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GAAP Dynamics

Impairment: Reminders and Hot Topics

Webinar: Co-sponsored with Intelligize
October 19, 2022

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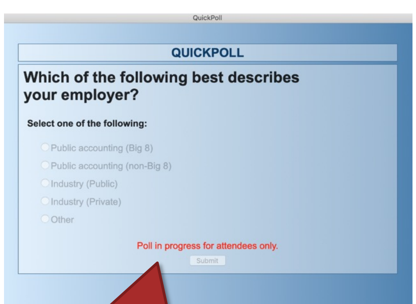
CPE specifics

- CPE credits: 1 hour
- Course format: Live, facilitator-led webinar, which includes lecture, examples, exercises, polling questions, and Q&A
- Instructional delivery method: Group Internet Based
- Field of study: Accounting
- Knowledge level: Overview
- Prerequisites: None
- Advanced preparation: None

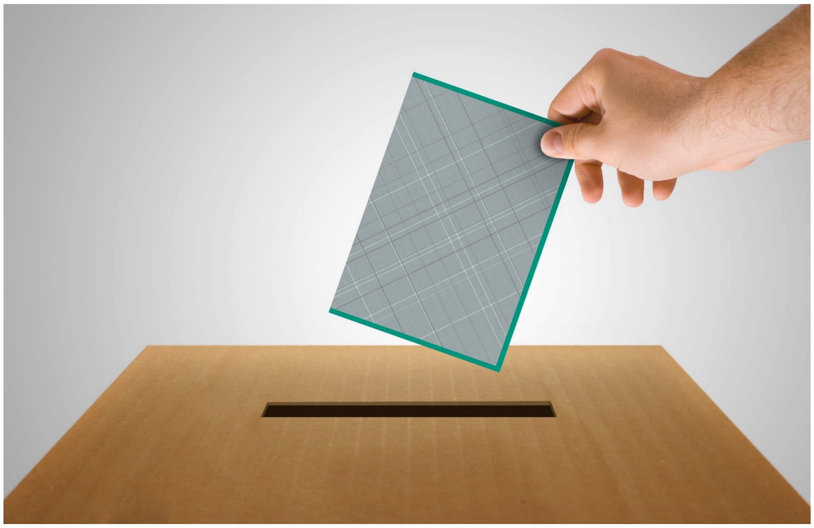
WARNING: Don’t miss out on CPE!!!



If we do not have your responses logged, we cannot issue you CPE!

- **Must answer at least 3 of polling questions in order to receive the 1.0 CPE credit**
- **TIP #1: Close your other browser windows and tabs**
- **TIP #2: Do not watch in full-screen mode**
- **TIP #3: Use the GoToWebinar App to join the session**
- **TIP #4: Use the Question Pane to submit responses when in doubt**

Polling question #1



Learning objectives

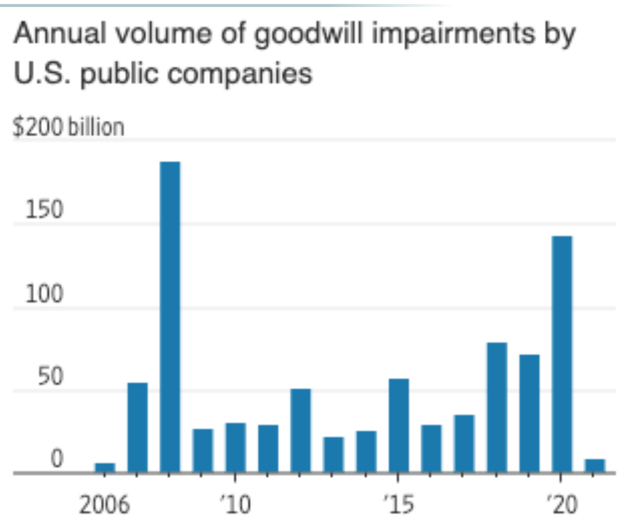
By the end of this course, you should be able to:

1. Identify the proper impairment model for long-lived assets, intangible assets, and goodwill under U.S. GAAP
2. Recall comment letter and SEC focus areas related to impairment
3. Understand how to use Intelligize to research and review impairment-related disclosures within SEC filings

