11-2014

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Julie Persellin
Trinity University

Mike Shaub

Michael S. Wilkins
Trinity University, mike.wilkins@trinity.edu

ISSUES IN ACCOUNTING EDUCATION
Vol. 29, No. 4
2014
pp. 577–586

American Accounting Association
DOI: 10.2308/iace-50890

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Julie S. Persellin, Michael K. Shaub, and Michael S. Wilkins

ABSTRACT: This case requires students to apply accounting and ethical decision making within the context of a potential land impairment decision. Students are required to research the relevant professional literature and provide appropriate FASB codification references and IAS cites as they investigate the significant uncertainties that frequently are associated with valuation and impairment analyses. Students also are required to evaluate the ethical implications of the decisions that could be made regarding the necessity of impairment. The case provides an opportunity for students to extend their research and financial accounting abilities, to consider the consequences associated with a set of potentially reasonable accounting alternatives, and to begin to appreciate how the significant uncertainties that are present in many accounting and auditing situations require consistent technical and ethical decision making. The case could be used in Intermediate Accounting I, as well as in undergraduate and graduate Auditing or Ethics classes.

Keywords: long-lived assets; impairment; fair value measurement; IFRS; ethics.

INTRODUCTION

You are a green-as-grass staff auditor for FBG LLP, a small CPA firm in San Antonio, TX. Your biggest client is CG Corporation, a publicly traded, regional land development company. One of CG's prime holdings is a sizable tract in the northeast part of town, where most of the city's growth has occurred during the past decade. As 2013 draws to a close, CG's CEO, Mark Kedman, is in negotiations with a group of buyers who are interested in establishing an upscale retirement community in the area. The buyers have obtained approval from the relevant authorities to build 250 homes, a golf course, and an activity center. The land is carried on CG's books at $50 million, but CG believes that it will be able to sell the land to the development group for $80 million. At that value, this particular piece of property comprises roughly 10 percent of CG's overall land holdings.

While working on the 2013 year-end audit in early January of 2014, you hear a couple of people at CG having a water cooler conversation about spiders. When you mention that you hate spiders, the following conversation ensues:

Julie S. Persellin is an Assistant Professor at Trinity University, Michael K. Shaub is a Professor at Texas A&M University, and Michael S. Wilkins is a Professor at Trinity University.

The authors thank Chris Hogan, Bill Miller, and participants at the 2013 AAA 18th Annual Ethics Symposium for helpful comments and suggestions.

Published Online: August 2014

Employee: I bet you don't hate them as much as Kedman does.
You: Why? Is Kedman allergic to spiders or something?
Employee: I guess you could say that . . . [laughing]
You: I don't get it.
Employee: A couple of surveyors were poking around on the northeast San Antonio site last week and found spiders on the property.
You: And?
Employee: Fish and Wildlife says they've not seen this particular species in 50 years.
You: So?
Employee: Do you not read the paper? San Antonio has a long history of being held hostage by rare spiders.
You: I see . . .

Intrigued, you return to your cubicle, put on your headphones to drown out the fluorescent bulb that is buzzing and flickering over your head, and run a quick Internet search for "San Antonio rare spiders." The first few articles that pop up are from San Antonio's major newspaper, the *Express-News*. One piece from October 2, 2012 describes a $15.1 million highway underpass project that was put on hold "indefinitely" when a Bracken Bat Cave meshweaver spider (yes, singular) was found in the excavation area. Another from February 25, 2013 notes that with only 1,500 feet to go, a six-mile, $11 million water pipeline project had to be halted because the same type of spider was found in a recently exposed underground cave. The second article also states that even if the construction companies are granted approval from federal authorities to find solutions and build in areas such as these, securing a permit can take up to two years. Who would have thought that a spider could wreak such havoc?

