

Meeting today's financial challenges

Impairment reporting:
improving stakeholder confidence

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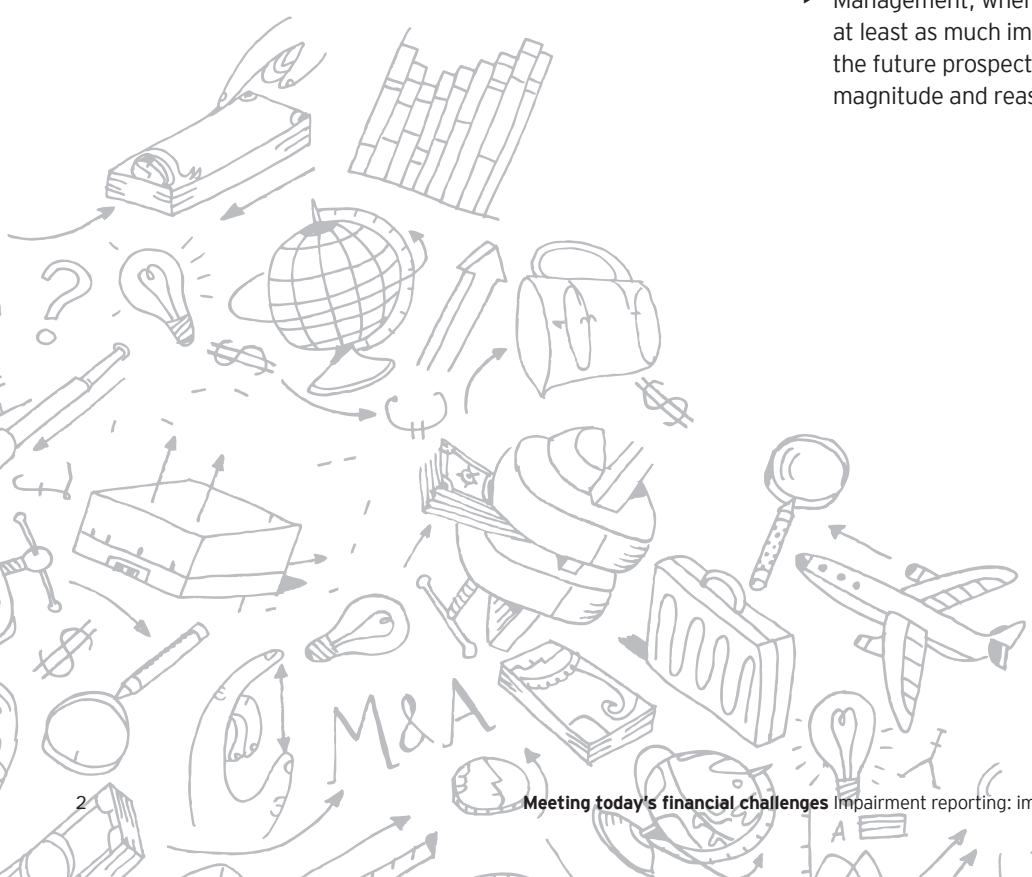
Executive summary

Complexity, consistency and building confidence

Despite growing signs that the global economy is regaining its health, it is likely that recovery will be gradual for most and fragile for many. What is not in doubt is that market confidence was severely impacted in virtually every area of the global economy. Whatever the timeline for recovery, boards will continue to find it challenging to deliver the future performance and returns needed to satisfy investors. In the meantime, scarcity of capital and increased risk aversion are driving investors and lenders to focus on the reliability of information used to make investment decisions. In our experience, valuing businesses and their underlying assets is more challenging today than at any other time in recent history and prolonged uncertainty will only continue to add complexity to valuation assumptions. Our discussions with companies, financial institutions, governments and regulators around the world indicate that, for many, this level of uncertainty will be part of the landscape for some years to come.

Against this background we have asked those who use financial statements to tell us how they interpret impairment reporting, the information they find most valuable and their expectations for the next 18–24 months. We surveyed 170 users of financial statements during September and October 2009, including investors, analysts and lenders in 32 countries. In addition, we sought regulators' views on certain aspects of impairment. These are the major findings from our survey:

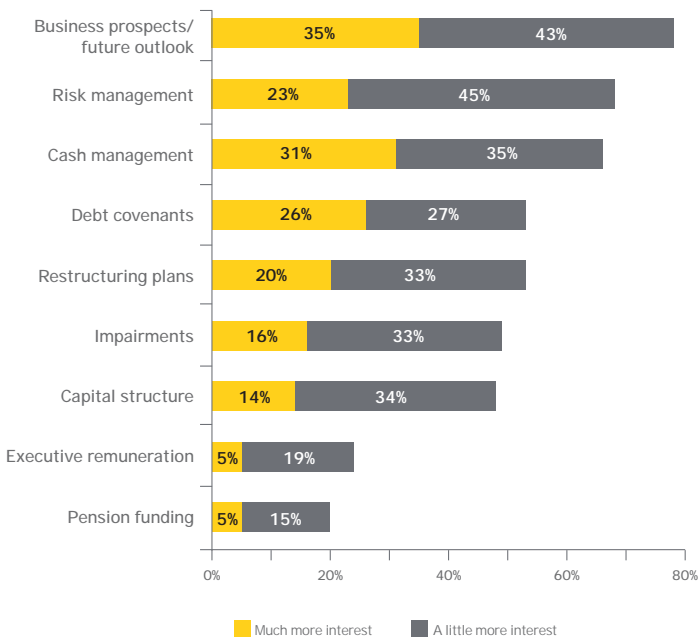
- ▶ More than half of the respondents were unconvinced that the global recovery is under way. Interestingly, lenders were notably more pessimistic about the state of recovery than other stakeholders.
- ▶ Most believe that the level of impairments to date are below expectations, and that the real estate, banking and capital markets, and automotive sectors are the most likely to experience further impairments.
- ▶ More than 90% indicated that forecasting cash-flows in the next 12–18 months will be either challenging or very challenging.
- ▶ More than 90% use impairment information disclosed in financial statements in their investment or lending decision-making process.
- ▶ Management, when communicating impairment, needs to place at least as much importance on the impact of the impairment on the future prospects of the business as it does on the size, magnitude and reason for the impairment.