Agenda

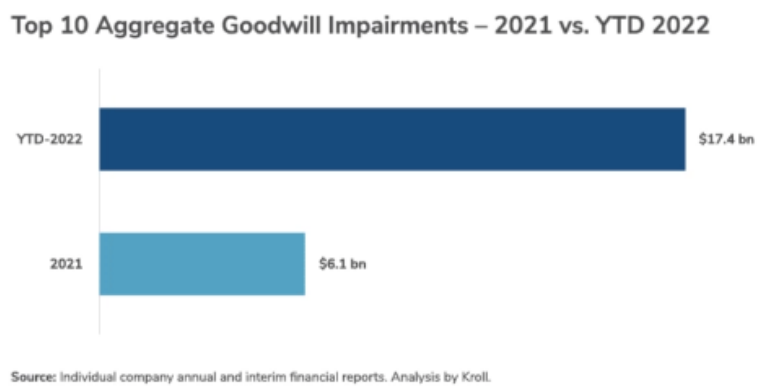
- Why are we here?
- Impairment models set out in ASC 350 and 360
- ASU 2017-04 Simplifying the Test for Goodwill Impairment
- Example financial statement and non-GAAP disclosures
- Comment letters and SEC focus areas related to impairment
- Wrap-up

Why are we here? I thought it was getting better!



Source: Kroll LLC

It's going back up!



Reasons for increasing goodwill impairments

- Market volatility, higher interest rates, and/or higher forecast risk leading to higher discount rates
- Lower financial performance than expected or even negative earnings
- Adverse impact of global supply chain disruptions
- Lower projected operating results due to exchange rate fluctuations, high inflation, and other macroeconomic factors
- Continued challenges in labor markets, including both shortages in workforce and inflationary wage pressures
- Significant decline in market capitalization

It's the perfect storm!

Let's use Intelligize®

What percentage of Fortune 500 companies note impairment as a Critical Audit Matter (CAM) in their most recent auditor's report?

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Impairment models for non-financial assets

Asset type	Indefinite-lived intangible assets	Long-lived assets and finite-lived intangibles	Goodwill
Guidance	ASC 350-30	ASC 360-10	ASC 350-20
Frequency	Annually, at a minimum	In result of triggering event	Annually, at a minimum
Impairment model	1-step + optional qualitative assessment	2-step model	1-step + optional qualitative assessment
Level to test	Individual asset	Asset group	Reporting unit
Measure and recognize	Recognize excess of carrying value over fair value (ASC 820)	Recoverability test based on undiscounted cash flows then, recognize excess of carrying value over fair value (ASC 820)	Recognize excess of carrying value over fair value (ASC 820)

Triggering events and qualitative factors

Triggering events

- Significant decrease in the asset's market price
- Significant adverse change in asset's use or physical condition
- Significant adverse change in legal factors or the business climate
- Historical and current-period operating or cash flow loss or a projection or forecast of continuing loss
- Costs significantly in excess of the amount originally expected for the acquisition/construction of an asset
- Expected asset sale/disposal significantly before the end of its previously estimated useful life

Qualitative assessment factors

- Macroeconomic conditions
  - Deterioration in general economic conditions, developments in equity and credit markets
- Industry and market conditions
- Cost factors resulting in negative effects
- Overall financial performance
  - Actual or projected
- Other relevant company-specific events
- Events affecting a reporting unit
- Sustained decrease in share price, if applicable

Asset groups

- **A trigger may apply to a specific asset, but for purposes of application of the impairment guidance for long-lived assets (ASC section 360-10-35) the unit of accounting is the "asset group"**
  - Long-lived assets should be grouped with other assets and liabilities at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities
- **Include goodwill in the asset group only if the asset group is a reporting unit or includes a reporting unit**

