# 18. Assets Impairment

When the carrying amount of a long-lived asset (or group of assets as appropriate) is not recoverable from its expected future cash flows, it is deemed to be "impaired." That is to say, the owner of the asset no longer expects to be able to generate returns of cash from the asset sufficient to recapture its recorded net book value. When this scenario occurs, a loss must be recognized for the amount needed to reduce the asset to its fair value (i.e., debit loss and credit the asset). The downward revised carrying value will then be depreciated over its remaining estimated life. Like other changes in estimates, this is a "prospective change," and no prior periods are restated.

Obviously, the measurements of impairment involve subjective components and require quite a bit of judgment. When the Financial Accounting Standards Board came up with these rules, they gave some guidance. Factors such as the following should be taken into account in considering whether an impairment exits: there has been a significant decrease in market value of an asset, the physical condition of the asset has declined unexpectedly, the asset is no longer being used as intended, legal or regulatory issues have impeded the asset, cost overruns are associated with the asset's acquisition, the overall business seems threatened by unsuccessful performance, or the asset is now expected to be disposed of ahead of schedule.

## 18.1 Taking a "Big Bath"

This terminology is sometimes used to characterize significant one-time impairment losses. You may see this occur when a business has gone through a significant down-period and is struggling to regain its footing. Coincident with the restructuring, numerous assets may be deemed impaired and their carrying value reduced. Management has some degree of incentive to engage in this "bath." Why? Given that the write down will produce a loss, isn't this something that management might wish to avoid? Well, the logic goes like this -- things are already bad, so where is the harm? And, more to the point, future periods' income will be buoyed by this action because the write-off will leave less assets that will need to be depreciated in the future. The reduction in future expenses increases the chances of painting a return to profitability. Memories are short, and management may hope the bath will be forgotten once profitability is restored.