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Impairment Considerations for the Energy Sector

AUDIT, ENERGY & RESOURCES
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As witnessed, the latter months of 2018 saw a dramatic downturn in oil prices. According to the U.S. Energy Information Administration, the West Texas Intermediate spot price, for instance, fell from \$75 per barrel at the beginning of October to \$46 per barrel by year's end. With the sharp decrease, regulators are likely to heighten focus on impairment testing for goodwill and on long-lived assets of energy-centric companies.

Under Accounting Standards Codification Topic 360, Property, Plant, and Equipment (ASC 360), impairment is the condition that exists when the carrying amount of a long-lived asset or asset group exceeds its fair value. For the oil and gas industry, assets should be evaluated on a field-by-field basis or other logical grouping of assets.

For long-lived assets to be held and used, companies should consider whether indicators of impairment are present inclusive of triggering events. The impairment evaluation should be performed on both proved and unproved properties at least annually, or when a triggering event is identified. Triggering events within the energy industry include changes in pricing; drilling costs significantly exceeding expectations; large increases in depreciation, depletion and amortization rates; production difficulties; and impending lease expirations.

The following two-step approach can be used to identify, recognize and measure the impairment under ASC 360-10 "Impairment of Disposal of Long-Lived Assets":

An initial check for impairment can be completed by comparing the estimated undiscounted cash flows attributable to the asset or asset group to the carrying amount of the asset or asset group. If the undiscounted cash flows attributable to the asset are less than the carrying amount of the asset, impairment exists.

The fair value of the long-lived asset and impairment loss should then be determined. Impairment loss should be measured as the amount by which the carrying amount of a long-lived asset or asset group exceeds fair value or discounted cash flow value.

In 2017, the Financial Accounting Standards Board released Accounting Standards Update (ASU) 2017-04 in an effort to simplify the process of testing goodwill for impairments. ASU 2017-04 eliminates the second step from the goodwill impairment test mentioned above, including reporting units with zero or negative carrying amounts. An impairment charge should be recognized for the amount by which the carrying amount exceeds the fair value; however, the loss should not exceed the total amount of goodwill allocated to the reporting unit.

ASU 2017-04 is effective for years beginning after December 15, 2019 for public SEC filing entities and for years beginning after December 15, 2020 for non-filing public entities. Nonpublic entities will be subject to

ASU 2017-04 for years beginning after December 15, 2021. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017.

As companies finalize 2018 asset balances, the pricing changes and impairment considerations mentioned above should be reviewed due to increased focus on impairment testing from regulators and auditors. If you have questions or concerns about impairment or impairment consideration related to the energy and natural resources industry, we welcome the opportunity to discuss your concerns and become a trusted advisor. Please visit our Energy and Resources Companies page.

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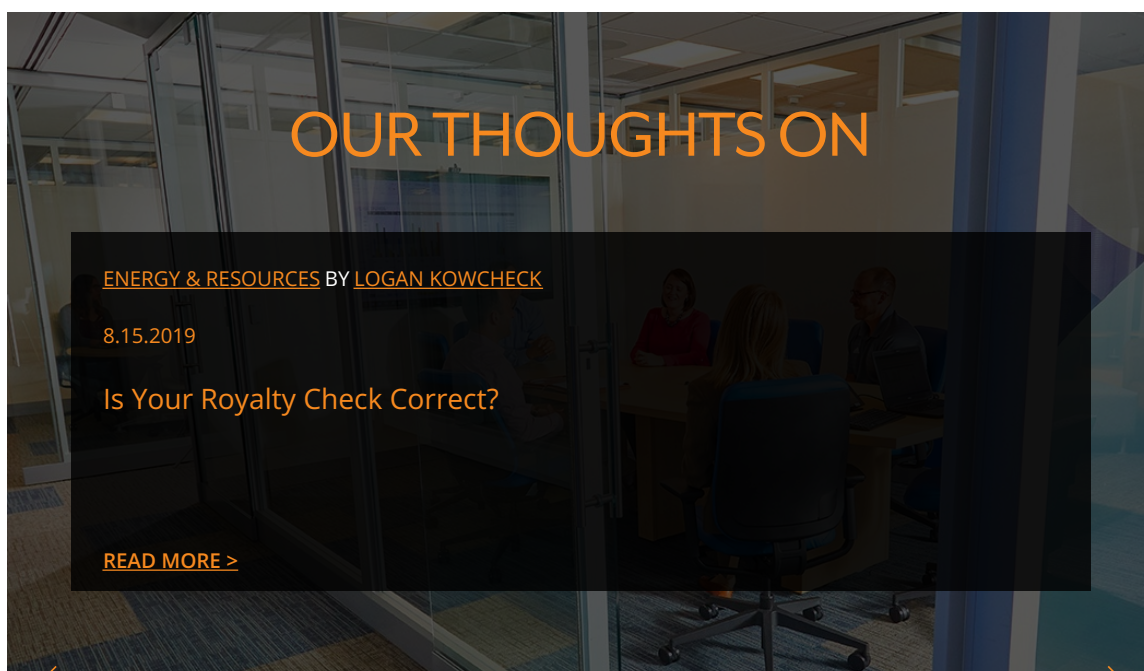


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