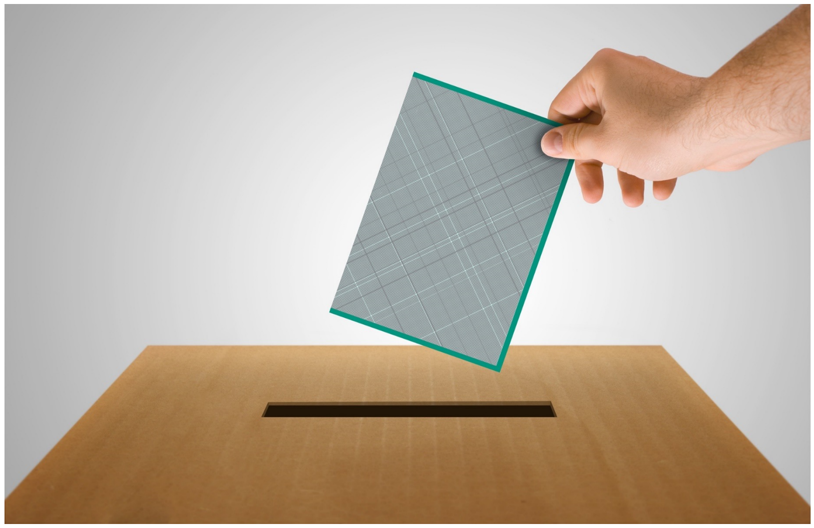
CLASS DISCUSSION

Impairment

Bleach Pharmaceuticals has experienced unprecedented disruption and uncertainty as a result of COVID-19. As it looks to close the books on its financials, management determines that impairment is a concern throughout the company, ranging from its fixed assets (e.g., PPE), intangible assets (both finite-lived and indefinite-lived), goodwill, and various financial assets. Management doesn't even know where to start but knows it must cleanse itself of impairment and is wondering if it matters what order it should conduct these impairment tests.

Which of these assets should be tested for impairment first?

Polling question #2



Sequencing for performing impairment testing

A
Assets out-of-scope of ASC 350 & 360

Inventory, A/R, other financial assets, etc.

B
Indefinite-lived intangible assets

Trademarks, customer lists, brands

C
Long-lived assets and finite-lived intangibles

PP&E, patents or licenses with a specific life/term

D
Goodwill

The order is important!

Allocation of impairment loss

- **Only allocate an impairment loss to those long-lived assets within the asset group that are included within the scope of this impairment guidance**
- **An impairment loss should be allocated to the long-lived assets in the asset group on a pro-rata basis using relative carrying amounts**
- **The loss allocated to an individual long-lived asset of the group should not reduce the carrying amount of that asset below its fair value whenever that fair value is determinable without undue cost and effort**

Remember, goodwill included in an asset group should be tested for impairment after the impairment test has been performed on PPE/long-lived assets and any impairment loss has been allocated!

CLASS DISCUSSION

Impairment of PP&E – Spot the errors!

During the 2nd quarter 20X2, Cowboys-R-Us noted a decrease in sales of its pink cowboy boots due to negative publicity. The book value of the pink boot production plant on June 30, 20X2 was $1 million, and it had a remaining useful life of 6 years. The undiscounted cash flows (including financing charges) for the next 7 years were estimated at $1.1 million (present value = $750,000). Therefore, Cowboys-R-Us recorded an impairment charge of $250,000 on June 30, 20X2. However, during the holiday season, pink cowboy boots were selling like “hotcakes” after a prominent product placement on a hit TV show. Therefore, Cowboys-R-Us reversed the impairment charge during the 4th quarter 20X2.

What are the inconsistencies with U.S. GAAP requirements for impairment testing? Type your responses in the Question pane!

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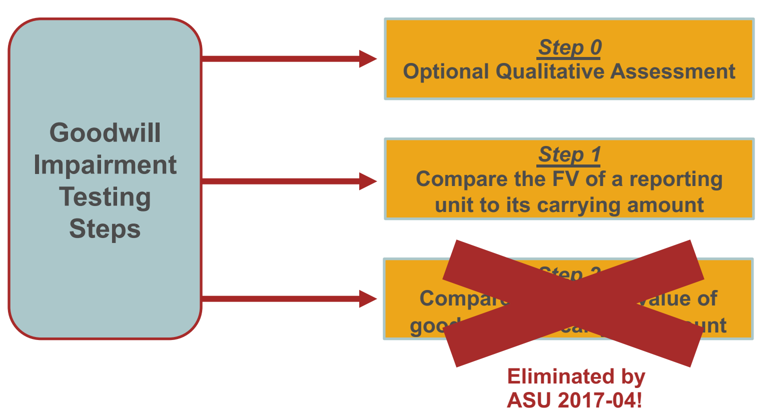
Overview of goodwill impairment testing

The annual goodwill impairment test *can* consist of three steps:



