Depreciation, Retirement and Impairment of Assets

Concept
Assets wear out and are used up. Depreciation is a contra-account that is subtracted from the cost of the asset to arrive at a book value. Market value may vary from book value. Depreciation expense is the cost to use assets, which are in place to produce revenue. Matching requires that expenses are recognized in the same period that they help generate revenues.

Terms
- **Cost**: purchase price and costs necessary to get asset into place and condition for use
- **Residual value**: the monetary consideration that can be obtained on scrap, salvage or trade-in.
- **Estimated useful life**: how long the asset will serve (may differ from actual physical life)
- **Depreciation**: for physical plant and equipment
- **Depletion**: for natural resources
- **Amortization**: for intangible assets and financial instruments

Retirement of Assets
- May be due to physical factors such as wearing out or being a casualty
- May be due to economic factors such as obsolescence for such reasons as:
  - Inadequacy: demands on the business have increased
  - Supercession: asset is replaced with another more efficient asset
  - Obsolescence: technology is out dated

Impairment of Real Assets
- This is when carrying amount is not recoverable
  - Significant decrease in market value
  - Change in extent or manner an asset is used
  - Adverse change in legal factors or business climate
  - Accumulation of costs in excess of original
  - Projection of losses associated with an asset
- Recoverability test:
  - If the estimated future net cash flows (fair market value) are less than the carrying amount, the asset is impaired and loss is recognized. The reduced carrying value becomes new cost basis.
  - Example:
    - Asset cost is $10000 with Accumulated Depreciation of $5000 → book value of $5000
    - The fair market value is $2000: there is impairment
    - JE: Loss on impairment $3000
    - Asset $3000
  - The new cost basis is $2000 with no A/D
  - Impairment loss may not be restored for asset held for us

Impairment of Investments
- Loss of major customers, changing economic conditions, loss of significant patent or legal right, damage to reputation
  - Non-temporary loss in value is same as loss of other long-term assets
    - Absence of ability to recover carrying amount of investment
- Write down is a realized loss
  - Debt is not probable to be able to collect
  - Equity: Net Realizable Value is less than the carrying amount
    - Time duration of condition, financial condition & investors intent and ability to persevere
- If value of stock is reduced to zero, discontinue equity method (the account retains a zero balance)
- When the stock is going to be sold: Update the carrying value
  - If the value goes below the requirement for the equity method, there is no retroactive adjustment