Grant Thornton

March 2020

Viewpoint

Applying ASC 360 to right-of-use assets

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Introduction

The guidance in ASC 842, *Leases*, requires lessees to recognize right-of-use assets for most leases, including operating leases. Paragraph 255 in the Basis for Conclusions (BC) in ASU 2016-02, which codifies the new guidance on lease accounting in ASC 842, describes a right-of-use asset as a long-lived nonfinancial asset. ASC 842 states that, like other long-lived nonfinancial assets, right-of-use assets are within the scope of ASC 360, *Property, Plant and Equipment*, for purposes of evaluating whether the asset's carrying amount is impaired.

The guidance in ASC 360 addresses the accounting for long-lived nonfinancial assets, differentiating between assets that are "held and used," assets that are "held for sale," and assets that an entity has decided to abandon.

The consequential amendments to ASC 360 within ASU 2016-02 are limited, which has led to implementation questions about how the subsequent measurement guidance in ASC 360 applies to right-of-use assets. This publication includes our views on those implementation questions.

1. Assets held and used

A lessee is required to evaluate the right-of-use asset for impairment using the guidance on the impairment or disposal of long-lived assets in ASC 360-10-35.

ASC 842-20-35-9

A lessee shall determine whether a right-of-use asset is impaired and shall recognize any impairment loss in accordance with Section 360-10-35 on impairment or disposal of long-lived assets.

The impairment model for long-lived assets that are held and used consists of the following steps:

1. Identify asset groups.
2. When a qualifying event or change in circumstances occurs, test an asset group for recoverability.
3. If the carrying amount of an asset group is not recoverable, measure and recognize an impairment loss.

1.1. Identifying asset groups

A right-of-use asset might be assessed for impairment individually or, if the cash flows related to the lease are not independent from the cash flows of other assets and liabilities, as part of an asset group.

Asset group: An asset group is the unit of accounting for a long-lived asset or assets to be held and used, which represents the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets and liabilities.

Practitioners have raised questions about whether an asset group that includes a right-of-use asset should also include the corresponding lease liability. Whether a lessee may include a lease liability within an asset group depends on whether the liability is associated with an operating lease or a finance lease.

Grant Thornton insights: Including lease liabilities in asset groups

Finance lease

How an entity chooses to finance its acquisition of capital assets (for example, by issuing debt) should not generally affect its impairment assessment for finance lease assets. Accordingly, entities would generally exclude debt obligations from asset groups under ASC 360. Likewise, we believe that lessees should exclude a **finance lease** obligation from the asset group that contains the corresponding right-of-use asset because a finance lease obligation is a financial liability, similar to a debt obligation. In addition, the undiscounted cash flows associated with such an asset group should exclude both the principal and interest components of the finance lease payments.

Operating lease

At its November 30, 2016 meeting, the FASB discussed several implementation issues associated with ASC 842, including how to evaluate a right-of-use asset under an **operating lease** for impairment pursuant to ASC 360. Based on this discussion, we believe there are two acceptable approaches that a lessee can take with respect to addressing operating lease liabilities in the impairment analysis:

- *Approach A:* A lessee could analogize to the guidance in ASC 360 that requires an entity to exclude a liability for an asset retirement obligation from the asset group, and therefore exclude the operating lease liability from the asset group.
- *Approach B:* Because paragraph BC14 of ASU 2016-02 characterizes operating lease liabilities as operating liabilities rather than debt, a lessee could include them in the asset group as it would with other operating liabilities whose future cash flows are linked with the cash flows of the asset group's other assets and liabilities.

After an entity has assigned a right-of-use asset to an asset group, it should reconsider that assignment if there is a change in facts and circumstances that indicates the cash flows associated with the lease are no longer dependent on the other assets and liabilities in the asset group (or vice versa). In some cases, entering into a sublease may indicate that the cash flows associated with the head lease are no longer, or will no longer be, interrelated with the cash flows associated with other assets and liabilities previously deemed to be part of the same asset group as the head lease's right-of-use asset.

To identify the asset group to which a right-of-use asset belongs, a lessee must determine the lowest level at which assets and liabilities can be grouped so that each asset group has cash flows that are largely independent from those of other asset groups, as described in ASC 360-10-35-23. Subleasing an asset (or a discrete portion of an asset) could cause the cash flows (including cash inflows from a sublease) associated with a right-of-use asset to cease being linked to the cash flows associated with the assets and liabilities of an existing asset group.