CLASS DISCUSSION

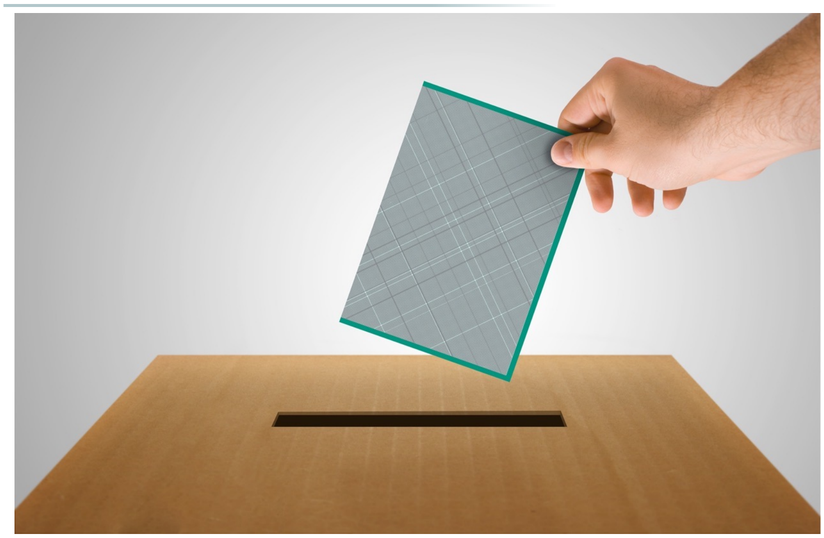
Goodwill impairment testing

Maverick has adopted ASU 2017-04 and is testing its three reporting units for impairment at year end. Little Freak determines it is more likely than not that the fair value of reporting units A and B is less than their carrying amount but notes on a consolidated basis they are fine.

	RU A	RU B	RU C	Consolidated
Fair value of reporting unit	1,000	500	3,000	4,500
Carrying value of reporting unit	1,500	600	1,000	2,900
Goodwill in reporting unit	200	300	400	900

How much goodwill impairment should be recorded at year end?

Polling question #3



Solution: Goodwill impairment testing

Total goodwill impairment is 300 at year end.

	RU A	RU B	RU C	Consolidated
Fair value of reporting unit	1,000	500	3,000	4,500
Carrying value of reporting unit	1,500	600	1,000	2,900
Goodwill in reporting unit	200	300	400	900
Overage / (deficit)	(500)	(100)	2,000	1,400
Amount of goodwill impairment	200	100	-	300
Remaining goodwill	-	200	400	600

ASU 2017-04: Effective Dates and Transition

Public business entities (PBEs) that are SEC filers (excluding SRCs)

Effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years.

All other entities

Effective for fiscal years beginning after December 15, 2022, and interim periods within those fiscal years.

Transition

Applied on a prospective basis with early adoption permitted.

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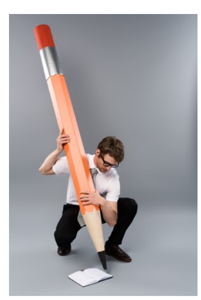
SEC comment letters: Overview

Between SEC staff and registrants

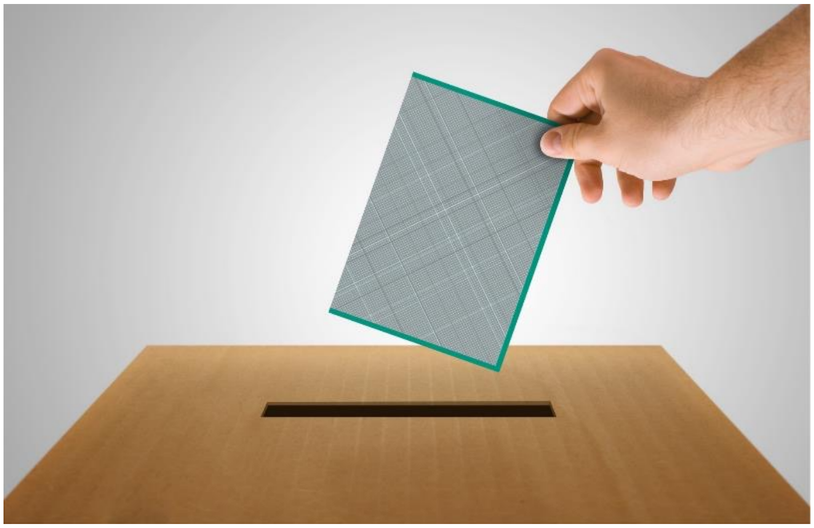
- Letters between SEC staff and SEC registrants
- Staff from the Divisions of Corporation Finance and Investment Management issue this type of comment letter in connection with their review of disclosure filings
- Just because a registrant receives a comment letter, it does not mean they were in the wrong!

