**Depreciation at Delta Air Lines: The "Fresh Start"**

Plant, property and equipment is one of the largest asset categories for airline companies. Flight equipment and ground property and equipment are often more than half of the total assets of an airline, and depreciation of those assets is a major operating expense. Depreciation is an exercise in cost allocation undertaken to match the cost of assets with the revenues earned during the periods that assets are used. Depreciation is not an attempt to measure the current value of assets. The amount of depreciation estimated by an airline company for each operating period is based on the cost of assets, estimates of asset lives, and assumptions about residual values at the end of the asset lives. These estimates and assumptions have changed through the years for almost all airlines. Delta Air Lines is no exception.

Delta Air Lines ﬁled for reorganization under Chapter 11 of the U.S. Bankruptcy Code in September 2005 and emerged from bankruptcy as a new company one year ahead of schedule on April 30, 2007. (Bankruptcy is a process providing protection of the court during a period when a company tries to restructure itself and its operations to return to viability.) Upon emergence from bankruptcy Delta adopted “fresh start" accounting in accordance with American Institute of Certified Public Accountants’ Statement of Position 90-7, "Financial Reporting by Entities in Reorganization under the Bankruptcy Code" (SOP 90-7).

Fresh start accounting requires resetting the historic net book value of assets and liabilities to fair value and becoming a new entity for ﬁnancial reporting purposes. Delta's consolidated ﬁnancial statements after May 1, 2007, are not comparable to consolidated financial statements before that date. On May 1, 2007, Delta adopted policies regarding estimated lives and residual values for aircraft, but it was far from the ﬁrst time it had changed its estimates. Depreciation practices had been changed several times before as ﬂight equipment and industry conditions changed. Delta Air Lines began 2008 with more worldwide destinations than any other airline, with 321 destinations in 58 countries. Delta added more international capacity during 2(I]6 and 2007 than any other major U.S. In 2008 Delta merged with Northwest Airlines to become the largest airline in the world.

**Depreciation at Delta Air Lines**

A signiﬁcant number of factors can be considered in estimating the economic life of a commercial aircraft —physical or economic life, corporate strategy, planned uses, expected technological changes all come to mind. Delta Air Lines has changed assumptions of economic life of aircraft four times since 1986, each time extending the expected life by five years. Intense competition and deregulation during this period invite consideration of regular extension of aircraft lives. This is at least partly motivated by the desire to reduce annual depreciation amounts in order to report higher net income or reduce losses, but there may have been other factors that make extended lives make sense in the industry.

Consider the issue of physical life of the modern jet-powered aircraft. The ﬁrst commercial jet passenger planes were sold in 1957. Before that year the majority of commercial aircraft were powered by piston engines, which subjected airframes to destructive vibrations. Ten-year lives were the norm in airline depreciation policies and had been for some time. With no real experience with turbofan-powered planes, management was reasonable in assuming that the new generation of aircraft would be similar in life span to the old generation. Experience showed that the turbofan engines offered considerably less wear and tear on the airframes and that the physical life of aircraft powered by jet engines was considerably longer than that of piston-engine powered planes.

Furthermore, as the passenger airline industry converted fleets to jet-powered aircraft, the replacement cycle lengthened because of production and delivery backlogs. From a competitive strategy point of view, it was important for an airline to offer jet planes, but whether those planes were new or considerably older became less important. Size of planes and economy of operation became more important factors in fleet selection as experience with new aircraft showed that their physical lives were going to be longer than those of prior generations of airplanes. Passengers sought out jet planes whether they were new or older models.

Other changes were also taking place in the airline industry. Deregulation brought competitive pricing and the introduction of “hub and spoke" route systems. Discount airlines emerged to challenge legacy carriers. All airlines experienced more pressure on profitability, and longer depreciable lives meant lower depreciation and the possibility of higher incomes. All airlines extended lives of aircraft. Delta Air Lines was more conservative than some in extending lives but more aggressive than others.

