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IFRS News

Shedding light on the IASB's activities*

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IAS 36 Impairment – Frequently asked questions

This supplement is the fourth in the series highlighting frequently asked questions (FAQs) relating to the impairment process. IAS 36 requires extensive disclosure of the results of the impairment testing process. The disclosures are designed to enable readers of financial statements to understand the process and to decide whether they would have reached the same conclusion. This final edition covers the minimum level of information that should be disclosed, and the additional disclosures required when there is significant goodwill or indefinite-lived intangible assets. It also explains the circumstances when sensitivity analysis are disclosed.

Many of the inputs to the impairment testing process will also feature in the critical accounting estimates and judgments disclosures required by IAS 1.

What information does management need to disclose?

Question 1
What general information is disclosed when there has been an impairment loss recognised or reversed on an asset or group of assets during a period?

Answer 1
Management must disclose the amount of losses recognised or reversed during the period for each class of asset. Separate disclosure is made of amounts recognised in profit or loss and amounts charged directly to equity. Management must also specify the line items in the income statement to which impairment has been charged or reversed.

Question 2
Are there any additional disclosure requirements if the impairment loss or reversal is material?

Answer 2
The following additional disclosures are required for a material impairment loss or reversal for an individual asset (including goodwill) or a cash-generating unit (CGU):

- circumstances giving rise to the impairment or reversal;
- amount of impairment loss or reversal;
- nature and description of the asset or CGU;
- reportable segment to which the asset or CGU belongs; and
- whether recoverable amount is fair value less costs to sell or value in use:
  - if fair value less costs to sell, how it was determined; and
  - if value in use, the discount rates used in the current assessment and in the previous one.

Question 3
What information is disclosed for each reportable segment if an entity reports segment information in accordance with IFRS 8/IAS 14?

Answer 3
Management should disclose, for each reportable segment, the impairment losses and reversals recognised in profit and loss and equity during the period.

Question 4
What additional disclosures are required for each group of CGUs to which a significant amount of goodwill or indefinite-lived assets have been allocated?

Answer 4
The additional disclosures are:

- basis of determination of recoverable amount (ie, value in use or fair value less cost to sell);
- the carrying amount of goodwill/indefinite lived intangible assets allocated to the CGU/groups of CGUs;
- identification of the key assumptions in the calculation;
- discussion of management's approach to determining each key assumption and whether it is based on past

performance/external sources of information, and if not, why not;
- period of cash flow projections;
- the long-term growth rate assumption and justification where it exceeds the growth rate in the territory, market or sector; and
- the pre-tax discount rate used in the calculations.

Question 5
What is a 'key assumption'?

Answer 5
Key assumptions are assumptions to which the recoverable amount of the CGU or group of CGUs is most sensitive. Key assumptions will usually include those underlying sales or income growth margins expected to be achieved and long-term growth assumptions.

Question 6
When does management disclose a sensitivity analysis and what are the disclosures?

Answer 6
In addition to those set out in Answer 4, the following disclosures are required if a reasonably possible change in a key assumption would lead to recoverable amount equalling carrying value:
- the headroom in the current calculation (by how much recoverable amount exceeds the carrying value);
- the value assigned to the key assumption(s); and
- by how much the key assumption(s) would have to change before recoverable amount equalled carrying value.

Question 7
What is meant by 'reasonably possible' change?

Answer 7
There is no definition in IAS 36 of 'reasonably possible'. It is a matter of judgment in the circumstances that apply – the same percentage headroom might give rise to different judgments by different entities. For example, an entity that has made assumptions that are aggressive by comparison to its peers and has only relatively marginal headroom (say 10%) would be more likely to suffer an impairment if the market moved only in line with the industry expectations than one with the same headroom but where the assumptions made in the cash flow forecasts were more conservative than the industry. See the example below.

