assets at the lowest level for which there are identifiable cash flows that are largely independent of the cash flows of other groups of assets.

103. The Board considered requests for a limited exception to the fair value measurement for impaired long-lived assets that are subject to nonrecourse debt. Some believe that the nonrecourse provision is effectively a put option for which the borrower has paid a premium. They believe that the impairment loss on an asset subject entirely to nonrecourse debt should be limited to the loss that would occur if the asset were put back to the lender.

104. The Board decided not to provide an exception for assets subject to nonrecourse debt. The recognition of an impairment loss and the recognition of a gain on the extinguishment of debt are separate events, and each event should be recognized in the period in which it occurs. The Board believes that the recognition of an impairment loss should be based on the measurement of the asset at its fair value and that the existence of nonrecourse debt should not

influence that measurement. The Board further believes that a gain on the extinguishment of debt should be recognized in the period in which it occurs and that it should continue to be classified as an extraordinary gain in accordance with FASB Statement No. 4, *Reporting Gains and Losses from Extinguishment of Debt*.

Restoration of Impairment Losses

105. The Board considered whether to prohibit or require restoration of previously recognized impairment losses. It decided that an impairment loss should result in a new cost basis for the impaired asset. That new cost basis puts the asset on an equal basis with other assets that are not impaired. In the Board's view, the new cost basis should not be adjusted subsequently other than as provided under the current accounting model for prospective changes in the depreciation estimates and method and for further impairment losses. Most respondents to the Exposure Draft agreed with the Board's decision that restoration should be prohibited.

Goodwill

106. The Exposure Draft proposed that goodwill identified with potentially impaired long-lived assets and identifiable intangibles be combined with those assets when testing for impairment. If the test indicates that an impairment exists, the carrying amount of the identified goodwill would be eliminated before making any reduction of the carrying amounts of impaired long-lived assets and identifiable intangibles. Several respondents to the Exposure Draft objected to the allocation of goodwill to the asset groups on the basis that goodwill is a residual that results from a business combination accounted for under the purchase accounting method. Some respondents suggested that the residual should be evaluated on its own merits, without describing how that evaluation might be accomplished. Others said that goodwill should be evaluated apart from long-lived assets and identifiable intangibles. They suggested excluding goodwill completely from the scope of this Statement, leaving all goodwill subject to the provisions of APB Opinion No. 17, *Intangible Assets*.

107. The Board decided to retain the provisions of the Exposure Draft to include goodwill identified with a potentially impaired asset with the carrying amount of that asset in performing the impairment test in paragraph 6 and in measuring an impairment loss in accordance with paragraph 7. The amount of the impairment loss should equal the difference between an asset's carrying amount, including identified goodwill, and the asset's fair value. If the carrying amount of an impaired asset, excluding identified goodwill, exceeds the asset's fair value, the identified goodwill should be eliminated and the asset should be written down to its fair value. If the fair value of an impaired asset exceeds the asset's carrying amount, excluding identified goodwill, the identified goodwill should be written down to an amount equal to that excess. The Board concluded that in the absence of evidence to support a more appropriate association, goodwill should be attributed to long-lived assets and identifiable intangibles that were acquired in a business combination using a pro rata allocation based on the relative fair values of those assets at the date of acquisition. Goodwill that is not identified with impaired assets should continue to

be accounted for under Opinion 17.

Reporting and Disclosure of Impairment Losses

108. The Board considered the alternative ways described in the Discussion Memorandum for reporting an impairment loss: reporting the loss as a component of continuing operations, reporting the loss as a special item outside continuing operations, or separate reporting of the loss without specifying the classification in the statement of operations. The Board concluded that an impairment loss should be reported as a component of income from continuing operations before income taxes for entities that present an income statement and in the statement of activities of a not-for-profit organization. If no impairment had occurred, an amount equal to the impairment loss would have been charged to operations over time through the allocation of depreciation or amortization. That depreciation or amortization charge would have been reported as part of continuing operations of a business enterprise or as an expense in the statement of activities of a not-for-profit organization. Further, an asset that is subject to a reduction in its carrying amount due to an impairment loss will continue to be used in operations. The Board concluded that an impairment loss does not have characteristics that warrant special treatment, for instance, as an extraordinary item.