Reassessing asset groups upon sublease commencement

An entity leases three warehouses that it uses to provide storage and logistics services to a single customer under a long-term contract. The right to use each warehouse represents a separate lease component. Historically, the three right-of-use assets are considered to be part of a single asset group for purposes of applying the impairment guidance in ASC 360. In the current period, the entity modifies the long-term contract with its customer so that it can fulfill the contract using only two warehouses, and enters into a sublease for the third warehouse with another party that will use that facility for its own purposes.

Once the third warehouse is no longer used to fulfill the long-term customer contract, the cash flows associated with that warehouse lease are independent of the other cash flows associated with that lease's existing asset group. At that point, the entity would assess whether the right-of-use asset associated with the third warehouse, as well as other related assets such as leasehold improvements installed in the third warehouse, constitutes a separate asset group, or whether they should be included as part of a different asset group.

1.2. When to test the carrying amount for recoverability

A long-lived asset or asset group must be tested for impairment when events or changes in circumstances indicate that the carrying amount of the asset or asset group might not be recoverable. ASC 360-10-35-21 includes examples of such events or changes in circumstances.

ASC 360-10-35-21

A long-lived asset (asset group) shall be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. The following are examples of such events or changes in circumstances:

a. A significant decrease in the market price of a long-lived asset (asset group)

b. A significant adverse change in the extent or manner in which a long-lived asset (asset group) is being used or in its physical condition

c. A significant adverse change in legal factors or in the business climate that could affect the value of a long-lived asset (asset group), including an adverse action or assessment by a regulator

d. An accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of a long-lived asset (asset group)

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 the use of a long-lived asset (asset group)

f. A current expectation that, more likely than not, a long-lived asset (asset group) will be sold or otherwise disposed of significantly before the end of its previously estimated useful life. The term more likely than not refers to a level of likelihood that is more than 50 percent.

1.3. How to test the carrying amount for recoverability

If an entity identifies a qualifying event or change in circumstances as described in ASC 360-10-35-21, it must evaluate the asset or asset group for impairment by determining whether (1) the carrying amount of the asset is recoverable, and (2) the carrying amount exceeds the asset's fair value. To determine if the carrying amount of the asset is recoverable, the carrying amount is compared to the undiscounted cash flows expected from the use and eventual disposal of the asset.

Practitioners have questioned whether the interest component of future lease payments associated with an operating lease should be included in the undiscounted cash flows for purposes of assessing whether the carrying amount of an asset group is recoverable. This question is relevant only if a lessee includes the lease liability in the asset group; otherwise, all cash outflows associated with the lease must be excluded from the undiscounted future cash flows.

Grant Thornton insights: Excluding interest from undiscounted cash flows

At its November 30, 2016 meeting, the FASB discussed several implementation issues associated with ASC 842, including how to evaluate a right-of-use asset under an operating lease for impairment pursuant to ASC 360. One of the issues discussed was whether a lessee may exclude the interest component of the remaining operating lease payments from the undiscounted cash flows associated with the first step of the impairment analysis, assuming the lessee includes the operating lease liability in the asset group being tested for impairment.

Although the Board reached no conclusions on this topic at that meeting, multiple Board members indicated that they would not object to a lessee adopting an accounting policy to exclude the interest component of the remaining operating lease payments from the undiscounted cash flows. Accordingly, we believe that such an accounting policy is acceptable.

This approach is consistent with how entities measure the cash flows associated with other liabilities included in asset groups subject to the impairment guidance in ASC 360. Since the interest component of such cash flows is associated with financing rather than operating the assets in the asset group, the interest component is excluded from the future cash flows for purposes of assessing whether the carrying amount of an asset group is recoverable.

By electing a policy to exclude the interest component from future cash flows associated with an operating lease, a lessee must bifurcate its operating lease cash flows when testing the recoverability of the carrying amount of an asset group. Under ASC 842, an operating lease has a single lease cost, unlike the cost for a finance lease, which consists of distinct interest and principal amortization components. Therefore, lessees electing such a policy might need to separately calculate an interest component for operating leases, as such information might not otherwise be available from their accounting systems.

If the interest component of operating lease payments is excluded from future cash flows, then the outcomes of applying Approach A and Approach B, as discussed earlier, to assess whether the carrying amount of an asset group is recoverable should be the same. In other words, both approaches will yield the same difference between the carrying amount of the asset group and the undiscounted future cash flows.

Under ASC 842, lessees are required to exclude variable payments from the lease payments, unless the variable payments depend on an index or a rate. This means that variable lease payments, other than those based on an index or a rate, are not included in measuring the carrying amount of the lease liability. Neither the guidance in ASC 842 nor in ASC 360 is clear about whether entities should include variable payments that do not depend on an index or a rate in the undiscounted future cash flows for purposes of assessing whether the carrying amount of an asset group is recoverable under ASC 360.

