

Impairment Review Best Practices

By R David Conover, Rob Herb and Christopher Nugent
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Note: For more on this topic, read the article "Portfolio Impairment Review: What Are Best Practices" in the November/December 2019 issue of Equipment Leasing & Finance Magazine at <http://bit.ly/37EiCgX>.

The impairment review process is one of the most common questions of new and experienced equipment managers, below are best practices to consider when creating or revising a policy and procedure in your organization.

Separation of policy versus procedures- policy should be brief, procedures dive into the "how." The goal is to have the Policy be a fairly static document, which may fall under your risk policy. Procedures can be updated without a governing body needing to approve.

	Policy	Procedures
General	General policy statement/overview.	Reference policy to create linkage.
Timing	Frequency: Define annually, bi-annual, quarterly, etc.	Calendar of Pulling data Testing Review with auditors Journal entries
Testing	<p>Selection criteria- varies by lessor. Examples:</p> <ul style="list-style-type: none"> • X% of portfolio • All RV > \$x • Review by programs/channels • Concentrations of models, industries, etc. • Increased scrutiny of newer asset classes or programs with no EOT experience. • Goal is to ensure a high probability of detection. <p>Threshold for internal or external review.</p> <p>Clear guidelines for which results trigger an impairment, e.g.- anticipated RV realization < Planned realization. There should not be any subjectivity into where the impairment should or should not be taken.</p>	<ul style="list-style-type: none"> • Method of selection • Method of testing (portfolio, individual transactions, etc.) • Program/segment/channel questionnaires • Evaluation required (Qualified Appraisal, On-Site Inspection, Desktop, etc.) • Physical inspection/audit of off-lease inventory- completeness, condition of equipment. • Review of soundness of vendor guarantees/service commitments.

Testers	Specify a specific title or categories (e.g., 'VP, Asset Management' or 'ASA certified appraiser'.) Statement of independence/no conflict of interest.	Specify whether there should be a separation of duties (e.g., not testing a portfolio you initially developed RVs). Criteria for internal and external appraisers with approved appraiser list. Vendor agreement with any approved appraiser. Use external appraisers to check work of internal appraisers or vice versa.
Documentation/ Deliverable	Roll-up documentation.	Specifics of ASA requirements. Who writes/produces what and reviewed by whom?
Governance	Approval process for recommended impairments.	
Definitions		List definitions. Use ASA definitions when applicable.

Deliverables and Reporting

The final work product is what the stakeholders see, review, approve etc. Behind this document will be a substantial amount of work completed by the equipment manager and others including appraisers and other suppliers of data / information that is incorporated into the process. The table below is a list of items to consider that was compiled based on the experience and feedback of experienced equipment managers.

	Document	Critical information
Deliverables	Impairment Review Memorandum	Formal documentation of review
		Include a brief statement of policy, and reference that document.
		Provide a brief description of when population data pulled from portfolio e.g. 1 June 20XX.
		Describe how data sliced, e.g. portfolio contained X# true leases with \$Y residual
		Note that TRAC leases were excluded and how that Split TRACs and third party guaranteed residual values were addressed. Note this may differ by Lessor as not all lease accounting systems capture the guaranteed and unguaranteed residual.
		Note any special considerations made due to how data is captured in the lease accounting system (e.g. asset identification, free form vs. drop down data, etc.) and how addressed via your procedures.
		Note the final true lease population after any exclusions. Some lessors look at exposure over a specific dollar amount e.g. \$250,000. Others exclude leases commenced within the past 12-18 months (range based on discussions with asset managers) as the appraisal to determine the RV is considered "current."
		A brief description of the process of selecting accounts for review, this can come from the policy or procedure.

		<p>A brief discussion of the process.</p> <p>A review of the findings and if additional actions were taken (e.g. an expanded sample was made).</p> <p>A discussion of the Asset Management Leader’s reviews of the analysis if appropriate.</p> <p>A discussion of any impairments found and if permanent or temporary and actions being taken to mitigate, monitor, and or process an adjustment.</p> <p>A list of impaired assets with impairment amounts. Ideally, the impairment is recorded on a transactional level so releases/additional losses can be tied to the termination of specific assets.</p> <p>A signature block for the Asset management Leader and others as required by your policy or procedure.</p>
	Accounting Adjustment Memo (to record the impairment)	A best practice is to leverage a form or other document that already exists and is used to document an accounting adjustment to a lease, this can become and exhibit to the memorandum.
Reporting	Portfolio Reports	Start at a high level with the total, make sure the number ties to standard Equipment management, financial, or management reporting.
		A best practice is to start with reporting that already exists, audience is comfortable with, and that can be used to simplify process.
		A best practice is to walk the stakeholders from the starting point to the population and stratifications or cuts made. A waterfall chart works well as do a series of pie charts. Chose a style that works well within your organization.
		A detail summary of all accounts reviewed, calculate a coverage ratio to quantify the percentage of the portfolio reviewed.
		A good idea is to include a grid or table of account reviewed and coverages if doing at an account level.
		If performing the review using realization rates then use a table or graph noting realization (point in time, rolling 5 quarters, or other metric that is used in your organization)
	Summary Report	<p>A best practice is to create a summary report or table that can be incorporated as an appendix to the documentation to further illustrate the and communicate the health or the portfolio and depth of diligence performed.</p> <p>Some lessors prefer tables with accounts, brief equipment descriptions, maturity date, residual, assessed FMV, and level of coverage (may be referred to as “expected margin”, but may be referred to as a cushion, buffer, etc.)</p>