109. The Board believes that financial statements should include information on impairment losses that would be most useful to users. After considering responses to the Exposure Draft, the Board concluded that an entity that recognizes an impairment loss should describe the assets impaired and the facts and circumstances leading to the impairment; disclose the amount of the loss and how fair value was determined; disclose the caption in the income statement or the statement of activities in which the loss is aggregated unless that loss has been presented as a separate caption or reported parenthetically on the face of the statement; and, if applicable, disclose the business segment(s) affected. The Board decided not to require further disclosures, such as the assumptions used to estimate expected future cash flows and the discount rate used when fair value is estimated by discounting expected future cash flows.

Early Warning Disclosures

110. In 1985, the AICPA established a task force to consider the need for improved disclosures about risks and uncertainties that affect companies and the manner in which they do business. In July 1987, the task force published *Report of the Task Force on Risks and Uncertainties*, which concluded that companies should make early warning disclosures in their financial statements. In December 1994, AcSEC issued AICPA Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties*. That SOP requires entities to include in their financial statements disclosures about (a) the nature of operations, (b) the use of estimates in the preparation of financial statements, (c) certain significant estimates, and (d) current vulnerability due to certain concentrations.

111. The Board observed that early warning disclosures would be useful for certain potential

impairments. However, most respondents to the Exposure Draft said that the Statement should not require early warning disclosures. The Board observed that SOP 94-6 uses essentially the same events or changes in circumstances as those in paragraph 5 of this Statement to illustrate when disclosures of certain significant estimates should be made for long-lived assets. Therefore, the Board concluded that it was not necessary for this Statement to require early warning disclosures.

Assets to Be Disposed Of

112. The Board agreed that accounting for long-lived assets and certain identifiable intangibles to be disposed of should be addressed by this Statement. In the Board's view, if those assets were not addressed, an entity could potentially avoid the recognition of an impairment loss for assets otherwise subject to an impairment write-down by declaring that those assets are held for sale. Existing guidance for assets to be disposed of that constitute a segment of a business is provided by Opinion 30. Some believe that Opinion 30 requires the use of a net realizable value measure because it anticipates a relatively short holding period for the assets to be disposed of. The last sentence of paragraph 15 of the Opinion states:

In the usual circumstance, it would be expected that the plan of disposal would be carried out within a period of one year from the measurement date and that such projections of operating income or loss would not cover a period exceeding approximately one year. [Footnote reference omitted.]

113. The net realizable value measure of Opinion 30 seems to anticipate that the disposal of an asset will be completed within approximately one year and does not consider the time value of money. However, a measurement principle for assets to be disposed of that assumes a disposal period of one year or less often is not realistic. For example, concerns about environmental liabilities, such as remediation costs that must be incurred before legal title can be transferred, often extend the period of time necessary to dispose of an asset well beyond one year. The Board considered several alternative measures. For reasons similar to the conclusions reached for assets held for use, the Board concluded that the appropriate measure for assets to be disposed of is the lower of carrying amount or fair value less cost to sell. If the fair value of an asset is measured by the current market value or by using the current selling price for a similar asset, that fair value should be considered to be a current amount and that fair value and cost to sell should not be discounted. If the fair value of an asset is measured by discounting expected future cash flows and if the sale is expected to occur beyond one year, the cost to sell also should be discounted.

114. Opinion 30 applies to assets to be disposed of in a limited context. The Board realizes that potential inconsistencies might arise if fair value is used to measure impairment losses for assets held for use and net realizable value is used to measure certain assets to be disposed of. Several respondents to the Exposure Draft suggested that the Board consider the issues related to Opinion 30 in a separate project. Others suggested that the Board modify Opinion 30 to provide

consistency between the provisions for disposal of a segment of a business and those for all other assets to be disposed of.

115. The Board considered amending Opinion 30 to change the lower of carrying amount or net realizable value measure to the lower of carrying amount or fair value less cost to sell measure. However, the Board did not wish to expand the scope of this Statement and undertake an examination of all the issues contained in Opinion 30 on the expected disposal of a segment of a business. Those issues include the calculation of operating results during the holding period, the presentation of operating results in the income statement, and the netting of operating income or loss with adjustments to the carrying amounts of assets held for disposal. The Board decided not to amend Opinion 30 and concluded that long-lived assets and certain identifiable intangibles to be disposed of that are not covered by that Opinion should be measured at the lower of carrying amount or fair value less cost to sell.