After reading the articles carefully and thinking about things a bit, you approach the senior on the engagement and ask him what he thinks. As it turns out, the senior has already heard about the spider issue. Kedman called the lead partner that morning and told her that the retirement community deal was off. When Kedman told the potential buyers about the spiders, they told him that they would re-evaluate things over the weekend and get back with him. On Monday's conference call, the buyers told Kedman that their valuation team had reduced their appraisal of the property to $10 million, based on its potential as an eco-friendly hill country golf club. The buyers are convinced that they can work around the spider issue by minimizing excavation and strategically placing greens and fairways on the golf course such that the "spider areas" would remain unmolested. Kedman declined, indicating that he would just "wait for the right buyer."

When the senior finishes his story, you have the following conversation:

You: So do you think the land is still worth $80 million? Or even $50 million?
Senior: Right now? Probably not. Why?
You: Well, don't you think we should consider recommending impairment?
Senior: Impairment? On land?
You: Does FAS 144 not apply to land?
Senior: Very funny. Look, nobody impairs land. Land has an infinite life.
You: I realize that, but these guys just had a $10 million offer on property they were on the verge of selling for $80 million because the buyers know that you can't really build on it. I mean, you can't dig. Period. If you can't dig, you can't build houses. If you can't build houses, you can't sell houses. And if you can't sell houses and charge outrageous community fees and all that, the potential revenue stream is seriously compromised. That's why the new appraisal is so much lower. Basically, CG is now holding a big chunk of land that has to be converted into a nature preserve or maybe—just maybe—a golf course. I think this probably is the best offer they're going to get.

Senior: Relax, will you? You can't build houses on the land *right now*. At some point those spiders will be gone and everything will be fine. Impairing land . . . wow . . . [walks away]

Being annoyed rather than satisfied, you head back to your cube, open a spreadsheet, and look at some numbers. What you find is both interesting and discouraging. First, *if* the land really is impaired and *if* it is really only worth $10 million, CG obviously is looking at a pre-tax impairment loss of $40 million. That would turn their preliminary earnings estimate of $7 million into a big red number. Collateral damage here would include the employee bonus plan, which covers all nonsalaried workers. It has been a while since the employees have gotten much in the way of bonuses and they are hoping for a good year. Second, if that loss is booked, CG's debt-to-total-equity ratio spikes and one of their loan covenants is triggered. Before the housing market collapse that started in 2007–2008 this would not have been that big of a deal, but the past few years have been rough and CG's lenders have expressed serious concerns about both earnings and cash flows. Armed with these data, you meekly approach the senior and present your findings. His response?

> Well, that's even more evidence that you should leave this alone, now isn't it? Like I said before, nobody impairs land. Besides, that particular investor group is just one vote where valuation is concerned. I heard that an independent appraiser valued the land at $60 million and the client believes they should at least be able to recover the carrying value. Their analysis suggests that no impairment has occurred. I know that you are fresh out of school and are wearing your conquer-the-world hat and all, but seriously . . . this is real life. Think of all the people who are affected here. If the spider problem goes away and they can unload the land for closer to $50 million, everybody wins. With your doomsday scenario, everybody loses.

Having finished enlightening you, the senior dismisses you from his presence. As you head back down the hall, you admit to yourself that the senior may be right about the relative infrequency of land impairment. You also know that the accounting treatment of this situation affects a lot of people. With various ideas buzzing around in your head—impairments, land, virtues, consequences, stakeholders, ethical decision making—you briefly ponder a career as a small-town librarian. Welcome to public accounting.

Requirements: Part 1

Many of the requirements below involve use of the FASB codification. You will need to provide the username and password supplied to you by your institution. (If your institution does not have access, enrollment information is available at: http://aaahq.org/FASB/Access.cfm.) Provide codification references for all your responses. A copy of IAS 36 can be found at numerous online sites. Please reference the specific section of the standard you used to formulate your response.

1. Based on U.S. GAAP, what triggering events or changes in circumstances should be evaluated in testing for the recoverability of long-lived assets? Which of these factors are particularly relevant to the circumstances presented in this case? Based on this information, do you believe that an impairment analysis is required (i.e., that an impairment event has occurred)?
2. Are the impairment guidelines different for assets held for sale versus assets held for use? Does the fact that land is involved as opposed to another type of long-lived asset alter the situation? Evaluate your answers using specific guidelines from the standards.
3. As the auditor on this engagement, what concerns (if any) might you have about using the $10,000,000 purchase price offered by the potential buyer as fair value when you determine

whether an impairment loss should be recognized? What alternatives might you have to determine fair value?