Grant Thornton insights: Including variable payments in undiscounted cash flows

When calculating the undiscounted future cash flows associated with an asset group, we believe a lessee should include estimated variable payments that are not reflected in the carrying amount of the lease liability, regardless of whether the lease liability is included in the asset group.

ASC 360-10-35-29 through 35-35 provides guidance on estimating the cash flows used to test a long-lived asset (or asset group) for recoverability. ASC 360-10-35-33 states, "Those estimates shall include cash flows associated with future expenditures necessary to maintain the existing service potential of a long-lived asset (asset group)…." We believe that this guidance encompasses variable lease payments that do not depend on an index or a rate. Further, ASC 360-10-35-30 contemplates using a probability-weighted approach to estimate future cash flows, which acknowledges that contingent (variable) cash flows should be reflected in an entity's estimate of future cash flows associated with an asset (asset group).

1.4. Example – recoverability test

The following example illustrates how to apply the guidance in ASC 360 on testing an asset group's carrying amount for recoverability.

Testing an asset group's carrying amount to determine recoverability

Lessee operates retail stores in three cities: Chicago, New York, and Los Angeles. Lessee determines that each location represents an asset group. As of December 31, 20X0, a competitor's entry to the Chicago market has negatively affected, and is expected to continue to negatively affect, the cash flows of the Chicago location. Accordingly, Lessee tests the carrying amount of the Chicago asset group for recoverability as of December 31, 20X0.

The Chicago location consists of an operating lease of retail space and leasehold improvements. As of December 31, 20X0, the carrying amounts of the Chicago location's assets are as follows:

Right-of-use asset	$418
Leasehold improvements	$ 50

The carrying amount of the lease liability at December 31, 20X0 is $445.

As of December 31, 20X0, the lease term for the Chicago location has five years remaining, and the remaining useful life of the leasehold improvements is five years. The lease requires Lessee to make escalating fixed payments over the lease term, as well as variable payments at the end of each calendar year equal to 5 percent of the Chicago location's sales during that year.

Lessee determines that five years is the appropriate period over which to estimate the future cash flows for purposes of testing the recoverability of the Chicago asset group, and decides that there will be no proceeds from the eventual disposition of those assets. The undiscounted expected future cash flows associated with the Chicago location for each of the following five years are shown in the following table.

	20X1	20X2	20X3	20X4	20X5
Sales	$400	$375	$350	$350	$350
Fixed lease payments	(110)	(113)	(115)	(117)	(120)

Variable lease payments	(20)	(19)	(18)	(18)	(18)
Other costs	$(325)	$(300)	$(275)	$(275)	$(275)

Approach A – exclude lease liability from asset group

If Lessee applies Approach A and excludes the lease liability from the Chicago asset group, then it must exclude the "fixed lease payments" from the undiscounted expected future cash flows used to test the recoverability of the asset group's carrying amount. However, Lessee should include estimated variable lease payments in the undiscounted expected future cash flows, regardless of whether it includes the lease liability in the asset group.

Accordingly, Lessee calculates its undiscounted expected future cash flows as shown in the following table.

	20X1	20X2	20X3	20X4	20X5	Total
Sales	$400	$375	$350	$350	$350	$1,825
Variable lease payments	(20)	(19)	(18)	(18)	(18)	(93)
Other costs	(325)	(300)	(275)	(275)	(275)	(1,450)
Total	$55	$56	$57	$57	$57	$282

Comparing the carrying amount of the asset group to the total undiscounted expected future cash flows indicates that the carrying amount of the asset group is not recoverable.

Right-of-use asset	$418
Leasehold improvements	50
Carrying amount of asset group	468
Undiscounted expected future cash flows	282
Difference	$(186)

Approach B – include lease liability in asset group

If Lessee applies Approach B, as described earlier in this section, and includes the lease liability in the Chicago asset group, then it must include the "fixed lease payments" in the undiscounted expected future cash flows used to test the recoverability of the asset group's carrying amount. In this example, Lessee has elected a policy to exclude the interest component of the lease payments (the "lease liability accretion") from the undiscounted expected future cash flows. Lessee also includes estimated variable lease payments in the undiscounted expected future cash flows, regardless of whether it includes the lease liability in the asset group.

Accordingly, Lessee calculates its undiscounted expected future cash flows as follows.