116. The Board concluded that the cost to sell an asset to be disposed of generally includes the incremental direct costs to transact the sale of the asset. Cost to sell is deducted from the fair value of an asset to be disposed of to arrive at the current value of the estimated net proceeds to be received from the asset's future sale. The Board decided that costs incurred during the holding period to protect or maintain an asset to be disposed of generally are excluded from the cost to sell an asset because those costs usually are not required to be incurred in order to sell the asset. However, the Board believes that costs required to be incurred under the terms of a contract for an asset's sale as a condition of the buyer's consummation of the sale should be included in determining the cost to sell an asset to be disposed of.

117. Some respondents to the Exposure Draft objected to the elimination of the last question and its interpretation of AICPA Accounting Interpretation 1, "Illustration of the Application of APB Opinion No. 30." Those respondents said that the Interpretation's guidance for disposals of assets that do not meet the requirements of Opinion 30 has been helpful in practice. Other respondents stated that the guidance was too permissive and agreed that it should be superseded. Interpretation 1 is not specific as to the grouping of assets to which it applies, is not clear in its definitions of gains and losses and holding period, and provides no guidance on how to distinguish a portion of a segment of a business from other assets.

118. Because of the ambiguities associated with the Interpretation, the Board concluded that it was not feasible to amend the Interpretation to conform its requirements to this Statement. The Board decided that the only practical solution was to supersede the last question and its interpretation of Interpretation 1 and that all long-lived assets and certain identifiable intangibles to be disposed of not covered by Opinion 30 should be covered by this Statement. The Board agreed that applying this Statement to assets not already covered by Opinion 30, leaving that Opinion unchanged, and superseding the portion of the Interpretation that specified another accounting treatment for a portion of a line of business to be disposed of would enhance reporting and disclosure consistency for assets to be disposed of.

119. This Statement addresses the measurement of long-lived assets and certain identifiable intangibles to be disposed of not covered by Opinion 30 and whether those assets should be depreciated (amortized) during the holding period. This Statement also provides guidance on the cost to sell an asset to be disposed of, including the determination of the cost to sell an asset when a contractual obligation for an asset's sale requires an entity to incur certain costs during the holding period. This Statement does not address the general issue of accounting for the results of operations of assets to be disposed of during the holding period.

120. In March 1994, the EITF began discussing EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The EITF completed its discussion of the issues in January 1995 after reaching a number of consensuses. Certain consensuses address the issue of when an entity should recognize a liability for costs, other than employee termination benefits, that are directly associated with a plan to exit an activity. In part, the consensuses establish certain criteria that must be met in order for an entity to recognize a liability for those costs and require the results of operations of an activity that will be exited to be recognized in the periods in which the operations occur. The Board believes that the consensuses provide useful guidance about the accounting for the results of operations of an asset to be disposed of when the planned disposal also involves an exit from an activity.

Depreciation of Assets to Be Disposed Of

121. The Board considered whether assets to be disposed of that are carried at the lower of carrying amount or fair value less cost to sell should be depreciated while they are held for disposal. Depreciation is the systematic allocation of an asset's cost over the asset's service period. Some believe that depreciation accounting is inconsistent with the notion of assets to be disposed of and with the use of the lower of carrying amount or fair value less cost to sell measure for those assets. They believe that assets to be disposed of are equivalent to inventory and should not be depreciated. Others believe that all operating assets should be depreciated and that no exception should be made for operating assets held for disposal.

122. The Board concluded that assets to be disposed of covered by this Statement should not be depreciated during the period they are held. Because the assets will be recovered through sale rather than through operations, accounting for those assets is a process of valuation rather than allocation. An asset to be disposed of will not be reported at carrying amount but at the lower of carrying amount or fair value less cost to sell and fair value less cost to sell will be evaluated each period to determine if it has changed.

Goodwill Related to Assets to Be Disposed Of

123. Goodwill related to assets to be disposed of by an entity should be accounted for under the provisions of Opinion 17, paragraph 32, which states:

Ordinarily goodwill and similar intangible assets cannot be disposed of apart from

the enterprise as a whole. However, a large segment or separable group of assets of an acquired company or the entire acquired company may be sold or otherwise liquidated, and all or a portion of the unamortized cost of the goodwill recognized in the acquisition should be included in the cost of the assets sold.