In another recent survey of European CFOs by Ernst & Young, many indicated greater interest in understanding impairments in the current economic environment. Many of these CFOs also indicated a need to better understand other issues that have valuation implications (e.g., business prospects, debt covenants, restructuring plans). The views expressed by these CFOs align with the findings of our survey regarding the need for greater transparency.

Where do investors show more interest, as a result of market conditions?



Source: *Reporting in adversity*, Ernst & Young, July 2009.

Variations in accounting standards and interpretation of International Financial Reporting Standards (IFRS), particularly around financial instruments, add further complexity for users of financial statements. The G20 leaders recognize this and have repeatedly called for standard-setters to work together toward developing a common set of global accounting standards. Furthermore, although valuation standards exist in several countries, a globally-consistent set of valuation standards does not exist. We believe that greater transparency could be achieved through a single set of high-quality international accounting and valuation standards, which would also make for easier comparison with similar companies for stakeholders.

To build confidence with investors, analysts, lenders and regulators, leading companies will need to adopt a robust and integrated impairment testing process addressing four key steps:

1. **Escalate to the highest levels of the organization.** While the finance team is the likely owner of the impairment process, input from and collaboration with others in the company and valuation specialists are required. Senior management input on the key assumptions about the business and the environment is critical.
2. **Integrate with capital management and strategic planning.** Management should embed the overall assessment of impairment in its strategic planning and capital management processes.
3. **Improve reliability of valuation with better forecasting information.** Companies should reflect the latest analyses of economic and industry trends in their cash-flow projections of and determination of appropriate discount rates.
4. **Communicate the information that stakeholders need.** Stakeholders will require improved transparency through more effective communication and disclosures of the assumptions management has used and the sensitivity analysis it has conducted.

We believe those companies that successfully focus on these areas and provide well-prepared financial statements, alongside clear and consistent explanations about business prospects and management's approach to determining asset values, will build the greater confidence and trust with their stakeholders, and ultimately have the better access to capital.



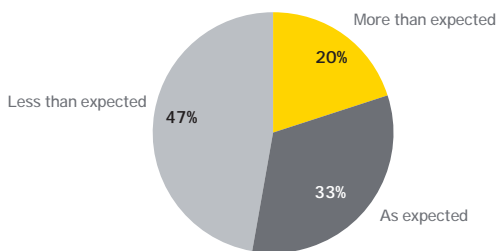
Impairments move up the agenda

2008 was clearly a difficult year for many companies. An increased level of impairments was reported, particularly in certain industries. In a sample of European companies reviewed by Ernst & Young, 83% reported impairment charges in either goodwill, property, or plant and machinery in 2008.

In the past decade when transaction multiples were increasing, businesses had little experience with widespread asset impairment. Today, many companies may be caught off-guard and may need to take a charge against earnings in 2009. Our research shows that in 2008 these charges accounted for 9% of net assets, compared to just 2% in the previous year.¹

Given the economic uncertainty, survey respondents are skeptical about the levels of impairments being reported. Nearly half of our survey respondents believe that the level reported is lower than expected, and indicated there may be more to come in 2009.

Given the economic environment over the past two years, and your assessment of the short- to mid-term economic outlook, how would you describe the overall level of impairments that companies have recorded?



1. *Reporting in adversity*, Ernst & Young, July 2009

Outlook remains uncertain

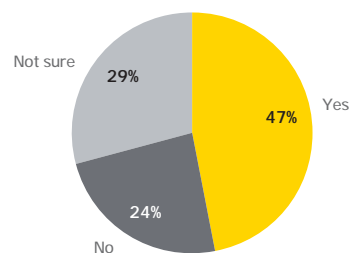
The view from the boardroom on a timeline for global economic recovery is uncertain. According to Ernst & Young's *Capital confidence barometer* survey carried out in October 2009,² more than half of senior global executives estimate that the downturn will persist for at least a year or two.

More than half of our stakeholder respondents are unconvinced that a recovery is under way. Lenders are even more doubtful, with 66% indicating they do not believe the recovery has begun or are unsure. Corporate leaders are equally uncertain.

Financial stakeholders in Latin America, the Far East, and Australia are inherently more positive about the outlook. Their financial institutions were not as exposed and vulnerable to the global financial crisis as in other parts of the world. As a result, individuals and companies were not affected to the extent of their American and European counterparts in terms of job losses and the deterioration of wealth, and they have recovered more quickly.

With prolonged uncertainty, impairments will remain a focus for all participants in global capital markets.

Do you believe that the economic recovery has commenced?



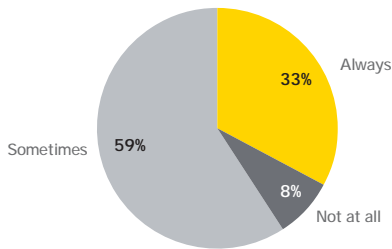
2. To gauge how companies around the world are positioned to respond to the recovery's challenges and opportunities, Ernst & Young surveyed 490 senior executives.



Impairment testing information is used extensively for analysis and comparison

We asked participants to indicate how they use the impairment information disclosed in financial statements. The overwhelming majority use impairment disclosures in their decision-making process, with 66% of respondents finding impairment disclosures useful in making decisions to buy, hold or sell assets.

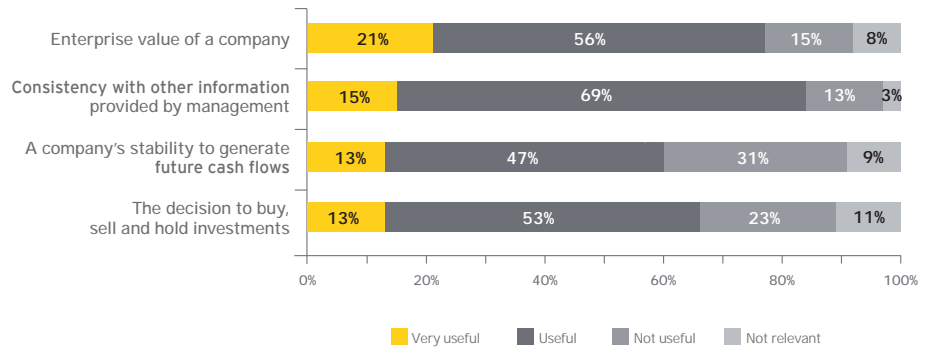
In your decision-making process do you use impairment information disclosed in the financial statements of companies relating to the valuation of their goodwill, intangible, tangible and financial assets – always, sometimes or not all?