	20X1	20X2	20X3	20X4	20X5	Total
Sales	$400	$375	$350	$350	$350	$1,825
Fixed lease payments	(110)	(113)	(115)	(117)	(120)	(575)
Lease liability accretion	40	34	27	19	10	130
Variable lease payments	(20)	(19)	(18)	(18)	(18)	(93)
Other costs	(325)	(300)	(275)	(275)	(275)	(1,450)
Total	$(15)	$(23)	$(31)	$(41)	$(53)	$(163)

Comparing the carrying amount of the asset group to the total undiscounted expected future cash flows indicates that the carrying amount of the asset group is not recoverable.

Right-of-use asset	$ 418
Leasehold improvements	50
Lease liability	(445)
Carrying amount of asset group	23
Undiscounted expected future cash flows	(63)
Difference	$(186)

Conclusion

Regardless of whether Approach A or Approach B is used, Lessee determines that the carrying amount of the Chicago asset group is not recoverable. Accordingly, Lessee must compare the carrying amount of the asset group to its fair value to calculate the amount of the impairment loss.

It is important to note that since Lessee excluded the interest component of the lease payments from the undiscounted expected future cash flows under Approach B, the difference between the carrying amount of the asset group and the undiscounted expected future cash flows is the same under Approaches A and B.

1.5. How to measure an impairment loss

If the carrying amount of an asset (asset group) exceeds the expected undiscounted cash flows, then the carrying amount is compared to the fair value of the asset (asset group) as of the impairment assessment date. If the carrying amount exceeds the fair value, the impairment charge is equal to the difference between the carrying amount and the fair value.

ASC 360-10-35-17

An impairment loss shall be recognized only if the carrying amount of a long-lived asset (asset group) is not recoverable and exceeds its fair value. The carrying amount of a long-lived asset (asset group) is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset (asset group). That assessment shall be based on the carrying amount of the asset (asset group) at the date it is tested for recoverability, whether in use (see paragraph 360-10-35-33) or under development (see paragraph 360-10-35-34). An impairment loss shall be measured as the amount by which the carrying amount of a long-lived asset (asset group) exceeds its fair value.

In many cases, an entity estimates the fair value of a nonfinancial asset using an expected present value technique, as described in ASC 360-10-35-36. Applying such a technique may involve probability weighting future cash flows associated with the asset and then discounting those cash flows to the date of the impairment analysis.

ASC 360-10-35-36

For long-lived assets (asset groups) that have uncertainties both in timing and amount, an expected present value technique will often be the appropriate technique with which to estimate fair value.

Practitioners have raised questions about how to estimate the fair value of a right-of-use asset, similar to those questions about how to estimate the undiscounted future cash flows associated with an asset or asset group. The guidance in ASC 360 does not specifically address this issue.

Grant Thornton insights: Alignment between estimating cash flows and fair value

Section 1.1 addresses whether the lease liability associated with an operating lease should be included in the asset group along with a right-of-use asset, and whether variable payments should be included in the undiscounted cash flows used to assess the recoverability of an asset or asset group's carrying amount. The same questions exist when estimating the fair value of an asset or asset group for purposes of measuring an impairment charge. We believe that a lessee's policy for measuring the fair value of an asset group should align with how it estimates undiscounted cash flows for the recoverability test in terms of including the lease liability in, or excluding it from, the asset group.

Therefore, if a lessee elects to include the lease liability along with the corresponding right-of-use asset in an asset group for purposes of assessing recoverability, then we believe the lessee should include the lease liability in the asset group for purposes of measuring fair value.

Likewise, if a lessee elects to include the lease liability in the asset group, we believe it should consider cash outflows associated with the lease in applying its fair value measurement methodology to the asset group. An important difference between how lease-related cash outflows are viewed for the recoverability test and for fair value measurement is that the interest component of the future cash outflows should not be disregarded when measuring fair value. A lessee applying a discounted cash flow approach to measure the fair value of an asset group that includes an operating lease liability should include the interest component in the future cash outflows, because those cash outflows will be discounted for purposes of estimating fair value.

In addition, a lessee should include variable payments that are not reflected in the carrying amount of the lease liability (that is, they are not based on an index or a rate) in expected future cash flows for purposes of measuring the fair value of an asset group using a discounted cash flow approach.

Practitioners have raised questions about whether the discount rate used to compute the expected present value should equal the discount rate used to compute the lease liability in accordance with ASC 842, which is generally the entity's incremental borrowing rate at the lease commencement date for lessees.

Grant Thornton insights: Discount rate used to estimate an asset's fair value

For purposes of measuring an impairment loss under ASC 360, an entity should measure the fair value of the asset (asset group) based on the guidance in ASC 820, *Fair Value Measurement*. ASC 820 requires an entity to estimate fair value from a market participant's perspective.