Real Estate Development

124. The Exposure Draft proposed amending FASB Statements No. 66, *Accounting for Sales of Real Estate*, and No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects*, to change the lower of carrying amount or net realizable value measure to the lower of carrying amount or fair value less cost to sell measure. The Board initially decided to amend those Statements to conform the measurement of assets subject to those Statements with the measurement of assets to be disposed of.

125. Some real estate development organizations objected to the proposed amendments in the Exposure Draft. They questioned why the scope of a project on long-lived assets included real estate development. They argued that real estate development assets are more like inventory and, therefore, the lower of carrying amount or net realizable value measure is more relevant. They did not address, however, why that measure would be more appropriate for real estate inventory than the lower of cost or market measure required for inventory under paragraph 4 of ARB No. 43, Chapter 4, "Inventory Pricing."

126. Others disagreed with the inventory argument, asserting that although real estate development assets will eventually be disposed of, the provisions of the Exposure Draft would have required long-term real estate projects to recognize impairments far too frequently. They said that nearly all long-term projects, regardless of their overall profitability, would become subject to write-downs in their early stages of development, only to be reversed later in the life of the project due to revised estimates of fair value less cost to sell. The Board considered alternative approaches to measuring those real estate assets. The Board decided to apply the provisions of paragraphs 4-7 to land to be developed and projects under development and to apply paragraphs 15-17 to completed projects. The Board believes that assets under development are similar to assets held for use, whereas completed projects are clearly assets to be disposed of.

Regulated Enterprises

127. FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*, establishes the accounting model for certain rate-regulated enterprises. Because the rates of rate-regulated enterprises generally are designed to recover the costs of providing regulated services or products, those enterprises are usually able to recover the carrying amounts of their assets. Paragraph 10 of Statement 71 states that when a regulator excludes a cost from rates, "the carrying amount of any related asset shall be reduced to the extent that the asset has been impaired. Whether the asset has been impaired shall be judged the same as for enterprises in

general" (footnote reference omitted). Statement 71 does not provide any guidance about when an impairment has, in fact, occurred or about how to measure the amount of the impairment.

128. The Board considered whether the accounting for the impairment of long-lived assets and identifiable intangibles by rate-regulated enterprises that meet the criteria for applying Statement 71 should be the same as for enterprises in general. In March 1993, the EITF discussed incurred costs capitalized pursuant to the criteria of paragraph 9 of Statement 71. The EITF reached a consensus in EITF Issue No. 93-4, "Accounting for Regulatory Assets," that a cost that does not meet the asset recognition criteria in paragraph 9 of Statement 71 at the date the cost is incurred should be recognized as a regulatory asset when it does meet those criteria at a later date. The EITF also reached a consensus that the carrying amount of a regulatory asset should be reduced to the extent that the asset has been impaired with impairment judged the same as for enterprises in general; the provisions of this Statement nullify that consensus.

129. The Board considered several approaches to recognizing and measuring the impairment of long-lived assets and identifiable intangibles of rate-regulated enterprises. One approach the Board considered was to apply paragraph 7 of FASB Statement No. 90, *Regulated Enterprises—Accounting for Abandonments and Disallowances of Plant Costs*, to all assets of a regulated enterprise and not just to costs of recently completed plants. That paragraph requires that an impairment loss be recognized when a disallowance is probable and the amount can be reasonably estimated. If a regulator explicitly disallows a certain dollar amount of plant costs, an impairment loss should be recognized for that amount. If a regulator explicitly but indirectly disallows plant costs (for example, by excluding a return on investment on a portion of plant costs), an impairment loss should be recognized for the effective disallowance by estimating the expected future cash flows that have been disallowed as a result of the regulator's action and then computing the present value of those cash flows. That approach would recognize a probable disallowance as an impairment loss, the amount of the loss would be the discounted value of the expected future cash flows disallowed, and the discount rate would be the same as the rate of return used to estimate the expected future cash flows.

130. A second approach the Board considered was to supersede paragraph 7 of Statement 90 and apply this Statement's requirements to all plant costs. A disallowance would result in costs being excluded from the rate base. The recognition and measurement requirements of this Statement would be applied to determine whether an impairment loss would be recognized for financial reporting purposes.