For their ongoing assessment of companies, our respondents find disclosures most useful in determining the enterprise value of a company. But importantly, disclosures are most valued overall to check for consistency with other information provided by management or by others in their industry.

Our survey findings also revealed that users of financial statements closely examine management assumptions such as revenue projections, mid- to long-term growth and margins, and make comparisons with peers. They review all the information received from management to build a detailed outlook of the company’s future.

How useful do you find impairment disclosures provided in financial statements when assessing the following?





Valuation has become much more complex

Valuing businesses and their underlying assets is more difficult than in recent times. Economic uncertainty over the last 18 months and market volatility have directly effected valuation assumptions such as growth rates, and have made forecasting cash-flows challenging. In addition, the decline in transactions has increased the complexity of performing valuations and determining fair value due to the lack of comparable transactions information. The valuation challenges faced by companies today will require stronger technical skills and more frequent discussion around cash-flow projections and business risk modeling.

An Ernst & Young survey carried out in 2009 on global purchase price allocation examined 1,400 transactions disclosed in 2007 and 2008. The study found that nearly half of the enterprise value of acquired companies was ascribed to goodwill, with an additional 25% tied to intangible assets. Clearly, the companies involved in executing transactions at the peak of the market are likely to be more susceptible to impairment charges.

“Our regulatory model is that price-sensitive information should be disclosed as soon as companies identify that the market has mispriced their shares. This should be well in advance of booking an intangible loss.”

– European regulator

There is an intuitive but indirect link between impairment and share price

Investors believe that share prices typically reflect the impact of anticipated impairment charges before management officially announces them. “In most cases, the market will have discounted the asset a long time before management got around to writing it down,” one respondent from a US investment management firm told us. This is because most market participants have already anticipated the impairment based on management’s prior communications about the business and its performance before financial statements are prepared (e.g., – decreasing cash-flows).

Some respondents noted that impairment charges are by their nature backward-looking, and therefore do not affect future cash-flows, which have a greater impact on share price. “The general investor community believes that asset impairment is a temporary phenomenon due to the current ongoing market disruption or panic, and may not subsist long enough to affect the target company’s operating performance,” said a lender from the Middle East.

Investors further commented that if debt covenants are based on equity measures, and an impairment charge reduces equity below the minimum required, the cost of financing is likely to increase, which will impact share price. This indicates that it is not the impairment itself that affects the price but the potential consequences implied.

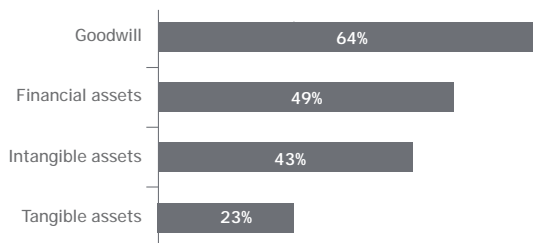
Beyond the impact on share prices, others went further to suggest that impairments raise questions about a company’s and management’s corporate and M&A strategy. “Even though impairments (and especially goodwill) have no immediate impact on cash flows, they tend to evidence that management has somehow failed in its M&A strategy. ...Hence, market reaction is questioning management’s ability to run the company efficiently”, said an investment banker based in Europe.



Outlook for impairments

Looking forward, survey respondents expect impairments to most severely impact goodwill, intangible assets and financial assets in 2009 and 2010.

Which classes of assets do you believe will experience the largest impairments in 2009 and 2010?



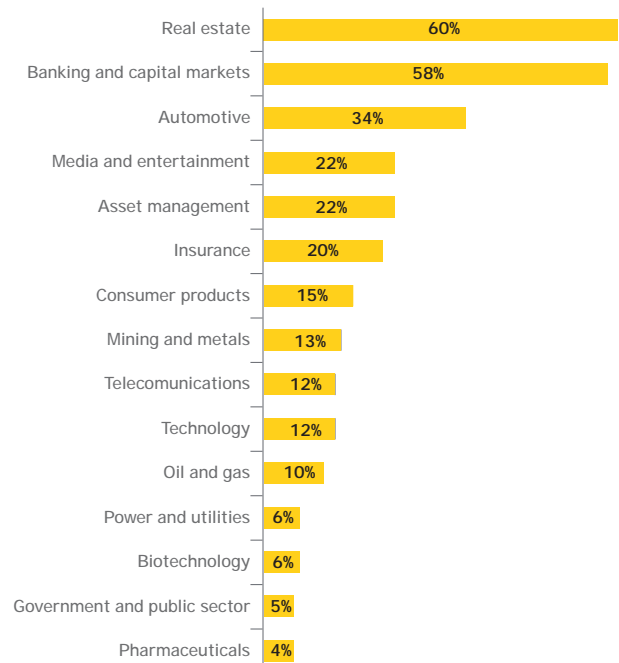
This outcome is not a surprise, given the lower-than-expected level of impairments to date; the complexity of impairment testing of goodwill and intangible assets; and the ongoing doubt about the timing, strength and speed of the economic recovery. Similarly for financial assets, there is a significant level of judgment involved in valuing them. In some circumstances, IFRS appliers may reverse prior-period impairment charges on other assets, such as intangible and tangible assets. However, other accounting standards, such as US GAAP do not permit the reversal of any impairment charges. Coupled with the broad range of interpretations of IFRS (for those companies applying IFRS) and market volatility, impairments of financial instruments will be very much under the microscope for the foreseeable future.

Management will understandably adopt a cautious approach to the impairment of goodwill and, for those countries where IFRS is applied, certain financial assets. Under IFRS, impairment of other assets may be reversed in some cases while under US GAAP they may not. Because these charges cannot be reversed, regardless of future economic developments, they result in a permanent erosion of equity.

Sector impact varies

According to our survey participants, the three sectors most likely to experience further impairments over the next 18–24 months are the real estate, banking and capital markets, and automotive industries. The media have reported extensively on these industries' high-profile corporate failures, significant reduction in asset values, and government intervention, on a global scale. The survey findings also indicate that users of financial statements may not always distinguish between impairment charges and decreases in fair value. In the real estate industry, for example, assets are carried at either fair value or cost, depending on which accounting standards are applied. Therefore, reduction in asset value will be reported as either an impairment charge or a decrease in fair value.