Rulemaking

- Letters that individuals, firms, and companies submit in response to requests for public comment on SEC rule proposals or concept releases



Polling question #4



SEC comment letters: Frequent areas

2022 Ranking*	Comment letter topic
1	Non-GAAP financial measures
2	Management's discussion and analysis (MD&A)
3	Segment reporting
4	Risk factors – climate change matters
5	Revenue recognition
6	Fair value measurement
7	Disclosure controls and ICFR
8	Inventory and cost of sales
9	Form compliance and exhibits
10	Business combinations

** Source: PwC's comment letter trends as of June 30, 2022*

Impairment-related SEC comment within MD&A

Please provide information for investors to assess the probability of future goodwill impairment charges. For example, please disclose whether your reporting unit is at risk of failing step one of the quantitative impairment test or that the fair value of this reporting unit is substantially in excess of carrying value and is not at risk of failing step one. If the reporting unit is at risk of failing step one, you should disclose:

- the percentage by which fair value exceeded carrying value at the date of the most recent step one test;
- the amount of goodwill allocated to the reporting unit;
- a detailed description of the methods and key assumptions used and how the key assumptions were determined;
- a discussion of the degree of uncertainty associated with the assumptions; and
- a description of potential events and/or changes in circumstances that could reasonably be expected to negatively affect the key assumptions

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Can you give me example of impairment-related issues noted in SEC comment letters?

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Example disclosures – Cardinal Health (FYE: 6/30/22)

Total goodwill impairment charges of $2.1 billion!

4. Goodwill and Other Intangible Assets

Goodwill

The following table summarizes the changes in the carrying amount of goodwill by segment and in total:

(in millions)	Pharmaceutical (1)	Medical (2)	Total
Balance at June 30, 2020	$ 2,657	$ 5,700	$ 8,357
Goodwill acquired, net of purchase price adjustments	2	—	2
Foreign currency translation adjustments and other	—	18	18
Cordis goodwill reclassified to assets held for sale	—	(388)	(388)
Balance at June 30, 2021	2,659	5,330	7,989
Goodwill acquired, net of purchase price adjustments	14	—	14
Foreign currency translation adjustments and other	—	(64)	(64)
Goodwill impairment	—	(2,084)	(2,084)
Balance at June 30, 2022	**$ 2,673**	**$ 3,182**	**$ 5,855**

(1) At June 30, 2022 and 2021, the Pharmaceutical segment accumulated goodwill impairment loss was $829 million.

(2) At June 30, 2022 and 2021, the Medical segment accumulated goodwill impairment loss was $3.5 billion and $1.4 billion, respectively.

During fiscal 2022, the Medical Unit experienced adverse financial results related to inflationary impacts and the adverse impact of global supply chain constraints and lower volumes from PPE. Due to the risks and uncertainties related to these impacts and an increase in the risk-free interest rate used in the discount rate, we elected to bypass the qualitative assessment and perform quantitative goodwill impairment testing for the Medical Unit at June 30, 2022. This quantitative testing resulted in the carrying amount of the Medical Unit exceeding the fair value, resulting in a pre-tax impairment charge of $303 million and cumulative pre-tax impairment charges of $2.1 billion recognized during fiscal 2022, due to the impairment charges recognized during the third and second quarters of fiscal 2022 as described further below. This impairment charge was driven by an increase in the discount rate primarily due to an increase in the risk-free interest rate. Our determination of the estimated fair value of the Medical Unit is based on a combination of the income-based approach and the market-based approach. For this testing performed at June 30, 2022, we used a discount rate of 10 percent and a terminal growth rate of 2 percent. The goodwill balance of the Medical Unit, after recognizing the impairment, was $1.9 billion at June 30, 2022.