NEW DEVELOPMENTS

The next morning the senior approaches you looking a bit sheepish. It seems that the partner on the CG engagement has become increasingly concerned about the cancelled retirement community deal. The uncertainty surrounding the ultimate value of the land has significantly elevated the engagement's risk. In response to this increased risk, the partner believes that additional work should be performed to evaluate the client's assessment that an impairment is not necessary. She suggests that the team obtain a better understanding of the potential issues involved when a species is classified as "endangered" by the U.S. Fish and Wildlife Service (the Service). In addition, the partner recommends that the engagement team hire its own independent valuation expert in order to corroborate the $60,000,000 estimate that was obtained by the client.

After hearing the partner's requests, the audit team immediately begins researching the federal regulations related to endangered species on private land. The information they discover is eye-opening. For example, according to National Center for Policy Report No. 303, any land, private or public, that is a habitat for an endangered species is potentially subject to federal land-use controls. Landowners very rarely receive any compensation for the loss of land value, lost income, or lost use of the land. This reality can have severe consequences for landowners because over 75 percent of the species named on the endangered list have at least some of their habitat on private land.

On a more positive note, the research did uncover that the Service does potentially allow land that is an endangered species habitat to be developed. However, the owner of the land must obtain clearance from the Service. If obtained, additional funds would have to be spent to ensure that the habitat area is properly preserved, which would entail paying biologists, attorneys, and possibly other experts. Therefore, the ultimate value of the land would depend upon the severity of the restrictions the Service placed upon the land's development and the costs incurred to maintain the spider's habitat.

A final determination on the level of restrictions placed on the land's development (and the associated costs involved) will not be made by the Service for quite some time. As such, the audit team decides to take the partner's advice and hire an additional independent valuation expert to appraise the land. The audit team believes that considering this appraisal, along with the one already obtained by the client, will provide them with adequate sufficient competent evidence to make an impairment determination. As mentioned previously, Appraiser One (hired by the client) determined the fair value to be $60,000,000. She is optimistic that the restrictions on the land's use will be fairly minimal given the area in which the habitat was discovered and based on her belief that a majority of the property can still be developed. Appraiser Two (hired by the auditors) believes that the property's future development will be substantially hindered by the spider situation. Therefore, he determines that the fair value of the property is only $35,000,000. After evaluating both appraisals, the auditors feel that there is merit to both estimates. Upon review, and in an effort to be somewhat conservative, the auditors decide that they are 40 percent confident that Appraiser One is correct, and 60 percent confident that Appraiser Two is correct. Expected costs to sell the property are estimated to be approximately $2,500,000 under either scenario.

Requirements: Part 2

Please answer the requirements that follow independent of the conclusions that you reached for Requirements 1, 2, and 3 in Part 1. As noted in Part 1, many of the requirements involve access to the FASB codification. You will need to provide the username and password supplied to you by your institution. Provide codification references for all your responses. A copy of IAS 36 can be found at numerous online sites. Please reference the specific section of the standard you used to formulate your response.

4. What guidance is provided in the authoritative literature regarding how to handle uncertainty related to the fair value of a long-lived asset? Based upon this guidance, and assuming an impairment event has occurred, determine whether an impairment loss should be recognized. Show your calculations.
5. Assume that you are now performing the 2014 year-end audit. The company finally has an offer on the table for the property. The fair value of the property, less cost to sell, is expected to be $53,000,000. The sale is not expected to close until the first quarter of 2015. For the property that is being held for sale, is an adjustment to the impairment loss appropriate at the end of 2014? If yes, provide the amount. Cite specific guidance from the codification.
6. Consider the spider issue in another context. Assume the endangered spider habitat was found in a large manufacturing facility that the company had been using for 18 years, as opposed to on land that was being held for sale. The U.S. Fish and Wildlife Service has given the company permission to continue to use the facility; however, production located in the area around the habitat has ceased, thereby reducing the available working capacity of the facility. In addition, costs are being incurred to protect and maintain the spider habitat (see below).
The relevant cost information is as follows (January 2014):