In which sector you expect the largest number of impairments?





Improving the effectiveness of the impairment process

Impairment testing requires an assessment of whether an asset's carrying amount is recoverable. Depending on the accounting standard applied, this will involve determining the asset's fair value or its value in use.

We believe that performing this complex exercise effectively requires four steps:

1. Escalate to the highest levels of the organization
2. Integrate with capital management and strategic planning
3. Improve valuation accuracy with better forecasting information
4. Communicate the information that stakeholders need

1. Escalate to the highest levels of the organization

The impairment assessment is not just an accounting exercise. It is an assessment of the business that may have an impact on its future. Senior executives must be involved early in the process, providing support, input and an assessment of the outcomes.

The finance team, while likely to be the primary owner of the process, must have access to the right skills: accounting, valuation, project management, forecasting, and an understanding of business issues and developments. The process requires collaboration between the business units and the finance team, and may need the involvement of external valuation specialists.

Senior management input into the key assumptions about the business and the environment is critical. Executives already report on these factors outside of the financial reporting process – for example, in the analysis that accompanies the financial statements, press releases, analyst briefings and shareholder meetings.

The objectivity of the process can be enhanced if the executives who played a critical part in the acquisition of the assets being tested for impairment do not play a leading role in the impairment assessment.

- Executive support and input is critical to manage stakeholders' expectations. Impairment testing is not just an accounting exercise; it is an assessment of the business.





2. Integrate with capital management and strategic planning

In the boom times, when the likelihood of impairment was low, some accounting standards allowed certain shortcuts, but with the current market uncertainty and the increased risk of impairment, such shortcuts are likely to be unavailable.

As recovery begins, early identification of reversals of previous impairment charges (for IFRS applicers) will be important and can be achieved only through an integrated process.

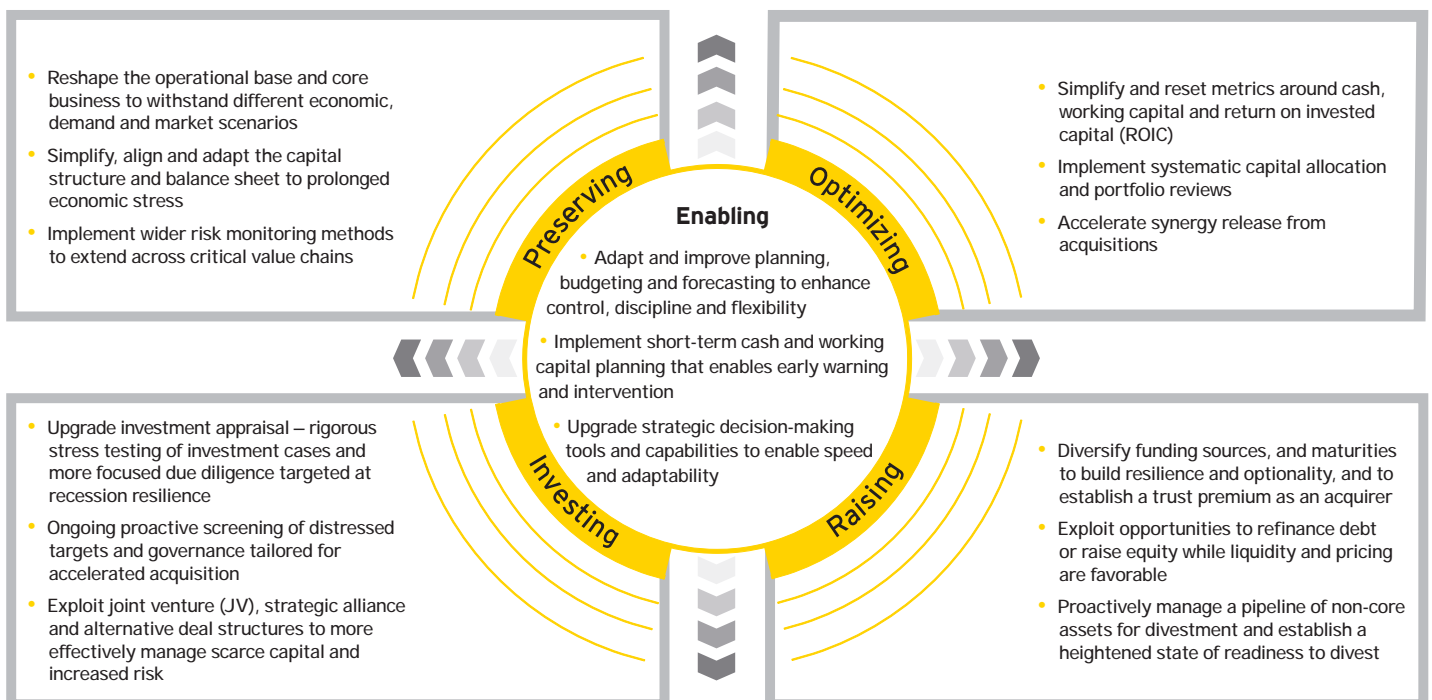
Asset impairment assessments should not be viewed as just an annual compliance exercise. The process of monitoring impairments, and re-evaluating the underlying assumptions, when integrated into the wider finance functions, can deliver improved efficiency. Executives use financial forecasts for internal management and decision-making purposes – the same data that is needed for the impairment assessment.

Management should embed it into its strategic planning, internal management, investment decision-making and the company's capital management process – issues that are all within the company's overall capital agenda of optimizing, raising, investing and preserving capital, as described in the following diagram:

Impairment shortcuts under IFRS

When assessing goodwill or indefinite-life intangible assets for impairment, under IFRS a full impairment test may not be required if:

- ▶ The most recent calculation of recoverable amount or fair value was substantially in excess of the asset's carrying amounts
- ▶ The events since that calculation and changes in circumstances, mean it is remote that a current assessment of value will be less than the asset's carrying amounts
- ▶ There is no significant change in the composition of the cash-generating units to which the intangible asset belongs





For example, obtaining a better understanding of the value of the company's key assets will allow management to raise capital or divest non-core assets on a timely basis.