131. A third approach the Board considered was to apply the general impairment provisions of this Statement to all assets of a regulated enterprise except for disallowances of costs of recently completed plants, which would continue to be covered by paragraph 7 of Statement 90. A disallowance would result in the exclusion of costs from the rate base. That disallowance would result in an impairment loss for financial reporting purposes if the costs disallowed relate to a recently completed plant. If the costs disallowed do not relate to a recently completed plant, the recognition and measurement requirements of this Statement would be applied to determine

whether and how much of an impairment loss would be recognized for financial reporting purposes.

132. A fourth approach the Board considered was to apply the general impairment standard to all assets of a regulated enterprise except (a) regulatory assets that meet the criteria of paragraph 9 of Statement 71 and (b) costs of recently completed plants that are covered by paragraph 7 of Statement 90. Impairment of regulatory assets capitalized as a result of paragraph 9 of Statement 71 would be recognized whenever the criteria of that paragraph are no longer met.

133. The Board decided that the fourth approach should be used in accounting for the impairment of all assets of a rate-regulated enterprise. The Board amended paragraph 9 of Statement 71 to provide that a rate-regulated enterprise should charge a regulatory asset to earnings if and when that asset no longer meets the criteria in paragraph 9(a) and (b) of that Statement. The Board also amended paragraph 10 of Statement 71 to require that a rate-regulated enterprise recognize an impairment for the amount of costs excluded when a regulator excludes all or part of a cost from rates, even if the regulator allows the rate-regulated enterprise to earn a return on the remaining costs allowed.

134. The Board believes that because a rate-regulated enterprise is allowed to capitalize costs that enterprises in general would otherwise have charged to expense, the impairment criteria for those assets should be different from enterprises in general. The Board believes that symmetry should exist between the recognition of those assets and the subsequent impairment of those assets. The Board could see no reason that an asset created as a result of regulatory action could not be impaired by the actions of the same regulator. Other assets that are not regulatory assets covered by Statement 71 or recently completed plant costs covered by Statement 90, such as older plants or other nonregulatory assets of a rate-regulated enterprise, would be covered by the general provisions of this Statement.

135. Some respondents to the Exposure Draft also asked that the Board clarify the accounting for previously disallowed costs that are subsequently allowed by a regulator. The Board decided that previously disallowed costs that are subsequently allowed by a regulator should be recorded as an asset, consistent with the classification that would have resulted had those costs initially been included in allowable costs. Thus, plant costs subsequently allowed should be classified as plant assets, whereas other costs (expenses) subsequently allowed should be classified as regulatory assets. The Board amended Statement 71 to reflect this decision. The Board decided to restore the original classification because there is no economic change to the asset—it is as if the regulator never had disallowed the cost. The Board determined that restoration of cost is allowed for rate-regulated enterprises in this situation, in contrast to other impairment situations, because the event requiring recognition of the impairment resulted from actions of an independent party and not management's own judgment or determination of recoverability.

Loan Impairment

136. In May 1993, the Board issued FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*, which requires certain impaired loans to be measured based on the present value of expected future cash flows, discounted at the loan's effective interest rate, or as a practical expedient, at the loan's observable market price or the fair value of the collateral if the impaired loan is collateral dependent. Regardless of the measurement method, a creditor should measure impairment based on the fair value of the collateral when the creditor determines that foreclosure is probable. A creditor should consider estimated costs to sell, on a discounted basis, in the measure of impairment if those costs are expected to reduce the cash flows available to repay or otherwise satisfy the loan.

137. As suggested by one commentator to the Exposure Draft, the Board decided to amend Statement 15 to make the measurement of long-lived assets that are received in full satisfaction of a receivable and that will be sold consistent with the measurement of other long-lived assets under this Statement. The amendment requires that those assets be measured at fair value less cost to sell. The Board considered amending Statement 15 to address shares of stock or equity interests in long-lived assets that are received in full satisfaction of a receivable and that will be sold, but it determined that those items are outside the scope of this Statement.

138. Loans and long-lived assets are similar in that both are cash-generating assets that are subject to impairment. However, inherent differences between monetary and nonmonetary assets have resulted in different accounting treatments for them under the current reporting model.

Benefits and Costs

139. In establishing standards that are cost-effective, the Board must balance the diverse and often conflicting needs of constituents. The Board must conclude that a proposed standard will fulfill a need and that the costs it imposes, compared with possible alternatives, will be justified in relation to the overall benefits. There is no objective way to determine the costs to implement a standard and weigh them against the need to report consistent, comparable, relevant, and reliable information in the financial statements.