Initial Cost of Facility:	$100,000,000
Accumulated Depreciation:	$54,000,000
(straight line, 30-yr. life, $10M salvage value)	
Undiscounted Expected Future Net Cash Flows:	$41,000,000
Present Value of Expected Future Net Cash Flows:	$34,000,000
Purchase Offer*	$25,000,000
Costs to Sell	$1,000,000

*Based upon a bid to purchase from a wealthy eccentric spider lover.

Assuming an impairment analysis has been "triggered," determine if an impairment loss should be recognized. Explain your selection of the amount used to approximate the fair value of the asset, providing support from the codification to justify your choice. Show all of your calculations, including the amount of the impairment loss that should be recorded, if necessary.
7. Does U.S. GAAP allow for the reversal of impairments on assets held for use? How does this compare to the treatment for assets held for sale? Explain and cite references.
8. Review the requirements for impairment recognition under International Financial Reporting Standards (IAS 36). How would the answer differ in Requirement 6 if the manufacturing facility were owned by a U.K. company that prepared its financial statements in accordance with IFRS?
9. What impact would changing the undiscounted expected future net cash flows presented in Requirement 6 from $41,000,000 to $47,000,000 have on the impairment calculation under both U.S. GAAP and IFRS? Assume that the present value of these cash flows stays the same. Show amounts and calculations. Explain the potential financial significance of this difference in treatment.
10. Does IAS 36 allow for the reversal of impairment losses on assets held and used? Are there any restrictions? Explain.
11. Suppose you decide to recommend to your senior that the land be impaired, but your senior does not support this recommendation. What should you do? Be specific and fully discuss your process, including issues related to chain of command.

12. Many decisions in accounting and auditing involve considerable uncertainty, require the application of judgment, and have a significant ethical component. In such instances, accountants and auditors must be aware both of their responsibilities as CPAs and of the impact their actions might have on relevant stakeholders. What parties are stakeholders in this case and how (conceptually, not numerically) would the impairment decision impact each of these stakeholders? Which of these stakeholders should be the primary focus of the auditor? Finally, if an impairment analysis is triggered but there are uncertainties regarding valuations and/or materiality, what would the various ethical decision-making theories have to say about what an auditor "should" do?

CASE LEARNING OBJECTIVES AND IMPLEMENTATION GUIDANCE

Overview of Learning Objectives

Many business schools have learning objectives—either explicit or implicit—that are tied to functional-area knowledge, international business, ethical reasoning, and communication skills. Those with master's programs may also emphasize the development of research skills. This case provides an opportunity for universities to evaluate student performance in all of these areas. While learning objective specifics obviously vary according to different university missions, we offer the following to illustrate the objectives we had in mind during the development of this case. We request that any instructors who use this case in their courses contact us, as this information will be useful as we assess the impact our case is having on accounting education.

Objective 1: Students will have a more comprehensive understanding of GAAP as it relates to potential impairment decisions.

Objective 2: Students will learn how potential impairment situations are treated under International Financial Reporting Standards and will be able to document similarities and differences with GAAP treatment.

Objective 3: Students will be able to identify an ethical issue in an auditing setting and to recommend a solution based on sound ethical decision making.

Objective 4: Students will demonstrate strong written communication skills, including clarity of thought, concise presentation, and appropriate structural and grammatical accuracy.[1]

Objective 5: Students will demonstrate research skills via extensive use of the FASB ASC database.