During the third and second quarters of fiscal 2022, we performed interim goodwill impairment testing for the Medical Unit at March 31, 2022 and December 31, 2021, which resulted in pre-tax impairment charges of $1.3 billion and $474 million, which were recognized during the second and third quarters of fiscal 2022, respectively, and are included in impairments and (gain)/loss on disposal of assets in our consolidated statements of earnings/(loss). Our determination of the estimated fair value of the Medical Unit is based on a combination of the income-based approach (using a terminal growth rate of 2 percent), and the market-based approach. For the income-based approach, we also used discount rates of 9 percent and 9.5 percent for the interim testing during the second and third quarters of fiscal 2022, respectively. The increase in the discount rate was primarily due to an increase in the risk-free interest rate. Our fair value estimates utilize significant unobservable inputs and thus represent Level 3 fair value measurements.

In connection with the divestiture of the Cordis business, during fiscal 2021 we allocated and reclassified $388 million of goodwill from the Medical Unit (within our Medical Segment) to the Cordis disposal group based on the estimated relative fair values of the business to be disposed of and the portion of the reporting unit that was retained.

Other Intangible Assets

The following tables summarize other intangible assets by class at June 30:

	2022			
(in millions)	Gross Intangible	Accumulated Amortization	Net Intangible	Weighted-Average Remaining Amortization Period (Years)
Indefinite-life intangibles:				
Trademarks and patents	$ 11	$ —	$ 11	N/A
Total indefinite-life intangibles	11	—	11	N/A
Definite-life intangibles:				
Customer relationships	3,272	2,165	1,107	10
Trademarks, trade names and patents	552	360	192	8
Developed technology and other	1,038	574	464	9
Total definite-life intangibles	4,862	3,099	1,763	9
Total other intangible assets	**$ 4,873**	**$ 3,099**	**$ 1,774**	**N/A**

	2021		
(in millions)	Gross Intangible	Accumulated Amortization	Net Intangible
Indefinite-life intangibles:			
Trademarks and patents	$ 12	$ —	$ 12
Total indefinite-life intangibles	12	—	12
Definite-life intangibles:			
Customer relationships	3,330	1,989	1,341
Trademarks, trade names and patents	551	328	223
Developed technology and other	1,035	506	529
Total definite-life intangibles	4,916	2,823	2,093
Total other intangible assets	**$ 4,928**	**$ 2,823**	**$ 2,105**

Total amortization of intangible assets was $311 million, $428 million and $512 million for fiscal 2022, 2021 and 2020, respectively. The estimated annual amortization for intangible assets for fiscal 2023 through 2027 is as follows: $283 million, $260 million, $235 million, $208 million and $175 million.

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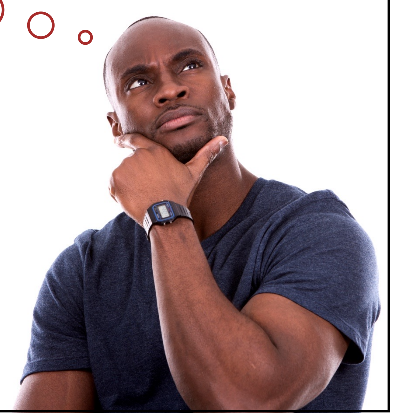
What are some examples of
non-GAAP financial measures
noting impairment?



Example non-GAAP: Teladoc Health

PURCHASE, NY, July 27, 2022 (GLOBE NEWSWIRE) -- Teladoc Health, Inc. (NYSE: TDOC), the global leader in whole-person virtual care, today reported financial results for the second quarter ended June 30, 2022.

"Teladoc Health delivered solid second quarter results with significant progress against our whole person care strategy, including growing momentum in Primary360", said Jason Gorevic, chief executive officer of Teladoc Health.

"While we continue to see increased uncertainty in the macroeconomic backdrop, we remain confident in our ability to execute against our strategy to deliver a unified care experience that we believe only Teladoc Health has the breadth and scale to achieve."