Example
Management has performed an impairment test. It has calculated for one group of CGUs with net assets (including goodwill) of £400m a recoverable amount of £430m, giving headroom of £30m. The key assumptions are consistent with external data. The calculation is most sensitive to discount rates; the current rate of 8.5% is 1.0% lower than the prior year due to a fall in the risk-free rate in the territory in which the operation is based. A 0.6% increase in the discount rate would lead to an impairment. The risk-free rate in the territory where the CGU is based was last as low as it is now in the 1950's but shows no immediate sign of rising.

Does the possibility of a change in the risk-free rate qualify as a 'reasonably possible' change?

Solution
Yes, local risk-free interest rates have fallen sharply in the last year to historically low levels. The history of movements in risk-free rates has shown that it goes through cycles. It seems reasonably possible that the rate would rise. An impairment would be triggered even if it returned to the level of the previous year. The change in discount rate would therefore seem to be reasonably possible; the sensitivity analysis disclosures should be made.

Question 8
Some of the information that the standard requires to be disclosed could be regarded as comprising sufficient information to be a type of profit forecast. Such disclosure has been rare for listed companies. What should management do if the types of information disclosed fall within the definition of a profit forecast under the local regulations?

Answer 8
There is no exemption under IAS 36 from making disclosures on the grounds that such information may or may not constitute a profit forecast. The information required by the standard must be provided. Local rules must be followed in order to determine what further actions management should take, if any.

Example
Management has performed an impairment calculation on one poorly performing business and calculated that the recoverable amount marginally exceeds carrying value. A reasonably possible change in the discount rate, sales growth rate or gross margin would trigger an impairment, and the calculation is sensitive to all three assumptions. None of the entity's competitors disclose their assumptions; management argues that to disclose as required by IAS 36 would put the entity at a competitive disadvantage.

Is there any exemption from disclosure on these grounds?

Solution
No, such an exemption does not exist. The purpose of the sensitivity disclosures is to enable the reader of the financial statements to understand the key assumptions that have been made in determining whether an asset is impaired or not. Where the impairment decision is borderline, the assumptions made are a critical component in determining whether an impairment has arisen or not. The standard therefore requires management to disclose these judgments in the financial statements.

Question 9

What disclosure does management provide if any portion of the goodwill acquired in a business combination during the period has not been allocated to a CGU at the reporting date?

Answer 9

Management discloses the amount of the unallocated goodwill together with the reasons why that amount remains unallocated.

Clarification of Question 7 in the *IFRS News* May supplement on impairment

Question

How soon is goodwill acquired in a business combination tested after an acquisition?

Answer

Goodwill is tested for impairment in the year of acquisition. However, the standard also states that if the initial allocation of goodwill cannot be completed within the year of acquisition, that initial allocation is completed before the end of the first financial year beginning after the acquisition date. Goodwill is tested once the allocation is completed within the imposed time limit. For example, if a December year-end entity makes an acquisition in January 2006, the maximum period allowed to complete the allocation of goodwill is December 2007.

Some readers confused the purchase price allocation required by IFRS 3 with the goodwill allocation process required by IAS 36. As a reminder, the sequence of events is as follows:

1. IAS 36.96 requires the goodwill arising on a business combination in the current year to be tested for impairment before the end of the current year. In our example above, the goodwill should ideally be tested by the end of 2006.
2. However, an entity cannot allocate goodwill to CGUs until it has completed its purchase accounting and knows what the goodwill number is. This is recognised in IAS 36.85.
3. IFRS 3.62 allows an entity 12 months from the acquisition date to complete the purchase accounting. In our example, the purchase accounting must be completed by January 2007, now the entity knows the goodwill number for allocation.
4. IAS 36.84 requires the goodwill to be allocated to CGUs at the latest by the end of the period following that in which the acquisition took place. In our example, the goodwill arising on a January 2006 acquisition may have as long as until December 2007 before it has to be allocated and tested for impairment.

Contacts:

olivier.scherer@uk.pwc.com; Tel: +44 20 7213 1497

dave.walters@uk.pwc.com; Tel: +44 121 232 2677

caroline.woodward@uk.pwc.com; Tel: +44 20 7804 7392