Impairment accounting – the basics of IAS 36

Impairment of Assets
IAS 36 *Impairment of Assets* (the standard) sets out the requirements to account for and report impairment of most non-financial assets. IAS 36 specifies when an entity needs to perform an impairment test, how to perform it, the recognition of any impairment losses and the related disclosures. Having said that, the application of IAS 36 is wide and its requirements may be open to interpretation.

The recent economic uncertainty has thrown a spotlight on impairment. As such, many entities have decided to reassess their impairment testing processes, models and assumptions.

In this introductory publication, we provide an overview of the key requirements of IAS 36 – an introduction for those who have not performed an impairment test in accordance with IAS 36 and a refresher for existing IFRS preparers. We point out areas where IAS 36 differs from US GAAP and also highlight some of the practical considerations for first-time adopters of IFRS.

For further reading, we recommend our publication *IAS 36: Practical Issues*, which discusses practical application issues available on ey.com/ifrs.

**Impairment principle and key requirements**

IAS 36 deals with impairment testing for all tangible and intangible assets, except for assets that are covered by other IFRS.

IAS 36 requires that assets be carried at no more than their recoverable amount. To meet this objective, the standard requires entities to test all assets that are within its scope for potential impairment when indicators of impairment exist or, at least, annually for goodwill and intangible assets with indefinite useful lives.

Diagram 1 illustrates the process for measuring and recognising impairment loss under IAS 36. Some of the components in the diagram are discussed in more detail in the sections below.

**Key requirements of IAS 36 illustrated in Diagram 1**

The entity assesses, at each reporting date, whether there is any indication that an asset may be impaired.

- If there is an indication that an asset may be impaired, the recoverable amount of the asset (or, if appropriate, the cash generating unit (CGU)) is determined.
- The recoverable amount of goodwill, intangible assets with an indefinite useful life and intangible assets that are not available for use on the reporting date, is required to be measured at least on an annual basis, irrespective of whether any impairment indicators exist.
- The asset or CGU is impaired if its carrying amount exceeds its recoverable amount.
- The recoverable amount is defined as the higher of the ‘fair value less costs to sell’ and the ‘value in use’.
- Any impairment loss is recognised as an expense in profit or loss for assets carried at cost. If the affected asset is a revalued asset, as permitted by IAS 16 *Property, Plant and Equipment* (IAS 16) and IAS 38 *Intangible Assets* (IAS 38), any impairment loss is recorded first against previously recognised revaluation gains in other comprehensive income in respect of that asset.
- Extensive disclosure is required for the impairment test and any impairment loss recognised.
- An impairment loss recognised in prior periods for an asset other than goodwill is required to be reversed if there has been a change in the estimates used to determine the asset’s recoverable amount.
Diagram 1: Determining and accounting for impairment

- **Are there any other indicators of impairment?**
  - **Yes (Y):** Can RA of the individual asset be estimated?
    - **Yes (Y):** Identify CGU to which the asset belongs
      - **If goodwill cannot be allocated to an individual CGU, allocate it to a group of CGUs:** Is CA>RA for CGU or group of CGUs?
        - **No (N):** Reduce CA of goodwill
        - **Yes (Y):** Reduce other assets of CGU pro rata on the basis of their CA
          - **End**
    - **No (N):** Reduce CA to RA
  - **No (N):** Is the asset goodwill or an intangible asset with indefinite useful life?
    - **Yes (Y):** Is CA>RA for CGU or group of CGUs?
      - **No (N):** Reduce CA of goodwill
      - **Yes (Y):** Reduce other assets of CGU pro rata on the basis of their CA
        - **End**
    - **No (N):** Identify CGU to which the asset belongs
      - **If goodwill cannot be allocated to an individual CGU, allocate it to a group of CGUs:** Is CA>RA for CGU or group of CGUs?
        - **No (N):** Reduce CA of goodwill
        - **Yes (Y):** Reduce other assets of CGU pro rata on the basis of their CA
          - **End**
  - **End**

**Notes:**
- **RA** = Recoverable amount
- **CA** = Carrying amount
- **CGU** = Cash generating unit

**Diagram:** [Diagram of Impairment Accounting Process]
**Indicators of impairment**

The standard requires an entity to assess, at each reporting date, whether there are any indicators that assets may be impaired. An entity is required to consider information from both external sources (such as market interest rates, significant adverse changes in the technological, market, economic or legal environment in which the entity operates, market capitalisation being lower than net assets) and internal sources (such as internal restructurings, evidence of obsolescence or physical damage to the asset). Notwithstanding whether indicators exist, recoverability of goodwill and intangible assets with indefinite useful lives or those not yet in use are required to be tested at least annually.