When an entity uses a discounted cash flow method to estimate fair value, the discount rate should reflect a market participant's assumptions in valuing the asset (asset group). The discount rate used by a market participant will likely differ from the discount rate used by a lessee, which is generally the lessee's incremental borrowing rate, in applying the classification and measurement guidance in ASC 842.

In addition, we believe that the rate that a market participant would use to discount the net cash flows associated with an asset group in estimating the asset group's fair value will depend on whether the asset group includes an operating lease liability. We expect that the estimated fair value of an asset group should be similar whether an operating lease liability is included in or excluded from the asset group.

1.6. Example – measuring impairment loss

The following example, assuming the same facts in the example from the preceding section, illustrates how to apply the guidance in ASC 360 on measuring an impairment loss.

Measuring an impairment loss

Lessee has determined that the Chicago asset group is impaired and must now calculate the amount of the impairment loss. Lessee estimates the fair value of the asset group using a discounted cash flow method.

Lessee must elect an accounting policy to either include the lease liability in, or exclude it from, the asset group—an election that applies to both assessing the recoverability of the asset group's carrying amount and measuring the amount of the impairment loss.

Lessee would exclude the lease liability and the lease payments from the asset group and future cash flows, respectively, under Approach A, and would include the lease liability and the lease payments (less the portion representing accretion of the lease liability) in the asset group and future cash flows, respectively, under Approach B. (See "Including lease liabilities in asset groups" above for a discussion of both approaches.)

Approach A – exclude lease liability from asset group

Lessee determines that a market participant would use the same expected cash flows to estimate the fair value of the asset group that Lessee has used in assessing whether the carrying amount of the asset group is recoverable.

Under Approach A, Lessee forecasts annual cash inflows over the next five years as shown in the following table.

20X1	20X2	20X3	20X4	20X5
$55	$56	$57	$57	$57

Lessee determines that a market participant would use a rate of 7 percent to discount the future cash flows associated with this asset group. Discounting these cash flows at 7 percent yields an estimated fair value of $231 for the asset group.

The impairment loss is calculated as shown below.

Carrying amount of asset group	$468
Fair value of asset group	231
Impairment loss	$237

Approach B – include lease liability in asset group

Lessee determines that a market participant would use the same expected cash flows to estimate the fair value of the asset group that Lessee has used in assessing whether the carrying amount of the asset group is recoverable, except that the full lease payments, including both the accretion and amortization components, are included in the cash flows used to estimate fair value.

The cash flows used to estimate the fair value of the asset group are shown below.

	20X1	20X2	20X3	20X4	20X5	Total
Sales	$400	$375	$350	$350	$350	$1,825
Fixed lease payments	(110)	(113)	(115)	(117)	(120)	(575)
Variable lease payments	(20)	(19)	(18)	(18)	(18)	(93)
Other costs	(325)	(300)	(275)	(275)	(275)	(1,450)
Total	$(55)	$(57)	$(58)	$(60)	$(63)	$(293)

Lessee determines that a market participant would use a rate of 11 percent to discount the future cash flows associated with this asset group, considering that the asset group includes the lease liability. Discounting these cash flows at 11 percent yields an estimated fair value for the asset group of ($215).

The impairment loss is calculated as follows.

Carrying amount of asset group	$ 23
Fair value of asset group	(215)
Impairment loss	$238

Conclusion

Regardless of whether it applies Approach A or Approach B, Lessee calculates a similar impairment loss. In this example, although the cash flows are different under the two approaches, Lessee determines that a market participant would use a higher discount rate when estimating the fair value of an asset group that includes the lease liability than the rate it would use in estimating the fair value of the same asset group excluding the lease liability.

1.7. Accounting for an impaired right-of-use asset

If an operating lease right-of-use asset has been impaired, the asset is amortized from the date of the impairment on a straight-line or another systematic basis over the period extending to the earlier of the end of the right-of-use asset's useful life or the end of the lease term.

The single lease cost for an operating lease is calculated differently before and after a right-of-use asset is impaired. Before impairment, the cost of the lease is generally allocated over the remaining lease term on a straight-line basis, which results in a back end–loaded amortization pattern for the right-of-use asset, assuming level payments throughout the lease term. After impairment, lease expense is calculated as the sum of (1) the amortization of the remaining balance of the right-of-use asset on a straight-line or other rational, systematic basis, and (2) the "accretion" of the lease liability, which is the amount that produces a constant periodic discount rate on the remaining lease liability. In other words, following impairment, an operating lease is accounted for like a finance lease, except for presenting a single lease cost rather than separate interest and amortization.