By increasing the financial reporting team's understanding of the business decisions and information needs, management can improve its ability to recognize changes in industry and market

trends, thereby identifying more quickly issues that may affect the assumptions it has used to forecast the company's outlook. As a result, management can more effectively determine the impact of any revised assumptions as soon as changes occur, take timely decisions on the possible actions that may avoid the need to recognize impairment charges and offer the communication needed to inform the market.

Key IFRS conversion considerations

Companies in countries preparing for the adoption of IFRS, such as the US, Canada and India, face additional practical issues to implement IAS 36, *Impairment of Assets*. Upon the adoption of IFRS, a first-time adopter must apply the provisions of IAS 36 as of the transition date to determine whether an impairment loss exists on non-current assets other than financial instruments. In preparing for the adoption of IFRS, a reporting entity could contemporaneously prepare US GAAP (or other local standard) and IFRS impairment analyses to avoid the unnecessary burden of collecting or reconstructing prior-period information at the date of adoption. The timing of, and amount of any impairment recognized under IFRS can differ to that recognized under other accounting standards, including US GAAP.

Some of the key IFRS conversion issues and differences with other accounting standards include:

1. Reversal of asset impairment. Companies should monitor whether there are indicators that an impairment loss recognized in a previous period on assets other than goodwill, no longer exists or has decreased. If so, IFRS requires that impairment losses be reversed if there has been a change in the estimates used to determine the asset's recoverable amount. Goodwill impairment reversals are not permitted under IFRS.
2. Definition of the cash generating unit (CGU). CGUs may differ from groups of assets defined under other standards, such as reporting units or asset groups under US GAAP.

This may require changes to the information systems and cash-flow forecast models to capture impairment testing requirements. This may also result in different impairment charges and different assets being tested at different levels. For example, goodwill may be tested at a level that is effectively a grouping of CGUs, based on the internal monitoring by management.

3. Recognition of impairment losses. In some standards, such as US GAAP, impairment losses are only recognized if a preliminary step is "failed," i.e., the sum of the undiscounted expected future cash flows is less than the carrying amount of the asset for long-lived assets or if the fair value of a reporting unit is less than its carrying amount for goodwill. Under IFRS, each time an indicator of impairment exists, the recoverable amount of the asset must be assessed, potentially resulting in the earlier or more frequent recognition of impairment losses for long-lived assets.
4. Value-in-use. Under IFRS, the recoverable amount is the higher of the value in use and the fair value less costs to sell. Unlike fair value, which is a concept common to other accounting standards, the value in use concept measures the value of the asset in its current condition, using entity-specific assumptions about cash flows, as corroborated with observable market evidence where possible and is based on pre-tax cash flows and pre-tax discount rates (discount rates based on current market assumptions).



Alternative impairment approaches

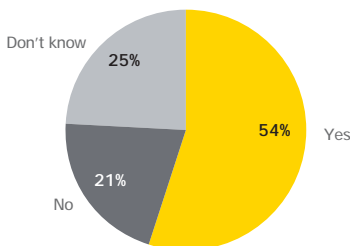
The approach to determine an asset's value for impairment differs depending on the accounting standards being applied. For example, IFRS uses either fair value or value in use, while US GAAP uses fair value. For those countries where more than one approach may be applied, each company needs to make a decision based on the assets being assessed and their business overall. There are two broad methods for determining the value of an asset:

- ▶ Market value – reflecting what a “market participant” would pay, often referred to as fair value.
- ▶ Long-term operational value – reflecting the cash flows that the business is expected to generate, often referred to as entity-specific or value-in-use.

In our survey, only 55% of participants believed that there was a significant difference between market value and long-term operational value (LTOV), while 24% did not know whether there was a difference. This indicates there may be a lack of understanding and clarity among key stakeholders on the effect of the approach adopted by different companies.

Of our survey participants who believe there is a significant difference, 50% had no preference for one method over the other. Many noted that the appropriateness of the model depends on the specific circumstances of each company. One European investor noted, “I don't think that there is an approach that has to be regarded as more reliable than the other. The first one is more influenced by the actual market conditions and the second has a longer-term point of view but, also has many implementation risks.”

Do you believe there is a significant difference in practice between the estimated market value (e.g., discounted cash flows from market participants' perspective or the use of multiples) and the estimated long-term operational value of business?



The remaining group was split between which method was preferable, giving the following reasons:

Market value	Long-term operational value
Management can be too optimistic in LTOV	Markets are bad at pricing assets
Markets are only prepared to pay so much despite how the business is managed	Markets are influenced by many factors, including sentiment, and are more susceptible to cycles and large swings unrelated to business
More reliable and objective	More reliable and objective
Gives a more macro view	Market players focus too much on the short-term

The most common reasons given by participants for the difference in the outcome from each method included:

- ▶ Alternative time horizons – management has a long-term view, and consequently, a more stable cost of capital, while the market approach takes a shorter-term view and adjusts to current market changes
- ▶ Different assumptions and forecasts, reflecting the level of knowledge available, diverse capital structures, and varied interpretation of market conditions and risk premiums

This illustrates the need for management to understand the impact of applying a market value approach if it hasn't done so, in order to reconcile its views with those of shareholders. In the current environment, understanding the reasons for these differences and communicating them clearly to the market may require extra attention – yet this may support the company in building confidence among shareholders and lenders.



The selection of valuation techniques also affects shareholder communication

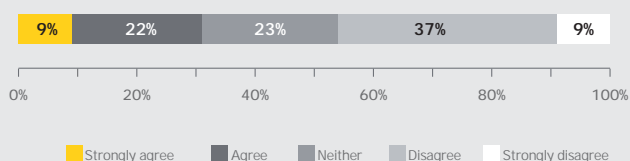
Different valuation techniques, such as discounted cash flows and multiple of earnings, are applied to determine the recoverable amount or fair value.

According to our survey, 46% of the respondents believe that valuation techniques used to assess impairments are not applied consistently. More specifically, 60% of lenders believe the techniques are not applied consistently. This means that sometimes, even when companies apply the same accounting standard, they may not apply valuation approaches (e.g., discounted cash flow, multiples) in a consistent manner or that they may not assess valuation parameters, such as discount rates, in the same way.

The International Valuation Standards Council (IVSC) develops and maintains standards for the reporting and disclosure of valuations, especially those that are relied upon by investors and other third party stakeholders. It also supports the need to develop a framework of guidance on best practice for valuations of the various classes of assets and liabilities, and for the consistent delivery of the standards by properly trained professionals around the globe.