**Recoverable amount**

The recoverable amount of an asset is the greater of its ‘fair value less costs to sell’ and its ‘value in use’. To measure impairment, the asset’s carrying amount is compared with its recoverable amount.

**Diagram 2: Determining recoverable amount**

Carrying amount compared with Recoverable amount

higher of

Fair value less costs to sell and Value in use

The recoverable amount is determined for individual assets. However, if an asset does not generate cash inflows that are largely independent of those from other assets, the recoverable amount is determined for the CGU to which the asset belongs. A CGU is the smallest identifiable group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

**Textbox 1: Primary differences compared with US GAAP**

Unlike IFRS, under US GAAP for long-lived assets and definite-lived intangibles that are held for use, a two-step approach to impairment is required. A recoverability test is performed first. The recoverability test compares the sum of the undiscounted expected future cash flows with the carrying amount of the asset or reporting unit. If the carrying amount of the asset is greater than the amount, as determined under the recoverability test, the asset is considered not recoverable. Only when the asset is determined not to be recoverable may an impairment be recorded for assets held for use. This difference may result in recognition of impairment losses at an earlier period under IFRS compared to US GAAP.

Consistent with the requirements of IAS 36, US GAAP requires indefinite-lived intangible assets to be tested for impairment annually, or more frequently if indicators exist. Indefinite-lived intangible assets are subject to a one-step assessment that reduces the carrying amount to fair value.

**Value in use**

Value in use (VIU) is the present value of the future cash flows expected to be derived from an asset or a CGU. A VIU calculation includes:

- **Cash flow projections:**
  - An estimate of the future cash flows that the entity expects to derive from the asset
  - Expectations about possible variations in the amount or timing of those future cash flows

- **Discount rate:**
  - The time value of money – that is a pre-tax discount rate that reflects current market assessments of the time value of money and risks specific to the asset for which the future cash flow estimates have not been adjusted
  - The price for bearing the uncertainty inherent in the asset which can be reflected in either the cash flow estimate or the discount rate
  - Other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset
When measuring VIU, the entity's cash flow projections:

- Must be based on reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the remaining useful life of the asset.
- Must be based on the most recent financial budgets/forecasts approved by management — without including cash inflows or outflows from future restructurings to which the entity is not yet committed.
- Should exclude borrowing costs, income tax receipts or payments and capital expenditures that improve or enhance the asset's performance.
- Should include overheads that are directly attributed or can be allocated on a reasonable and consistent basis and the amount of transaction costs if disposal is expected at the end of the asset's useful life.
- For periods beyond the periods covered by the most recent budgets/forecasts should be based on extrapolations using a steady or declining growth rate unless an increasing rate can be justified.

IAS 36 requires that entities compare their previous estimates of cash flows to actual cash flows as part of the assessment of the reasonableness of their assumptions, particularly where there is a history of management consistently overstating or understating cash flow forecasts. The results of past variances should be factored into the most recent budgets/forecasts. However, to the extent this has not occurred, management should make the necessary adjustments to the cash flow projections.

IAS 36 requires that VIU should reflect the present value of the expected future cash flows, that is, the weighted average of all possible outcomes. In practice, present values are computed either by a ‘traditional’ or ‘expected’ cash flow approach. In theory, the outcome of the impairment test should be the same regardless of which approach is used. Under a traditional approach, a single set of estimated cash flows and a single discount rate, often described as ‘the rate commensurate with the risk,’ are used. The expected cash flow approach applies different probabilities to expected cash flows rather than using a single most likely cash flow.

When comparable assets can be observed in the market place, the traditional approach is relatively easy to apply. However, as indicated in IAS 36, the expected cash flow approach is, in some situations, a more effective measurement tool than the traditional approach. Regardless of which approach is selected, both cash flows and the discount rate should be expressed consistently, either in real terms, which exclude inflation, or in nominal terms.

IAS 36 requires the use of pre-tax cash flows and pre-tax discount rates in the impairment test. In practice, primarily because of the widespread use of the Capital Asset Pricing Model — post-tax costs of equity are generally determined and used in the entity’s computations of the discount rate. Discounting post-tax cash flows at a post-tax discount rate and discounting pre-tax cash flows at a pre-tax discount rate should give the same result when there are neither temporary differences nor available tax losses at the measurement date.

