

**(Impairment)** The management of Petro Garcia Inc. was discussing whether certain equipment should be written off as a charge to current operations because of obsolescence. This equipment has a cost of \$900,000 with depreciation to date of \$400,000 as of December 31, 2007. On December 31, 2007, management projected its future net cash flows from this equipment to be \$300,000 and its fair value to be \$230,000. The company intends to use this equipment

oment

**a) Prepare the journal entry (if any) to record the impairment at December 31,**

31, 2007.

ment to

nt in the future.

Cost	\$900,000
Accumulated depreciation	400,000
Carrying amount of the equipment	<u>\$ 500,000</u>
Fair value of equipment (market value)	230,000
Loss on impairment	<u><u>\$ 270,000</u></u>

Petro Garcia Inc.

Journal Entry

December 31, 2007

Loss on Impairment	\$ 270,000	
Accumulated Depreciation		\$ 270,000

**b) Where should the gain or loss (if any) on the write-down be reported in the statement?**

This loss of this write-down should be shown as part of income from operations, in the "Other expenses and losses" section of the income statement.

**c) At December 31, 2008, the equipment's fair value increased to \$260,000. Prepare the journal entry (if any) to record this increase in fair value.**

No journal entry should be made. The carrying amount of the equipment will not change in 2008 except for the depreciation taken in 2008. Therefore, Petro Garcia, Inc. may not restore an impairment loss for an asset held for use. The rationale for not writing the asset up in value is that the new cost basis is compared to the impaired asset on an equal basis with other assets that are unimpaired.

**d) What accounting issues did management face in accounting for this impairment?**

Accounting issues management faced in accounting for this impairment

1) Once management realized an impairment had occurred, they had to determine the fair value of the asset by measuring the equipment based on an active market in which the asset exists. If no active market had existed then they would have had to estimate the fair value of the asset by discounting the expected future cash flows to determine the fair value of the asset.

2) Management had to incur a loss on this asset and show it on the income statement. They had to determine where to show the loss on the income statement.

statement, either under "Other expenses and losses" from continuing operations or as an extraordinary item. Since the company will continue to use these assets, they should have recorded it under "Other expenses and losses" from continuing operations.

(3) A company that recognized an impairment loss should disclose the nature of the impaired assets, the events leading up to the impairment, the amount of the loss, and how it determined fair value.

(4) One other issue management faces is whether or not to keep the assets or dispose of it all together. For example, if the assets fair value went below carrying amount, the company would not be able to recognize a write-up for the new carrying amount unless it was held for sale; then it would be able to recognize the gain. Since management will recover assets held for disposal through sale rather than through operations, it must continually revalue them, which can be a tedious process.