Implementation Guidance

This case is scalable and is suitable for individual or group use in Intermediate Accounting I, as well as in undergraduate and graduate auditing or ethics classes. One of the pilot instructors also used the case productively as an in-class instructional exercise. Depending upon the learning objectives for the target course, specific aspects of this case may be emphasized and/or expanded. For instance, the case materials lend themselves to an in-depth discussion of fair value measurement. The fair value hierarchy established by the FASB can be analyzed through reference to the codification, and alternative measures of fair value can be explored and debated. The PCAOB's current focus on deficiencies related to fair value measurement could be used to lend an additional sense of relevance and timeliness to the case. The appropriateness of asset grouping in an impairment calculation may also be expanded upon, and communication and negotiation between audit team members and between the auditors and the client could be further explored. Feedback obtained from pilot instructors indicates that in-class discussions of the case were productive and extended well beyond the specific case requirements themselves.

Case Pilot in Undergraduate Courses

The first undergraduate pilot occurred in two sections of an Intermediate Accounting I course (69 students) in the fall semester of 2013 at a small private university in the Southwest. Although this university has a liberal arts emphasis, it also has a master's program in accounting. The students involved in this pilot had not yet completed an auditing course, nor had they been formally exposed to the ethical theories that would be required to address some of the requirements that are included

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[1] Although students are not required to draft a formal, comprehensive report, their answers to the various case requirements may be used as a means of evaluating written communication skills.

in the case. Therefore, they were not assigned the requirements related to the auditing or ethical issues. However, the instructor did provide a brief in-class discussion of both the auditing and ethical responsibilities associated with the impairment issue. The case was assigned to students immediately following classroom coverage of long-lived asset impairments. Students approached the case as an independent assignment. They had two weeks to complete the case and it comprised 5 percent of the course grade.

The second undergraduate pilot occurred during the spring semester of 2014 in four sections of an Intermediate Accounting I course (130 students) at a large public university in the Southwest. The students recently had covered long-lived asset impairments and several had initial exposure to ethical issues via a freshman-level course. As with the initial pilot, the case was assigned to individual students and they had two weeks to complete the assignment. For students in this pilot, the case comprised 4 percent of the course grade.

Case Pilot in Graduate Courses

The case initially was piloted in three sections of a graduate auditing course (89 students) in the fall semester of 2013 at a large public university in the Midwest. Fair value estimates and long-lived asset impairments had been discussed in the two class sessions prior to the discussion of the case. In terms of protocol, students approached the case as an in-class instructional exercise. Prior to class, students read the case, as well as the previously mentioned news article from October of 2012, which provides background information on San Antonio's spider problem. Each case requirement was discussed during class, with students providing their suggested solutions. In addition, the instructor had online access to the FASB codification in order to walk students through the research process, when applicable. Because of the nature of the exercise, students were not given credit for their participation in the case.

The case was subsequently piloted in a graduate accounting theory course in the spring semester of 2014 at a small private university in the Southwest. Students in this course had taken a graduate ethics course and a graduate international financial accounting course in the previous semester. There were 20 students in the class, and the case was completed individually with no intervention by the instructor. Students had two weeks to complete the case and it comprised roughly 12 percent of their course grade.

Classroom Validation

All students were asked to anonymously complete a debriefing questionnaire that was included as an attachment to the case.[2] Table 1 provides a summary of the students' assessments for various facets of the case. For ease of exposition, we discuss only the overall assessments in the narrative. Note that Table 1 separately reports the students' assessments for the four courses in which the pilot was administered. Collectively, the case was administered to 308 students and 270 completed the questionnaire (88 percent). A five-point Likert scale was used with 1 = Strongly Agree, 2 = Agree, 3 = Neutral, 4 = Disagree, and 5 = Strongly Disagree.

Students reported the case to be an enjoyable read, with a weighted-average mean (WAM) across the four pilots of 2.08. Students also indicated that the case required the use of critical thinking skills (WAM = 1.56), and that they did not find the case to be too difficult (WAM = 3.23). In addition, students felt that the case increased their knowledge of how to use the FASB codification to research an accounting issue (WAM = 1.66), as well as how to account for the impairment of a long-lived asset under both U.S. GAAP (WAM = 1.67) and IFRS (WAM = 1.90).

[2] We chose to request the feedback anonymously to increase the likelihood of candid responses.