The pre-tax rate needs to be determined on an iterative basis, adjusted to reflect the specific amount and timing of the future tax cash flows, though still excluding the effects of any existing temporary differences and available tax losses at the measurement date. However, in many cases, a post-tax discount rate grossed up by a standard rate of tax may be a reasonable estimate of the pre-tax rate.
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**Impairment of Assets**

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
</tr>
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<tbody>
<tr>
<td>Revenue</td>
<td>3,500</td>
<td>3,710</td>
<td>3,933</td>
<td>4,169</td>
<td>4,419</td>
</tr>
<tr>
<td>Revenue growth per approved budget</td>
<td>6%</td>
<td>6%</td>
<td>6%</td>
<td>6%</td>
<td>6%</td>
</tr>
<tr>
<td>EBITDA</td>
<td>1,050</td>
<td>1,113</td>
<td>1,180</td>
<td>1,251</td>
<td>1,326</td>
</tr>
<tr>
<td>EBITDA margin per approved budget</td>
<td>30%</td>
<td>30%</td>
<td>30%</td>
<td>30%</td>
<td>30%</td>
</tr>
<tr>
<td>Add: Change in net working capital</td>
<td>(12)</td>
<td>(11)</td>
<td>(11)</td>
<td>(12)</td>
<td>(13)</td>
</tr>
<tr>
<td>Less: Replacement capital expenditure</td>
<td>(175)</td>
<td>(195)</td>
<td>(270)</td>
<td>(325)</td>
<td>(250)</td>
</tr>
<tr>
<td>Pre-tax Free cash flow</td>
<td>863</td>
<td>907</td>
<td>899</td>
<td>914</td>
<td>1,063</td>
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<tr>
<td>Discount rate (pre-tax rate based on WACC)</td>
<td>12.5%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Discount period (mid-year convention)</td>
<td>0.5</td>
<td>1.5</td>
<td>2.5</td>
<td>3.5</td>
<td>4.5</td>
</tr>
<tr>
<td>Discount factor</td>
<td>0.943</td>
<td>0.838</td>
<td>0.745</td>
<td>0.662</td>
<td>0.589</td>
</tr>
<tr>
<td>Present value of free cash flow</td>
<td>814</td>
<td>760</td>
<td>670</td>
<td>605</td>
<td>626</td>
</tr>
</tbody>
</table>

Present value of free cash flow (FY11 to FY15): 3,475

Present value of terminal value*: 5,557

**Value in use**: 9,032

* EBITDA can be used as a substitute in the projection of income and expense related cash flows. However, adjustments must be made to account for other cash flows not captured within EBITDA, including working capital movements and capital expenditure.

** As required by IAS 36, cash flow projections for periods beyond the most recent budgets/forecasts are determined by extrapolation using a steady or declining growth rate, unless an increasing growth rate can be justified. The resulting figure is called the terminal value. It is then discounted to present value.

To calculate the present value of the terminal value in this example, we

- Calculated the normalised future long-term cash flow of CU 1,074 - determined by using the 2015 pre-tax cash flow of CU 1,063 (per the above table) and adjusting it for a lower change in working capital due to a lower long-term growth rate.
- Applied the long-term annual growth rate of 1% to the normalised future cash flows to determine the terminal value.
- Discounted the terminal value using the assumed pre-tax discount rate of 12.5% and the discount factor used in 2015 of 0.589 (per the above table)

That is, CU 5,557 = (1,074*1.01)/(12.5%-1%)*0.589.

Illustrative Example 1: VIU calculation

The following example is included for illustrative purposes only. Assume a wholly-owned subsidiary is a CGU.

- The carrying amount of the CGU is CU 9,500 including allocated goodwill pertaining to synergistic cost savings arising from the parent’s bulk purchasing power.
- The industry to which the CGU belongs is experiencing mid to high level growth (6% – 14%) and market participants are forecasting future capacity shortage in the medium term. In the long term, industry growth of 1% is expected.
- Management has no plan to expand the capacity of the CGU and believes a reorganisation may achieve cost savings, but has not yet committed to a plan.

- Management determines the recoverable amount of the CGU at 31 December 2010 based on a VIU approach.
- The pre-tax discount rate is assumed at 12.5%.

Based on the VIU determined below, the CGU has an impairment loss of CU 468 (= 9,032 - 9,500).

Since VIU is lower than the carrying amount for the CGU, management would calculate the FVLCS, the higher of the two would be the recoverable amount of the CGU. Refer to Illustrative Example 2 below.

