Deloitte.

Issue 2, December 2012

Travel, Hospitality & Leisure Spotlight

Electing Qualitative Assessments for Goodwill and Indefinite-Lived Intangible Assets

In This Issue:

The Bottom Line

- Companies now have the option to qualitatively assess goodwill and indefinite-lived intangible assets for impairment. The qualitative assessment is an elective starting point (or "step zero") and, depending on its outcome, may permit a company to avoid performing a more detailed quantitative assessment. Companies can elect the qualitative assessment for any individual reporting unit (for goodwill) or indefinite-lived intangible asset, and it is not a permanent election. At any time, a company can bypass the qualitative assessment and proceed directly to a quantitative impairment test.
- Travel, hospitality, and leisure (THL) companies, in particular, may benefit from the option to perform a qualitative assessment. The ongoing recovery of the THL industry from the economic downturn may result in positive trends in important performance measures. Because the qualitative assessment involves considering how the inputs and assumptions of previous quantitative assessments might differ on the basis of present facts and circumstances, such positive trends might ultimately contribute, in part, to a company's conclusion that a quantitative impairment test is not necessary.
- The qualitative assessment can be a more efficient impairment test under the right circumstances. Yet, the qualitative assessment remains a significant undertaking because companies must identify and evaluate a variety of critical data points. Moreover, substantial quantitative analysis may be necessary to support a conclusion that is qualitative in nature. Further, companies often must exercise significant judgment in interpreting these results and forming an overall conclusion, especially in the presence of mixed indicators. Finally, companies must thoroughly document this analysis.

The qualitative assessment can be a more efficient impairment test under the right circumstances.

Beyond the Bottom Line

This *Travel, Hospitality & Leisure* Spotlight highlights the significant aspects of the qualitative assessments for goodwill and indefinite-lived intangible assets and provides insight on specific factors THL companies might consider when evaluating whether and how to perform these optional assessments.

Background

The FASB's objective in introducing the qualitative assessments was to simplify the way companies perform impairment tests. Under the right conditions, the qualitative assessments can be less costly and complex than quantitative impairment tests. The parameters of the qualitative assessments are outlined below.

Goodwill

In September 2011, the FASB issued ASU 2011-08,[1] which permits a company to conclude, on a qualitative basis, that goodwill is not impaired. The ASU was effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, and early adoption was permitted. Specifically, ASU 2011-08 allows for the optional application of a qualitative assessment (or "step zero") before initiating the two-step goodwill impairment test. The objective of the qualitative analysis is to determine whether it is more likely than not (MLTN) that the fair value of the reporting unit is less than its carrying amount. MLTN is defined as a likelihood of more than 50 percent. If it is not MLTN that the fair value of a reporting unit is less than its carrying amount, a company does not need to perform the quantitative goodwill impairment test.

Under the right conditions, the qualitative assessments can be less costly and complex than quantitative impairment tests.

The qualitative assessment is entirely optional. A company may decide to use it for any reporting unit in any period or proceed directly to the quantitative assessment for goodwill impairment. In addition, a company could use the qualitative assessment in one period and not the next; thus, the use of the qualitative assessment does not establish an accounting policy election. The ASU did not change the requirement to test goodwill for impairment annually (or between annual tests if warranted). However, the specific considerations described in the ASU as being relevant to a qualitative assessment would also be important in a company's evaluation of whether an interim impairment test is necessary. By introducing the qualitative assessment, the ASU eliminated the carryforward option that, under certain circumstances, permitted companies to reuse past years' detailed calculations of a reporting unit's fair value.

Indefinite-Lived Intangible Assets

In July 2012, the FASB issued ASU 2012-02,[2] which introduced a similar qualitative approach to testing indefinite-lived intangible assets for impairment. The ASU is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, and early adoption is permitted. In performing the qualitative assessment, if a company determines, on the basis of qualitative factors, that the indefinite-lived intangible asset is not MLTN impaired, the company would not need to calculate the fair value of the asset. Like the qualitative assessment for goodwill, the qualitative assessment for indefinite-lived intangible assets is optional and can be used for any asset in any period. Further, the ASU did not change the requirement to test indefinite-lived intangible assets for impairment annually (or between annual tests if warranted). However, it did revise the examples of events and circumstances that a company should consider in interim periods.

[1] FASB Accounting Standards Update No. 2011-08, *Testing Goodwill for Impairment.*

[2] FASB Accounting Standards Update No. 2012-02, *Testing Indefinite-Lived Intangible Assets for Impairment.*

THL companies will consider many factors in deciding whether to proceed with qualitative assessments. A major factor will be the relevance of the most recently calculated fair value. A qualitative assessment may become particularly challenging when factors, such as changes in a reporting unit or the passage of significant time, make it difficult for companies to look to a previously calculated fair value as a proxy. It will also be important for companies to consider the amount by which the previously calculated fair value exceeded the carrying amount (i.e., the "cushion"). If the most recent quantitative impairment test resulted in little or no cushion, it would be very difficult to subsequently perform a qualitative assessment.