Although valuation standards exist in several countries, a globally-consistent set of valuation standards, which are widely used, does not exist. Initiatives like the IVSC project to increase convergence in valuation practices will help users make more effective comparisons. In the short-term, companies need to review the disclosures they make to enable users to understand the approach taken and the technique applied. This is particularly important when dealing with lenders.

To what extent do you agree with the following statement: there is consistency in practice in the application of valuation techniques in determining impairments?



3. Improve valuation accuracy with better forecasting information

Almost all valuation techniques require forecasting information. For impairment purposes, the two key elements used in most techniques are cash flows and discount rates. It is essential that the assumptions companies use to determine forecasts reflect the latest analyses of economic and industry trends.

Projecting cashflows in the current environment will continue to be a challenge. Better judgment is required to make realistic assessments; prior-year cash flow projections can no longer just be rolled forward but must be critically analyzed. Projections that rely on historical information – for example, basing future sales on past sales levels – may no longer be appropriate. Similarly, cost outflows may need updating as the cost of inputs has changed.

Making realistic projections will require management to carefully review assumptions about the longer-term effects of the global recession; for example:

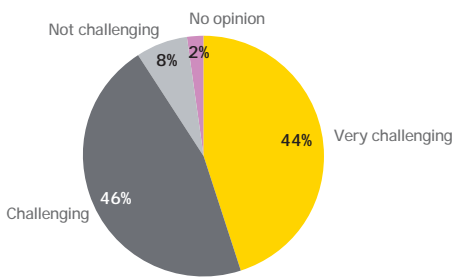
- ▶ What is the effect on cash flows if the global recession is deeper or shallower than management had assumed or if recovery is delayed?
- ▶ Will growth in revenue come more quickly than initially thought or will it be slower?
- ▶ Have the cost-reduction plans taken effect more slowly or more rapidly than budgeted?
- ▶ Should the forecasting model be changed because of the volatility in some currency exchange rates or raw material prices? Should the exchange rate assumptions be adapted to the current market situation? Should the sources used be challenged?
- ▶ Has there been a restructuring or reorganization that requires a change in the composition of the groups of assets used for impairment testing? Should cash-flow models be changed?

- Integrating the impairment process into other business processes brings both efficiency and improved decision-making about the business and management of capital.
- Management should understand the effect of different approaches where they are permitted.



Our survey indicates that users are aware of the complexity involved. Ninety-one percent of respondents agreed that forecasting cash flows over the next 12–18 months will be challenging or very challenging. This highlights the potential need for more commentary on management's judgments and, more importantly, on the effect of changes in assumptions.

In your opinion, given the current economic environment, how challenging is it for companies to forecast their cash flows over the next 12–18 months and determine their asset impairments?



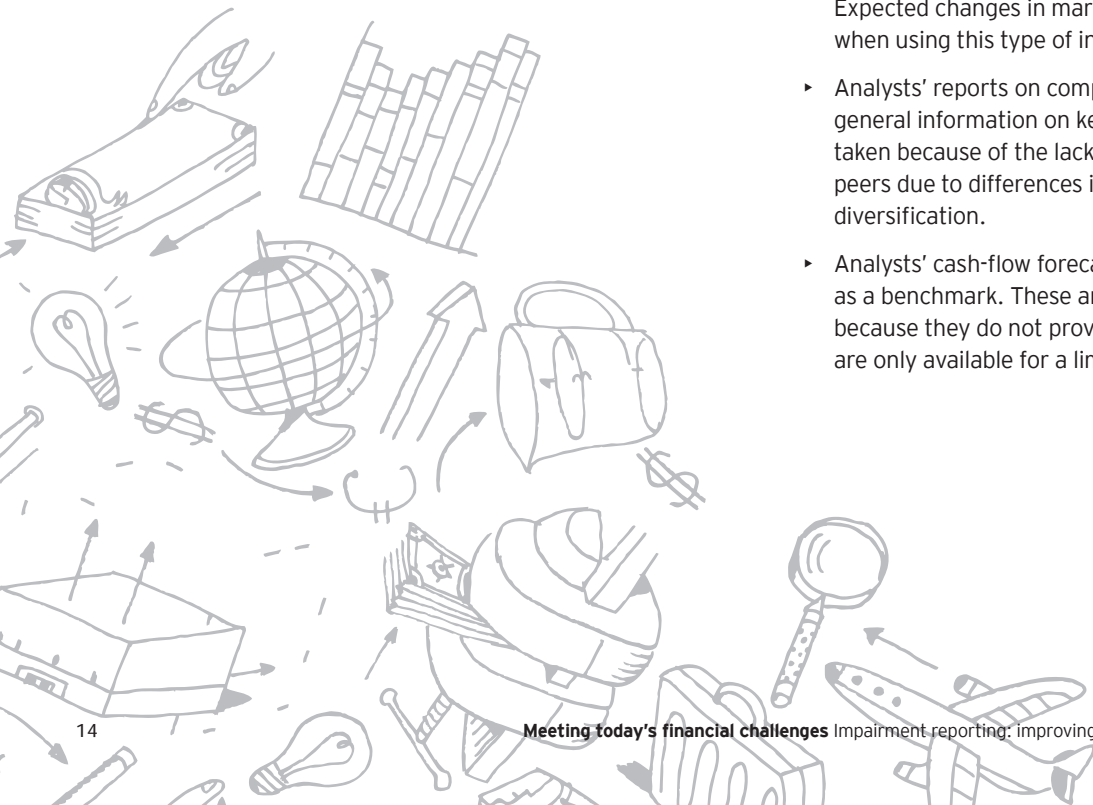
Importance of market data when using fair value

The basis for management's assumptions and an understanding of the market data available to shareholders are important. This survey shows that users access multiple sources of information in their decision-making process.

Management will choose of the external data to use in its forecasting, but investors also have multiple sources of information, and may not make the same selection. Management needs to understand the strengths and weaknesses of material available and articulate the reasons for the sources selected in their communications. This can also be a valuable element in management's own assessment – validating that its judgments are sensible as it prepares for questions from users of financial statements.