TABLE 1

Results of Debriefing Questionnaire

	Undergraduate		Graduate		p-values for Significance Tests		
	[1] Small Private (n = 55)	[2] Large Public (n = 110)	[3] Small Private (n = 16)	[4] Large Public (n = 89)	[1, 2] versus [3, 4]	[1] versus [2]	[3] versus [4]
I enjoyed reading the case.	1.78 (0.57)	2.51 (0.82)	2.50 (1.10)	1.86 (0.65)	0.002	0.000	0.038
The case required me to use critical thinking skills.	1.64 (0.65)	1.47 (0.59)	2.19 (0.91)	1.66 (0.72)	0.011	0.105	0.012
The case was too difficult.	3.16 (0.97)	3.39 (0.79)	3.69 (0.79)	3.30 (0.92)	0.671	0.110	0.121
The case increased my knowledge of how to use the FASB codification to research an accounting issue.	1.76 (0.69)	1.56 (0.60)	2.00 (0.63)	1.83 (0.68)	0.004	0.047	0.358
The case increased my knowledge of how to account for an impairment of a long-lived asset under U.S. GAAP.	1.64 (0.73)	1.89 (0.67)	1.75 (0.58)	1.55 (0.64)	0.008	0.032	0.247
The case increased my knowledge of how to account for an impairment of a long-lived asset under IFRS.	1.73 (0.68)	2.13 (0.83)	1.88 (0.62)	1.91 (0.70)	0.347	0.002	0.852
The case increased my awareness of the importance of ethical decision making in an accounting/auditing context.	2.04 (0.82)	1.95 (0.71)	2.38 (0.89)	1.98 (0.67)	0.499	0.464	0.104
I would recommend this case as a learning tool for future classes.	1.84 (0.79)	2.15 (0.71)	2.00 (1.07)	1.76 (0.67)	0.010	0.012	0.257

Scale: 1 = Strongly Agree, 2 = Agree, 3 = Neutral, 4 = Disagree, 5 = Strongly Disagree.

Furthermore, students expressed that the case increased their awareness of the importance of ethical decision making in an accounting/auditing context (WAM = 1.94), and also indicated that they would recommend this case as a learning tool for future classes (WAM = 1.89). The weighted-average mean time reported to complete the case was 4.19 hours.

Table 1 also highlights a number of interesting differences across the four pilots. For example, undergraduates found that the case increased their ability to use the codification more than graduate students did, presumably because graduate students had more previous exposure to the database. Another (marginally) significant difference involves ethical decision making. Graduate students at the large public university found that the case increased their understanding of the importance of ethical issues to a greater extent than graduate students at the small private university. The reason for this difference likely is because the graduate students at the private university had recently completed a graduate course in ethics, while their public university peers are not required by their State Board of Accountancy to take a graduate course in ethics.[3]

Relative to undergraduates at the private university, undergraduate students at the large public university found that the case was more useful in increasing their ability to use the codification but less useful in increasing their knowledge of GAAP and IFRS. However, the use of critical thinking skills was viewed as more extensive by undergraduates and graduate students at the large public universities than by their private-school counterparts. These differences could be random, of course, but they also suggest that the private-university experience may provide more opportunities for students to engage in research and critical thinking, while public universities emphasize the development of strong technical skills. Overall, Table 1 suggests that the case may be used productively for a broad range of both undergraduate and master's-level students.

TEACHING NOTES AND STUDENT VERSION OF THE CASE

Teaching Notes and the Student Version of the Case are available only to non-student-member subscribers to *Issues in Accounting Education* through the American Accounting Association's electronic publications system at http://aaapubs.org/. Non-student-member subscribers should use their usernames and passwords for entry into the system where the Teaching Notes can be reviewed and printed. The "Student Version of the Case" is available as a supplemental file that is posted with the Teaching Notes. Please do not make the Teaching Notes available to students or post them on websites.

If you are a non-student-member of AAA with a subscription to *Issues in Accounting Education* and have any trouble accessing this material, please contact the AAA headquarters office at info@aaahq.org or (941) 921-7747.

[3] Ethical issues are discussed within the graduate auditing course at this university, but a separate course is not required.