140. The Board determined that the information provided to users about impaired long-lived assets could be improved by increasing comparability in the recognition, measurement, display, and disclosure of impairment among entities. As discussed in FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information*, comparable financial information enables users to compare one entity's response to economic or other forces with the response of another. Therefore, to the extent that similar situations for impairment of long-lived assets are subject to the same requirements for recognition, measurement, display, and disclosure, financial reporting would be improved.

141. The Board believes that using the examples provided in paragraph 5 of events or changes in circumstances that might suggest a lack of recoverability will help maximize the use of

information already known by management. Comment letters and public hearing testimony on the Discussion Memorandum and the Exposure Draft clearly indicated that a requirement to specifically test each asset or group of assets for impairment each period would not be cost-effective.

142. Determination of an asset's fair value is required only if the asset's carrying amount, including identified goodwill, cannot be recovered. The Board believes that information necessary to perform the recoverability test is generally available from budgets and projections used by management in the decision-making process. Grouping assets at the lowest level of identifiable cash flows minimizes the offsetting of unrealized losses on one asset with the unrealized gains on another without requiring the complexities and costs of attributing interdependent cash flows to individual assets.

Effective Date and Transition

143. The Exposure Draft proposed that this Statement be effective for financial statements for fiscal years beginning after December 15, 1994. Some respondents requested a delay in the effective date to allow for a reasonable amount of time for entities to develop appropriate accounting policies and procedures. The Board agreed and decided that this Statement should be effective for financial statements for fiscal years beginning after December 15, 1995. The Board believes that the effective date provides adequate time for entities to make modifications to their procedures for reviewing long-lived assets and certain identifiable intangibles to conform with this Statement. The Board encourages early adoption of this Statement.

144. The recognition provisions of this Statement should be applied based on the facts and circumstances existing at the date of adoption. The continuing effect of events or changes in circumstances that occurred prior to the Statement's adoption should be considered when this Statement is initially applied. For example, the recoverability of an asset should be tested, in accordance with paragraph 6, on the date the Statement is adopted if that asset experienced a significant decrease in market value in a prior period and the market value of that asset has not recovered.

145. The Board considered requests to provide for a cumulative effect of a change in accounting principle adjustment for impairment losses that have not been previously recognized but are recognized at the time this Statement is implemented. The Board decided to prohibit the cumulative effect adjustment and retroactive application of this Statement's requirements for assets to be held and used because measurement of an impaired asset is based on estimates that are likely to change and management's assessment of events and circumstances is subjective and not readily subject to retroactive review. Impairment losses resulting from the application of this Statement should be reported in the period in which the recognition criteria are first applied and met.

146. The initial application of this Statement to assets that are being held for disposal at the

date of adoption should be reported as the cumulative effect of a change in accounting principle, as described in Opinion 20. The pro forma effects of retroactive application (Opinion 20, paragraph 21) are not required to be disclosed. The Board concluded that the effect of applying this Statement to assets to be disposed of represents a change in measurement principle and does not affect when management identifies an asset for future disposal. The Board decided to prohibit retroactive application of this Statement's requirements for assets to be disposed of because that approach would require an entity to derive fair values for assets that had been disposed of in periods prior to the Statement's initial application.

Appendix B: REFERENCES TO PRONOUNCEMENTS

147. There are many references in the existing authoritative literature to impairment of assets and disposal of assets. Paragraphs 20-33 indicate the amendments to existing pronouncements. The Board decided that the scope of this Statement should exclude financial instruments, long-term customer relationships of a financial institution (for example, core deposit intangibles and credit cardholder intangibles), mortgage and other servicing rights, deferred policy acquisition costs, and deferred tax assets. The Board also decided that assets whose accounting is specifically addressed in Statements covering certain specialized industries, specifically the record and music, motion picture, broadcasting, and software industries, would remain subject to the various requirements of the existing literature for those assets. The following table indicates (a) certain pronouncements that refer to impairment of assets and disposal of assets and (b) which of those pronouncements will apply this Statement and which will continue to apply the existing requirements.