Sources that can be used include:

- ▶ Macroeconomic forecasts such as gross domestic product, inflation or exchange rates can be used to provide comfort on revenue volume growth and inflation projections. This may not be specific enough for particular industry segments or regions.
- ▶ Industry forecasts from professional organizations, economists or brokers can be used for industry revenue growth, long-term profitability or capital expenditure levels. Expected changes in market shares should be considered when using this type of information.
- ▶ Analysts' reports on comparable companies also provide general information on key industry trends. Care should be taken because of the lack of comparability between some peers due to differences in geographic locations or revenue diversification.
- ▶ Analysts' cash-flow forecasts for the company can be used as a benchmark. These are sometimes of limited use because they do not provide an adequate level of detail and are only available for a limited number of years.





Assessing the discount rate

Determining an appropriate discount rate requires considerable judgment as well. Questions that management should consider about the components of the discount rate include:

- ▶ Risk-free rate – how does the variation in governments' rates affect the risk-free rate?
- ▶ Cost of debt – how do the currently observable spreads impact the cost of debt?
- ▶ Equity market risk premium – does the recently observed volatility impact the equity market risk premium?
- ▶ Leverage ratio – has the company's or industry's target leverage ratio changed? What should be the impact of the increased difficulty in refinancing debt on the discount rate?
- ▶ Should the increased uncertainty in cash-flow forecasts result in an additional risk premium?

When assessing the discount rate, it may sometimes make more sense to eliminate some of the impact of current fluctuations in the markets by referring to historical information in addition to spot data. While current market data cannot be ignored (including record government borrowings and deficits in certain countries), this approach may ensure more consistency with the long-term normalized profitability and return assumptions that are used in the terminal value computation. Ultimately, it is important that the discount rate has been determined consistently with the cash flows and that risks are not double counted.

Management should consider a range of projections using assumptions that are reasonable and justifiable under various possible scenarios. This can provide insight into the possible impact when actual results differ from assumptions, allowing the business to develop alternative strategies to respond to the actual results and identifying those assumptions to which management needs to pay most attention. It will also help with communication to stakeholders when results vary.

Reconciling discount rates

A particular discount rate should not be assessed in isolation, without giving consideration to the other discount rates used by a company:

- ▶ Different rates are used throughout the business for various calculations (impairment, pensions, financial instruments, fair value measurements on acquisition). Although all of these rates should not be the same, management should ensure it understands the nature of the differences and that the underlying assumptions are consistent.
- ▶ The starting point for the discount rate applied for impairment purposes is often the discount rate applied to the business as a whole. However, where specific assets or groups of assets have a different risk profile, the discount rates would be different. In such cases the weighted average of all discount rates used should correspond to the discount rate applied to the business as a whole. Consider assets in different geographic locations. Local interest rates and risk premium must be considered before testing assets for impairment within a group of companies, even though the group may finance its business centrally.

- Cash-flow projections and determination of discount rates will continue to be challenging. Rolling forward of prior years is not going to be sufficient. Increased judgment and greater effort will be required.
- There is a need for greater disclosure of the assumptions used in determining cash flows, and the discount rate applied.
- Understanding the impact of the changes in assumptions is a key aspect of managing the business and needs to be communicated to the users of financial statements.



Understanding stakeholders' information needs

Sensitivity analysis should be a critical element of management's decision-making process and communication. Through sensitivity analysis, users can better understand the effects on the business of future changes in the environment – particularly when there is a high level of market uncertainty. It allows them to compare companies with their peers and critically assess management's assumptions.

But as the results from our survey have shown, the disclosures required in financial reports are just one piece of information that stakeholders use to get the complete picture. In addition, companies must carefully assess each element of the required disclosure to ensure that it provides sufficient detail and is consistent with other information. Providing consistent information must be at the heart of an effective communication strategy.

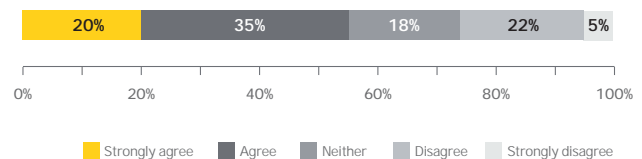
We asked participants to tell us what additional impairment disclosures they would like to see and they identified broader information about the business rather than more specific information about impairment, which doesn't necessarily fit within financial statements. They specifically asked for the following:

- ▶ Information about changes in key factors influencing the industry overall
- ▶ More detailed valuation assumptions and comparisons to others in the industry
- ▶ An explanation of going-concern assumptions

Regulators told us that their focus is on the sensitivity analysis, not just to assess the effect of different assumptions but also to challenge the consistency of management's entire package of communication. As a European regulator put it, "Management reasonably has a more optimistic view than the market. If they did not you would not employ them. This needs to be supported by clear disclosures of key assumptions so that investors can compare their own estimates with those used by management."

In some instances, the market capitalization of a company is below its book value, thereby indicating a potential impairment; in these circumstances, an impairment test is often necessary. Accordingly, we also asked respondents if management should explain in the financial statements, where applicable, the excess of the company's book value over its market capitalization. While 55% of all survey participants either agreed or strongly agreed, 77% of the lenders thought this was a valuable disclosure. Determining the reasons for these differences can be a challenge for management, so caution is needed when providing this information. In particular, management should thoroughly investigate and understand the reasons behind differences to more effectively respond to shareholder queries, particularly from lenders.

Companies should explain the excess of their book value over their market valuation – do you agree ?



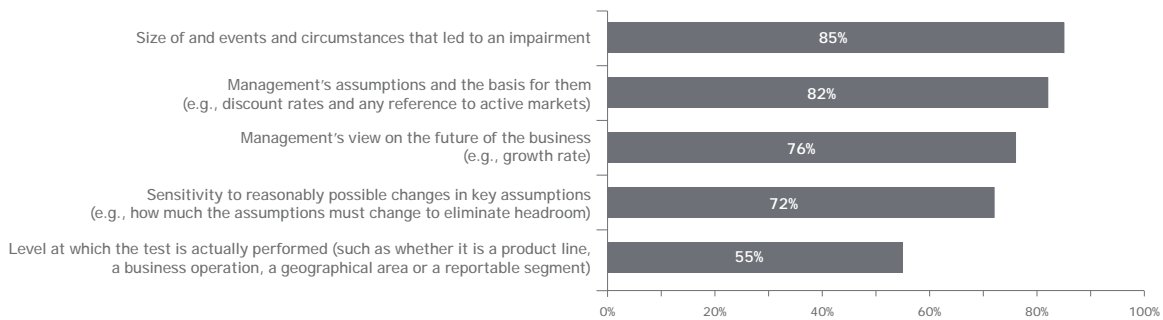
Disclosures in interim financial statements also play a vital role in the communications strategy, particularly in the context of continuing market uncertainty.