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**Discount rate (pre-tax rate based on WACC):** 12.5%

**Discount period (mid-year convention):**

- 0.5
- 1.5
- 2.5
- 3.5
- 4.5

**Discount factor:**

- 0.943
- 0.838
- 0.745
- 0.662
- 0.589

**Present value of free cash flow:**

- 814
- 760
- 670
- 605
- 626

**Present value of free cash flow (FY11 to FY15):** 3,475

**Present value of terminal value:** 5,557

**Value in use:** 9,032

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* EBITDA can be used as a substitute in the projection of income and expense related cash flows. However, adjustments must be made to account for other cash flows not captured within EBITDA, including working capital movements and capital expenditure.

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- Applied the long-term annual growth rate of 1% to the normalised future cash flows to determine the terminal value.
- Discounted the terminal value using the assumed pre-tax discount rate of 12.5% and the discount factor used in 2015 of 0.589 (per the above table)

That is, CU 5,557 = (1,074*1.01)/(12.5%-1%)*0.589.
**Fair value less costs to sell**

Fair value less costs to sell (FVLCS) is the amount obtainable from the sale of the asset in an arm’s length transaction between knowledgeable and willing parties, less the costs of disposal. This term is consistent with the measurement basis in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations.*

IAS 36 establishes a hierarchy for determining an asset’s FVLCS as follows:

- The best evidence of the asset’s FVLCS is a price in a binding sale agreement in an arm’s length transaction, adjusted for incremental costs that would be directly attributable to the disposal of the asset.
- If there is no binding sale agreement, but the asset is traded in an active market, FVLCS is the asset’s market price less the costs of disposal.
- If there is no binding sale agreement or active market for the asset, FVLCS is based on the best information available to reflect the amount that the entity could obtain at the end of the reporting period from the disposal of the asset in an arm’s length transaction after deducting the costs of disposal.

If a market price is not available, FVLCS can be determined using a discounted cash flow (DCF) approach. The following valuation principles will apply when determining FVLCS:

- The calculation of FVLCS should reflect all future events that would affect the expected cash flows for a typical market participant that holds the asset.
- Fair value should reflect information that is available without undue cost or effort about the market’s assessment of the future cash flows.
- Market-based assumptions should be based on current market data, unless reliable evidence indicates current experience will not continue.
- If there is contrary data indicating that market participants would not use the same assumptions as the entity, the entity should adjust its assumptions to incorporate the market information.
- FVLCS also includes the amount of transaction costs that would be incurred at the reporting date in disposing of the asset.

**Illustrative example 2: FVLCS calculation**

Consider Illustrative example 1 above. Since VIU is lower than the carrying amount for the CGU, management would calculate the FVLCS. The higher of the two would be the recoverable amount of the CGU.

If management calculated FVLCS using a DCF approach, the following differences would, for example, apply to the calculation:

- Market participants would estimate the fair value considering the effects of restructuring and increasing capacity. These activities will decrease the free cash flows in the short term, but will ultimately result in higher growth in revenues and increased cash flows.
- The estimated revenue margins in a FVLCS calculation would not include synergistic savings since these synergies would not be available to most market participants.
- The discount rate applied to the calculation would be based on what a normal market participant would consider.

**Risk and uncertainty**

Both FVLCS and VIU should reflect risk and uncertainty to the extent that these would be reflected in the price of an arm’s length transaction. Risk may be reflected by adjusting either the cash flows or the discount rate, but not both.

Determining an appropriate discount rate that reflects current market assessments and the appropriate risks (the risks not already reflected in the cash flows) will often be difficult and will require consideration and input from financial management, line management and, perhaps, valuation professionals.

Input from these parties will also be required to formulate assumptions regarding growth rates used to project cash flows until the end of the asset’s useful life, which will also require significant judgment to formulate.

**Cash generating units**

If it is not possible to estimate the recoverable amount of an individual asset, the entity should determine the recoverable amount of the CGU to which the asset belongs. It is not possible to estimate the recoverable amount of the individual asset if:

- The asset’s VIU cannot be estimated to be close to its FVLCS
- The asset does not generate cash inflows that are largely independent of those from other assets
The identification of CGUs requires significant judgment, as specifically acknowledged by IAS 36 and continues to create much debate. IAS 36 indicates that identification of the CGU will be influenced by “how management monitors the entity’s operations (such as by product lines, businesses, individual locations, districts or regional areas) or how management makes decisions about continuing or disposing of the entity’s assets or operations”. While monitoring by management may help identify CGUs, it does not override the requirement that the identification of CGUs is based on largely independent cash inflows.