**Exhibit 1** summarizes the depreciable life estimates and policies used by Delta Air Lines for flight equipment from before 1986 to 2008. The extension of estimated lives was typical of other airline companies during these periods as experience was gained with modern jet aircraft technologies. Other airlines used longer estimated lives than Delta—as long ago as 30 years earlier—as pressures to report profits caused them to report less depreciation than in the early years of jet powered flight. All major U. S. airlines use straight-line depreciation.

**Exhibit 2** summarizes the active ﬂeet of Delta Air Lines’ ﬂight equipment at December 31, 2007. Aircraft owned or leased on capital leases are all subject to depreciation. In addition, at the end of 2007 Delta had 76 aircraft on order for delivery in the 2008 to 2010 period and options on 160 more in the 2009 through 2012 period. The magnitude of these commitments can be appreciated in the summary of jet airplane prices quoted by Boeing shown in **Exhibit 3.**

**The "Fresh Start"**

Delta Air Lines adopted fresh start accounting on April 30, 2(IT7, becoming a new entity for ﬁnancial reporting purposes. Consolidated Financial Statements on or after May 1, 2007, are not comparable to financial statements prior to that date. Management did combine the results of operations for the eight months ended December 31, 2007, of the Successor; the four months ended April 30, 2007, of the Predecessor; and the years ended December 31, 2006, and 2(I}5, of the Predecessor. In their Form 10-K (Form 10-K is an annual report which must be filed with the U. S. Securities and Exchange Commission each year) discussion of these combined financial results, they wrote as follows:

“For purposes of management's discussion and analysis of the results of operations for the year ended December 31, 2007 in this Form 10-K, we combined the results of operations for the four months ended April 30, 2007 of the Predecessor with the eight months ended December 31, 2007 of the Successor. We then compared the combined results of operations for the year ended December 31, 2007 with the corresponding period in the prior year of the Predecessor and discussed significant fresh start reporting adjustments ("Fresh Start Adjustments") which impacted comparability. (page 26, Form10-K)

We believe the combined results of operation for the year ended December 31, 2007 provide management and investors with a more meaningful perspective of Delta's ongoing financial and operational performance and trends than if we did not combine the results of operations of the Predecessor and Successor in this manner.”

**Exhibits 4 and 5** show the resulting Consolidated Balance Sheets and Consolidated Statements of Operations shown in the Form 10-K for 2007 and prior years.

The Fresh Start adjustments for property and equipment and ﬂight equipment were described in notes to the consolidated ﬁnancial statements as follows:

Depreciation: We revalued property and equipment to fair value, which reduced the net book value of these assets by $1.0 billion. In addition, we adjusted the depreciable lives of ﬂight equipment to reﬂect revised estimated useful lives. As a result, depreciation expense decreased by $127 million for the year ended December 31, 2007. (Fresh Start Adjustments, p. 28, Form 10-K)

Fresh Start Reporting: As previously noted, upon emergence of Chapter 11, we adopted fresh start reporting, which required us to revalue our assets and liabilities to fair value. In estimating fair value, we based our estimates and assumptions on the guidance prescribed by SFAS No. 157, "Fair Value Measurements" (SPAS 157), which we were required to adopt in connection with our adoption of fresh start reporting. SFAS 157, among other things, defines fair value, established a framework for measuring fair value and expands disclosure about fair value measurements. (p. 42, Form 10-K)

Long-Lived Assets: Our flight equipment and other long-lived assets have a recorded value of $11.7 billion on our Consolidated Balance Sheet at December 31, 2007. This value is based on various factors, including the assets' estimated useful lives and their estimated salvage values. In accordance with SFAS No. 144, "Accounting for Impairment or Disposal of Long-Lived Assets" ("SPAS 144"), we record impairment losses on long-lived assets used in operations when events and circumstances indicate the assets might be impaired and the estimated future cash flows generated by those assets are less than their carrying amounts. The impairment loss recognized is the amount by which the asset's carrying amount exceeds its estimated fair value.

In order to evaluate potential impairment as required by SFAS 144, we group assets at the fleet type level (the lowest level for which there are identiﬁable cash ﬂows) and then estimate future cash ﬂows based on projections of passenger yield, fuel costs, labor costs and other relevant factors. We estimate aircraft fair values using published sources, appraisals and bids received from third parties, as available. (page 44, Form 10-K )