ASC 842-20-25-7

After a right-of-use asset has been impaired in accordance with paragraph 842-20-35-9, the single lease cost described in paragraph 842-20-25-6(a) shall be calculated as the sum of the following:

1. Amortization of the remaining balance of the right-of-use asset after the impairment on a straight-line basis, unless another systematic basis is more representative of the pattern in which the lessee expects to consume the remaining economic benefits from its right to use the underlying asset
2. Accretion of the lease liability, determined for each remaining period during the lease term as the amount that produces a constant periodic discount rate on the remaining balance of the liability.

ASC 842-20-35-10

If a right-of-use asset is impaired in accordance with paragraph 842-20-35-9, after the impairment, it shall be measured at its carrying amount immediately after the impairment less any accumulated amortization. A lessee shall amortize, in accordance with paragraph 842-20-25-7 (for an operating lease) or paragraph 842-20-35-7 (for a finance lease), the right-of-use asset from the date of the impairment to the earlier of the end of the useful life of the right-of-use asset or the end of the lease term.

1.8. Example – post-impairment accounting

The following example, continuing with the same basic fact pattern in the previous examples, illustrates how to apply the guidance in ASC 842 on measuring a right-of-use asset post-impairment.

Accounting for an impaired right-of-use asset

Lessee has determined that the Chicago asset group is impaired and has calculated an impairment loss of $237 under Approach A.

Lessee allocates the impairment loss to the long-lived assets in the asset group based on their relative carrying amounts, as shown below.

Asset	Old carrying amount	Allocation	Allocated loss	New carrying amount
Right-of-use asset	$418	89%	$211	$207
Leasehold improvements	50	11%	26	24
Total	$468		$237	$231

After recognizing the impairment loss, Lessee amortizes the right-of-use asset on a straight-line basis and accretes the lease liability using the interest method over the remainder of the lease term in accordance with ASC 842-20-25-7. Although the lease remains an operating lease, it is accounted for similar to a finance lease after impairment.

After recognizing the impairment loss, Lessee calculates an annual right-of-use asset amortization component of lease expense equal to $46 ($231 ÷ 5).

Lessee's incremental borrowing rate at the lease commencement date, which was used to calculate the lease liability, was 9 percent.

Therefore, Lessee's lease expense for the Chicago location in 20X1 is $86, including lease liability accretion of $40 ($445 × 9 percent) and right-of-use asset amortization of $46.

Lessee's journal entry related to the 20X1 lease payment is as follows:

Dr. Lease expense	$86	
Dr. Lease liability	$70	
Cr. Right-of-use asset		$46
Cr. Cash		$110

2. Assets held for sale

Long-lived assets that are held for sale are subject to a different impairment model than assets that are held and used. However, similar to long-lived assets that are held and used, assets held for sale must be aggregated into groups for purposes of evaluating impairment. ASC 360 refers to such a group as a "disposal group."

A long-lived asset (disposal group) that meets the criteria for "held-for-sale" classification, described in ASC 360-10-45-9, should be measured at the lower of its carrying amount or fair value less cost to sell.

2.1. Identifying a disposal group

A disposal group consists of assets, and liabilities directly associated with those assets, that will be disposed of as a group in a single transaction.

Disposal group: A disposal group for a long-lived asset or assets to be disposed of by sale or otherwise represents assets to be disposed of together as a group in a single transaction and liabilities directly associated with those assets that will be transferred in the transaction. A disposal group may include a discontinued operation along with other assets and liabilities that are not part of the discontinued operation.

The guidance in ASC 360 specifies certain criteria that must be met for a long-lived asset to be classified as held for sale.

ASC 360-10-45-9

A long-lived asset (disposal group) to be sold shall be classified as held for sale in the period in which all of the following criteria are met:

a. Management, having the authority to approve the action, commits to a plan to sell the asset (disposal group).

b. The asset (disposal group) is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (disposal groups). (See Examples 5 through 7 [paragraphs 360-10-55-37 through 55-41], which illustrate when that criterion would be met.)

c. An active program to locate a buyer and other actions required to complete the plan to sell the asset (disposal group) have been initiated.

d. The sale of the asset (disposal group) is probable, and transfer of the asset (disposal group) is expected to qualify for recognition as a completed sale, within one year, except as permitted by paragraph 360-10-45-11. (See Example 8 [paragraph 360-10-55-43], which illustrates when that criterion would be met.) The term probable refers to a future sale that is likely to occur.

e. The asset (disposal group) is being actively marketed for sale at a price that is reasonable in relation to its current fair value. The price at which a long-lived asset (disposal group) is being marketed is indicative of whether the entity currently has the intent and ability to sell the asset (disposal group). A market price that is reasonable in relation to fair value indicates that the asset (disposal group) is available for immediate sale, whereas a market price in excess of fair value indicates that the asset (disposal group) is not available for immediate sale.

f. Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

2.2. Accounting for an asset held for sale

An entity must measure a long-lived asset (disposal group) that is held for sale at the lower of its (1) carrying amount or (2) fair value less cost to sell.