Key Financial Data
($ thousands, unaudited)

	Quarter Ended June 30,		Year over Year Change	Six Months Ended June 30,		Year over Year Change
	2022	**2021**		**2022**	**2021**	
Revenue	$ 592,379	$ 503,139	18 %	$ 1,157,729	$ 956,814	21 %
Net Loss	$ (3,101,461)	$ (133,819)	N/M	$ (9,775,984)	$ (333,468)	N/M
Net Loss per share, basic and diluted	$ (19.22)	$ (0.86)	N/M	$ (60.72)	$ (2.16)	N/M
Adjusted EBITDA*	$ 46,711	$ 66,784	(30) %	$ 101,208	$ 123,388	(18) %

** A reconciliation of each non-GAAP measure to the most comparable measure under GAAP has been provided in this press release in the accompanying tables. An explanation of these Non-GAAP measures is also included below under the heading "Non-GAAP Financial Measures."*
nm – Not meaningful

Example non-GAAP: Teladoc Health (continued)

Reconciliation of GAAP Net Loss to EBITDA and Adjusted EBITDA
(In thousands, except for outlook data, unaudited)

	Quarter Ended June 30,		Six Months Ended June 30,		Outlook in millions (1) Third Quarter	Outlook in millions (1) Full Year
	2022	**2021**	**2022**	**2021**	**2022**	**2022**
Net loss	$ (3,101,461)	$ (133,819)	$ (9,775,984)	$ (333,468)	$ (138) - ($96)	$ (9,967) - ($9,866)
Adjustments:						
Goodwill impairment	3,030,000	0	9,630,000			
Loss on extinguishment of debt	(0)	31,419	(0)	42,878		
Other expense (income), net	1,760	(217)	1,036	(5,869)		
Interest expense, net	4,337	20,473	9,817	42,598		
Provision for income taxes	(1,188)	3,196	(800)	90,235		
Depreciation and amortization	59,371	51,341	118,304	100,000		
Total Adjustments	3,094,280	106,212	9,758,357	269,842	92 - 67	9,926 - 9,874
EBITDA	**(7,181)**	**(27,607)**	**(17,627)**	**(63,626)**	**(46) - (29)**	**(41) - 8**
Adjustments:						
Stock-based compensation	51,000	82,970	111,436	169,270		
Acquisition, integration, and transformation costs	2,892	11,421	7,399	17,744		
Total Adjustments	53,892	94,391	118,835	187,014	81 - 74	281 - 257
Adjusted EBITDA	**$ 46,711**	**$ 66,784**	**$ 101,208**	**$ 123,388**	**$ 35 - $45**	**$ 240 - $265**

(1) We have not provided a full line-item reconciliation for net loss to EBITDA or adjusted EBITDA outlook because we do not provide outlook on the individual reconciling items between net loss, EBITDA, and adjusted EBITDA. This is due to the uncertainty as to timing, and the potential variability, of the individual reconciling items such as goodwill impairment, stock-based compensation and the related tax impact, provision for income taxes and acquisition, integration, and transformation costs, the effect of which may be significant. Accordingly, a full line-item reconciliation of the GAAP measure to the corresponding non-GAAP financial measure outlook is not available without unreasonable effort.

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Questions?

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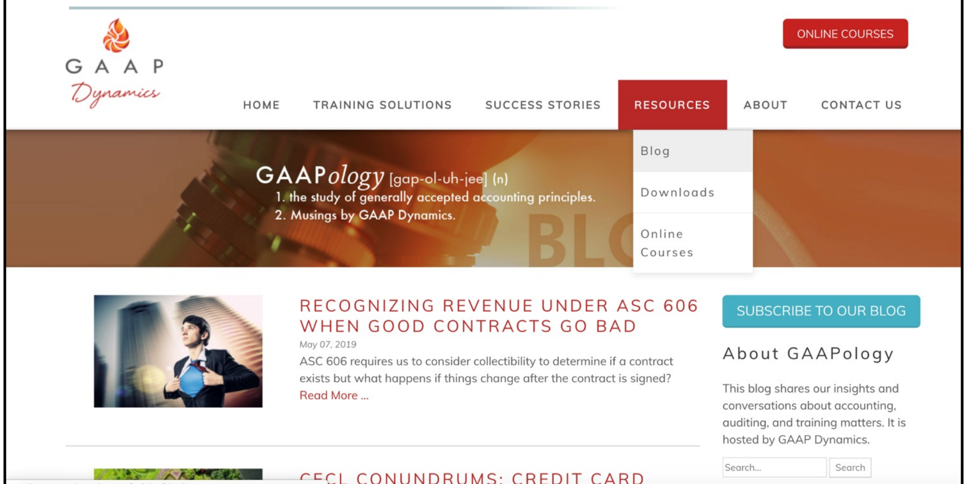

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