Performing a Qualitative Assessment

If a company elects to perform the qualitative assessment for goodwill, indefinite-lived intangible assets, or both, it must evaluate a variety of specific events and circumstances (both internal and external) in forming a conclusion. Examples of events and circumstances that companies should consider were included in the ASUs and are now codified in ASC 350-20-35-3C[3] and ASC 350-30-35-18B. The following are some of those events and circumstances, discussed in the context of the THL industry:

THL companies will consider many factors in deciding whether to proceed with qualitative assessments.

- *Macroeconomic Conditions* — Macroeconomic conditions can significantly influence THL companies; therefore, a variety of relevant indicators should be evaluated. First, because THL companies rely on customers' ability to spend disposable income, companies should consider the implications of any negative macroeconomic trends, such as (1) decreases in consumer sentiment, (2) rising or persistently high levels of unemployment, (3) low levels of wage inflation, (4) increases in consumer bankruptcies, or (5) low GDP growth rates. When appropriate, THL companies may want to consider these metrics specific to the demographics of their customer base. Second, owing to THL companies' need for financing for large capital projects, companies should specifically consider the implications of any negative changes in credit markets that may affect their ability to (1) renew revolving credit facilities, (2) access asset-backed security markets, or (3) receive favorable or consistent terms in capital transactions. THL companies should especially evaluate the implications of any unsuccessful attempts to access capital or credit markets. Negative developments in a company's access to capital may have a significant bearing on its overall analysis. Finally, THL companies should consider, when relevant, the effects of any significant foreign exchange rate fluctuations on their business.
- *Industry and Market Conditions* — Negative marketplace trends and conditions can also significantly influence THL companies. Thus, THL companies should identify and evaluate appropriate key industry metrics (e.g., a hotel company may focus on average daily room rates, occupancy rates, and revenue per available room; a timeshare company may focus on tour flow and volume per guest; and a casino company may focus on customer trips, spend per trip, and average daily rates). A THL company should evaluate the implications of current trends in such metrics. In addition, companies should consider other market factors, such as changes in the competitive landscape and political and regulatory developments.
- *Cost Factors* — THL companies should consider whether increases in the cost of materials, cost of labor, or other costs will have a negative effect on earnings and cash flows. Specifically, THL companies may require significant capital expenditures for construction or refurbishment of facilities. The costs may involve commodities (e.g., concrete, steel) that have volatile pricing. THL companies should carefully evaluate any potentially significant cost increases and may need to perform a quantitative analysis to support assertions related to expected changes in cost assumptions.

[3] For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

In general, the lists of events and circumstances in the ASUs are not all-inclusive, so THL companies should consider any other relevant factors that affect fair value. In addition, companies should identify positive and mitigating events but should not view these as creating a rebuttable presumption that a quantitative analysis would be unnecessary. Qualitative analyses often include mixed indicators. For example, an increase in revenue per available room in the current year may be driving positive operational results for a hotel operator but the operator may be leasing a number of its hotels and, should any lease renewals be in jeopardy, financial projections may need reexamination. Companies should consider all factors in the qualitative assessment and oftentimes quantitative analysis is necessary to determine the significance and extent of the impact on fair value.

When evaluating findings in the context of fair value, companies generally look to the method and inputs used in their most recent calculation of fair value. For example, companies may need to revisit key assumptions, such as growth, discount, and capitalization rates. The extent of the analysis should be proportional to the significance of the input to a company's calculation of fair value. Involvement from third-party specialists may still be necessary in this regard.

Thinking Ahead

The option to perform a qualitative assessment provides companies a means of potentially bypassing the traditional quantitative assessment — possibly saving time and reducing costs. Nevertheless, the process can still require substantial effort in gathering and interpreting data, and, moreover, a high degree of judgment in weighing various indicators and coming to an overall conclusion. In addition, the complexity of the qualitative test may increase as the most recently performed quantitative analysis becomes more outdated.

Qualitative analyses often include mixed indicators.

Finally, a company will need to prepare robust documentation when, on a qualitative basis, it has concluded a quantitative impairment analysis is not necessary. This would generally include a comprehensive and detailed analysis of the events and circumstances identified in the ASUs. In addition, a certain amount of quantitative analysis (e.g., financial projections, trade reports, specialist input) will likely be necessary to support conclusions on many of the key considerations. Ultimately, the nature and extent of documentation will vary on the basis of company- and asset-specific factors.

We expect that the general recovery of the THL industry may have a positive influence on some components of a company's qualitative assessment. However, the qualitative assessment is akin to a practical expedient, and many THL companies will continue to evaluate whether it suits their circumstances.

Other Resources

- *FASB's New Qualitative Goodwill Impairment Assessment — Implications and Opportunities*.
- May 17, 2012, *Qualitative Impairment Assessment — A Roadmap to Applying the Guidance in ASU 2011-08*.
- July 27, 2012, *Heads Up*, "FASB Finalizes Amendments on Testing Indefinite-Lived Assets for Impairment."

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