ASC 360-10-35-43

A long-lived asset (disposal group) classified as held for sale shall be measured at the lower of its carrying amount or fair value less cost to sell. If the asset (disposal group) is newly acquired, the carrying amount of the asset (disposal group) shall be established based on its fair value less cost to sell at the acquisition date. A long-lived asset shall not be depreciated (amortized) while it is classified as held for sale. Interest and other expenses attributable to the liabilities of a disposal group classified as held for sale shall continue to be accrued.

ASC 842 does not specify subsequent measurement guidance for a right-of-use asset that is part of a disposal group. Therefore, it is not clear whether right-of-use assets that are held for sale are subject to the subsequent measurement guidance in ASC 360 or ASC 842.

Grant Thornton insights: Accounting for right-of-use assets within a disposal group

We believe that a lessee may elect to apply the held-for-sale measurement guidance in ASC 360 to all right-of-use assets that are part of a disposal group. While ASC 842 does not specifically address whether or how to apply the held-for-sale guidance in ASC 360 to right-of-use assets, ASC 360-10-15-4 states that the guidance in the “Impairment or Disposal of Long-Lived Assets” Subsections in ASC 360, which includes the subsequent measurement guidance for disposal groups, applies to lessees’ right-of-use assets.

Under this approach, once a right-of-use asset becomes part of a disposal group, a lessee would cease amortization of the right-of-use asset, and would instead measure the right-of-use asset at each reporting date at the lower of its (1) carrying amount or (2) fair value less cost to sell.

2.3. Example – right-of-use asset held for sale

The following example, continuing the basic fact patterns from earlier sections, illustrates the application of the subsequent measurement guidance in ASC 360 to a right-of-use asset held for sale.

Accounting for an asset held for sale

On January 1, 20X3, Lessee decides to exit the Chicago market. Lessee plans to assign the lease of its Chicago location, and to sell all of the leasehold improvements installed in that location, to a third party. Lessee determines that it has met the held-for-sale criteria as of January 1, 20X3 for the disposal group consisting of the right-of-use asset, lease liability, and leasehold improvements. Lessee expects to close the disposal transaction on June 30, 20X3.

Lessee elects to apply the held-for-sale impairment guidance to its right-of-use assets included in a disposal group.

Lessee stops amortizing the right-of-use asset as of January 1, 20X3, and records the following journal entry related to the Chicago lease for the quarter ended March 31, 20X3:

Dr. Lease expense	$7	
Cr. Lease liability		$7

Once the lease becomes part of a disposal group, lease expense consists solely of lease liability accretion. Therefore, lease expense for the quarter ended March 31, 20X3 is equal to the discount rate (9 percent ÷ 4 quarters) multiplied by the beginning balance of the lease liability ($296 at December 31, 20X2).

At each reporting date, Lessee compares the carrying amount of the disposal group to its fair value less cost to sell and, if necessary, recognizes a loss, reducing the carrying amount to equal the fair value less cost to sell.

3. Assets to be abandoned

When an entity commits to a plan to abandon a long-lived asset within the scope of ASC 360 before the end of the asset’s useful life, the entity must reassess the asset’s estimated useful life in accordance with the guidance in ASC 250 on changes in accounting estimates.

ASC 360-10-35-47

For purposes of this Subtopic, a long-lived asset to be abandoned is disposed of when it ceases to be used. If an entity commits to a plan to abandon a long-lived asset before the end of its previously estimated useful life, depreciation estimates shall be revised in accordance with paragraphs 250-10-45-17 through 45-20 and 250-10-50-4 to reflect the use of the asset over its shortened useful life (see paragraph 360-10-35-22).

ASC 360-10-35-48

Because the continued use of a long-lived asset demonstrates the presence of service potential, only in unusual situations would the fair value of a long-lived asset to be abandoned be zero while it is being used. When a long-lived asset ceases to be used, the carrying amount of the asset should equal its salvage value, if any. The salvage value of the asset shall not be reduced to an amount less than zero.

ASC 842 does not specify how to subsequently measure a right-of-use asset that will be abandoned. Therefore, it is not clear whether right-of-use assets to be abandoned are subject to the subsequent measurement guidance in ASC 360 or ASC 842.