We asked survey respondents what disclosures they wanted to see in interim financial statements. Unsurprisingly, they told us they would like to see the same information that is currently required in the annual financial statements.

As one respondent noted, this doesn't mean including the same level of disclosures as in the annual financial statements, as this would be a time-consuming and costly exercise. However, users believe companies can use interim reporting more effectively to provide a careful assessment of their performance since the last annual report. Interim financial statements by their nature offer an update on changes in circumstances based on events that have occurred.

Which of the following information would you like to see disclosed in interim financial statements:

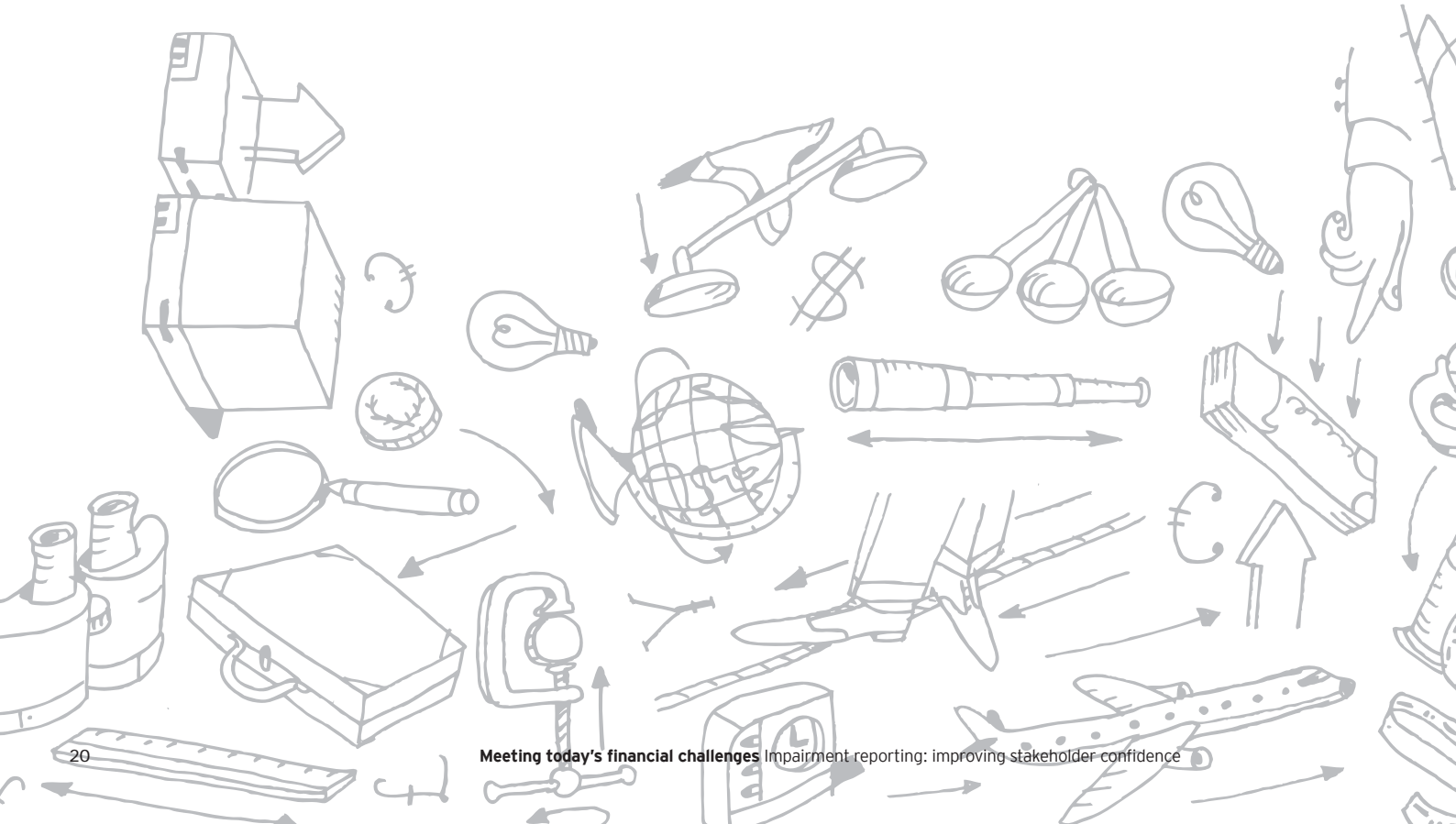
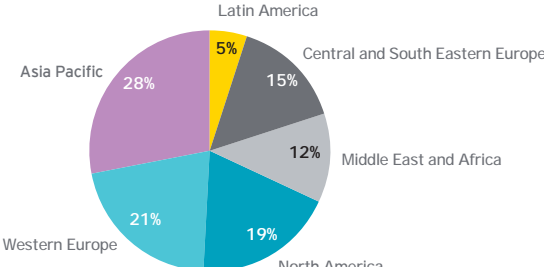
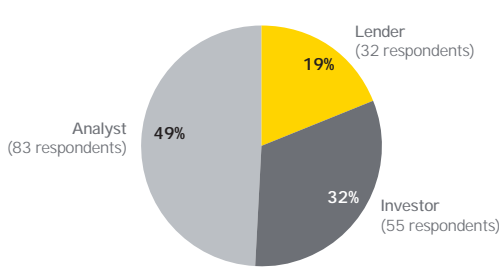


- Impairment disclosure in financial reports is an important element to provide transparency to stakeholders, but they don't provide the full story. Consistency of communication is vital to improving stakeholder confidence.
- In current market conditions, market values deserve specific attention, gaps between book value and market value should be understood and management's assessment fully explained.



Survey demographics

For this study on impairment reporting, Ernst & Young conducted research with investors, investment analysts and lenders - key users of financial statements. 170 participants from 32 countries representing leading banks and investment houses took part in an online survey during September and October 2009.



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