<u>Pronouncement</u>	<u>Title</u>	<u>Apply General Impairment Standard</u>	<u>Apply Existing Requirement</u>	<u>Existing Requirement Paragraph Number</u>
APB Opinion No. 17	<i>Intangible Assets</i>			
	• Identifiable intangibles specifically excluded from the scope of this Statement (long-term customer relationships of a financial institution [for example, core deposit intangibles and credit cardholder intangibles])		X	31
	• All other identifiable intangibles	X		
	• Goodwill identified with assets included in the scope of this Statement	X		
	• Goodwill identified with assets not included in the scope of this Statement		X	31
APB Opinion No. 18	<i>The Equity Method of Accounting for Investments in Common Stock</i>		X	19(h) (as amended by this Statement)

APB Opinion No. 30	<i>Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions</i>		X	14, 15
FASB Statement No. 7	<i>Accounting and Reporting by Development Stage Enterprises</i>	X		
FASB Statement No. 13	<i>Accounting for Leases</i>			
	• Capital leases of lessees	X		
	• Sales-type, direct financing, and leveraged leases of lessors		X	17
	• Assets of lessors subject to operating leases	X		
FASB Statement No. 19	<i>Financial Accounting and Reporting by Oil and Gas Producing Companies</i>			
	• Unproved properties		X	12, 27-29, 31(b), 33, 40, 47(g), 47(h)
	• Proved properties, wells and related equipment and facilities	X		
FASB Statement No. 34	<i>Capitalization of Interest Cost</i>	X		
FASB Statement No. 44	<i>Accounting for Intangible Assets of Motor Carriers</i>		X	3-7
FASB Statement No. 50	<i>Financial Reporting in the Record and Music Industry</i>		X	11
FASB Statement No. 51	<i>Financial Reporting by Cable Television Companies</i>	X		
FASB Statement No. 53	<i>Financial Reporting by Producers and Distributors of Motion Picture Films</i>		X	16-17
FASB Statement No. 60	<i>Accounting and Reporting by Insurance Enterprises</i>			
	• Deferred policy acquisition costs		X	32-37
	• All other assets	X		
FASB Statement No. 61	<i>Accounting for Title Plant</i>	X		
FASB Statement No. 63	<i>Financial Reporting by Broadcasters</i>		X	7
FASB Statement No. 65	<i>Accounting for Certain Mortgage Banking Activities</i>		X	7

FASB Statement No. 66	<i>Accounting for Sales of Real Estate</i>	X		
FASB Statement No. 67	<i>Accounting for Costs and Initial Rental Operations of Real Estate Projects</i>	X		
FASB Statement No. 71	<i>Accounting for the Effects of Certain Types of Regulation</i>	X		
FASB Statement No. 86	<i>Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed</i>		X	10
FASB Statement No. 90	<i>Regulated Enterprises—Accounting for Abandonments and Disallowances of Plant Costs</i>		X	7
FASB Statement No. 97	<i>Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments</i> • Deferred policy acquisition costs		X	25, 27
FASB Statement No. 101	<i>Regulated Enterprises—Accounting for the Discontinuation of Application of FASB Statement No. 71</i>	X		
FASB Statement No. 109	<i>Accounting for Income Taxes</i>		X	20-26
FASB Statement No. 114	<i>Accounting by Creditors for Impairment of a Loan</i>		X	8-16
FASB Statement No. 115	<i>Accounting for Certain Investments in Debt and Equity Securities</i>		X	16

Footnotes

FAS121, Footnote 1— Paragraph 10 of APB Opinion No. 20, *Accounting Changes*, addresses the accounting for changes in depreciation estimates, and paragraph 32 addresses the accounting for changes in the method of depreciation. Whenever there is reason to assess the recoverability of the carrying amount of an asset under paragraphs 4 and 5 of this Statement, there may be reason to review the depreciation estimates and method under paragraphs 10 and 32 of Opinion 20. However, an impairment loss that results from applying this Statement should be recognized prior to performing that review. The provisions of Opinion 20 apply to the reporting of changes in the depreciation estimates and method regardless of whether an impairment loss is recognized under paragraph 6 of this Statement.

FAS121, Footnote 2--Paragraphs 13-16 of Opinion 30 prescribe the accounting for the disposal of a segment of a business. Paragraph 13 defines a segment of a business as "a component of an entity whose activities represent a separate major line of business or class of customer." Paragraph 15 of that Opinion prescribes the determination of a gain or loss on the disposal of a segment of a business and states:

In the usual circumstance, it would be expected that the plan of disposal would be carried out within a period of one year from the measurement date and that such projections of operating income or loss would not cover a period exceeding approximately one year. [Footnote reference omitted.]