Grant Thornton insights: Accounting for right-of-use assets to be abandoned

A lessee might decide to abandon a right-of-use asset prior to the end of the lease term for various reasons. For example, a retailer might decide to close an underperforming store prior to the end of the lease term and, due to contractual restrictions, may not be permitted to sublease the space. We believe that a lessee should apply the abandonment guidance in ASC 360-10-35-47 through 35-48 to a right-of-use asset when the lessee decides to abandon the underlying asset. Within the context of a lease, we believe “abandonment” means ceasing to use the underlying asset and lacking either the intent or the ability to sublease the underlying asset.

On the date a lessee decides to abandon a right-of-use asset, the lessee must first consider whether an impairment assessment is required under ASC 360 and, if so, apply the relevant guidance to measure and recognize any impairment charge. After applying the impairment guidance, the lessee should shorten that asset’s useful life so that it extends only up to the abandonment date, provided that the right-of-use asset has not been entirely written off. Accordingly, the right-of-use asset must be amortized to its salvage value, which will typically be zero, from the date the entity decides to abandon the asset to the date the asset is actually abandoned.

There are two views in practice on how to subsequently measure an operating lease following the date when the lessee decides to abandon the right-of-use asset if the right-of-use asset is not impaired.

Under the first view, the decision to abandon the right-of-use asset is akin to determining that the asset is impaired, and the right-of-use asset is amortized on a straight-line basis from the date the decision is made to abandon the asset to the date when the asset is abandoned. In addition, the entity continues to measure the lease liability based on the effective interest method over the remaining lease term. Under this view, lease expense for an operating lease is no longer recognized on a straight-line basis when a lessee decides to abandon the right-of-use asset.

Under the second view, the guidance in ASC 842 only permits a departure from recognizing straight-line lease expense for operating leases if an impairment charge is recognized. Therefore, an entity should continue to recognize a straight-line lease expense during the remainder of the lease term until the right-of-use asset is abandoned.

We believe that either of these views is acceptable.

3.1. Example - abandonment

The following example illustrates how to apply the subsequent measurement guidance in ASC 360 to a right-of-use asset that will be abandoned.

Accounting for an asset to be abandoned

Lessee operates three stores in New York, which comprise a single asset group. On January 1, 20X1, Lessee decides to cease operating one of the New York stores, and plans to abandon the shuttered location. This means that Lessee will cease using the leased space, and will not sublease the space to another tenant, for the remainder of the lease term. Lessee expects to vacate and cease using the leased space by December 31, 20X2.

Lessee assesses the New York asset group for impairment at January 1, 20X1, and determines that the carrying amount of the asset group is recoverable. Lessee applies the abandonment guidance in ASC 360 to the right-of-use asset associated with the leased retail space that it will cease using.

Lessee's policy is to amortize a right-of-use asset on a straight-line basis to its salvage amount from the date Lessee commits to abandon the asset to the abandonment date.

For the operating lease associated with the right-of-use asset to be abandoned, Lessee had previously been recognizing straight-line lease expense of $123 per year. At January 1, 20X1, the carrying amounts of the right-of-use asset and lease liability are $429 and $449, respectively. The incremental borrowing rate applicable to this lease (as of the commencement date) is 5.5 percent.

Lessee determines that the right-of-use asset must be amortized to its salvage value, which Lessee has determined to be zero, from January 1, 20X1 to December 31, 20X2.

Following is a summary of activity and balances related to the lease associated with the right-of-use asset to be abandoned for the remainder of the lease term.

Date	Change in ROU asset	ROU asset	Change in lease liability	Lease liability	Lease expense	Cash
Jan. 1, 20X1		$429		$(449)		
Dec. 31, 20X1	$(214)[a]	$215	$ 99[b]	$(350)	$239[c]	$(124)
Dec. 31, 20X2	$(215)	$ -	$108	$(242)	$234	$(127)
Dec. 31, 20X3	$ -	$ -	$117	$(125)	$ 13[d]	$(130)
Dec. 31, 20X4	$ -	$ -	$125	$ -	$ 7	$(132)

(a) Once Lessee applies the ASC 360 abandonment guidance to the right-of-use asset, it recalculates the periodic amortization so that the asset will be amortized to its salvage value (zero) by the date Lessee ceases using the leased asset (December 31, 20X2).

(b) Lease payments are made on an annual basis. Therefore, the adjustment to the lease liability consists of an increase related to interest accretion, which is equal to the discount rate (5.5 percent) multiplied by the previous year-end balance of the lease liability, and a decrease related to the cash paid in the current period.

(c) Until the right-of-use asset is amortized to its salvage value, lease expense consists of right-of-use asset amortization and interest accretion.

(d) Once the right-of-use asset is amortized to its salvage value, lease expense consists solely of interest accretion.

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