The carrying amount of a CGU:
- Includes the carrying amount of assets that can be attributed directly, or allocated on a reasonable and consistent basis, to the CGU (e.g., corporate assets)
- Excludes the carrying amount of any recognised liability, unless the recoverable amount of the CGU cannot be determined without consideration of this liability.

**Allocation of goodwill to CGUs**

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the acquirer’s CGUs, or groups of CGUs, that are expected to benefit from the synergies of the combination. This allocation occurs irrespective of whether other assets or liabilities of the acquiree are assigned to those CGUs.

If the goodwill cannot be allocated to individual CGUs on a non-arbitrary basis, it is tested for impairment at the lowest level within the entity at which the goodwill is monitored for internal management purposes, which may comprise a group of CGUs. However, this level cannot be larger than an operating segment as defined in paragraph 5 of IFRS 8 Operating Segments (IFRS 8) before aggregation. This applies irrespective of whether the entity is within the scope of IFRS 8. Allocation of goodwill to a group of CGUs may result in more than one impairment test being required. For example, testing individual CGUs for impairment as well as the group of CGUs to which goodwill has been allocated.

**Textbox 2: Primary differences compared with US GAAP**

Under IAS 36, goodwill is allocated to a CGU or group of CGUs for the purpose of impairment testing. Under US GAAP, goodwill impairment is assessed at the ‘reporting unit’ level. A reporting unit is an operating segment or one level below an operating segment. Consequently, goodwill impairment may be determined on a different basis under IFRS than US GAAP.

**Annual impairment test requirements**

Goodwill, intangible assets with indefinite useful lives and intangible assets not yet available for use need to be tested for impairment annually. This is done by comparing the carrying amounts of these assets with their recoverable amounts, irrespective of whether there is any indication that these may be impaired. These assets are required to be tested for impairment even more frequently if events or changes in circumstances suggest that the asset might be impaired. However, the entity may re-use previous periods’ impairment calculations for intangible assets with indefinite useful lives and for goodwill that forms part of a CGU, or group of CGUs, when all of the following criteria are met:

- The assets and liabilities comprising the CGU, or group of CGUs, have not changed significantly since the most recent calculation of recoverable amount.
- The previously calculated recoverable amount exceeded the carrying amount by a substantial margin.
- The likelihood that an updated calculation of the recoverable amount would be less than the CGU’s, or group of CGUs’, carrying amount is remote.

The standard allows this impairment test to be performed at any time during an annual period, provided the tests are performed at the same time every year. Different CGUs may be tested for impairment at different times. Entities should determine the optimal time for assessing individual CGUs based on the availability of data – considering, for example, the availability of forecast or budget figures, the potential seasonality in a business or the year end close timetable – and use that date in future years.

**Impairment loss**

An impairment loss is recognised to the extent the carrying amount of the asset exceeds its recoverable amount. For assets carried at historical cost, impairment losses are recognised as an expense immediately in profit or loss. If the impaired asset is a revalued asset under IAS 16 or IAS 38, the impairment loss is treated as a revaluation decrease and recognised directly in other comprehensive income, reducing the revaluation surplus for that asset. To the extent the impairment loss exceeds the revaluation surplus, the remaining loss is recognised as an expense immediately in profit or loss. In recognising an impairment loss, the carrying amount of the asset will never be reduced below the higher of its individual recoverable amount and zero.
When a CGU, or group of CGUs, to which goodwill is allocated is tested for impairment, any impairment loss is allocated first to reduce the carrying amount of the goodwill. The remaining loss (if any) is then allocated to other assets of the CGU pro rata on the basis of the carrying amount of each asset in the CGU. However, in this process, the carrying amount of an asset will never be reduced below the higher of its individual recoverable amount and zero. The impairment loss allocation for a group of CGUs would follow the same process for a single CGU.

Textbox 3: Primary differences compared with US GAAP

When testing goodwill for impairment under US GAAP, step one involves comparing the fair value of the reporting unit to its carrying amount. If the fair value of the reporting unit is less than its carrying value, you proceed to step two to determine the impairment. Under step two, the implied fair value of the goodwill of the reporting unit is compared with the carrying amount of that goodwill. The implied fair value is determined by assigning the fair value of the reporting unit to all of the assets and liabilities of that unit (including any unrecognised intangible assets) as if the reporting unit had been acquired in a business combination at that time. An impairment loss is then recognised for any carrying amount in excess of the implied fair value. Unlike US GAAP, IFRS compares the total carrying amount of the CGU with its recoverable amounts and then allocates the loss first to goodwill and then to the other assets.

Reversal of impairment loss

External and internal sources of information may indicate that an impairment loss recognised for an asset, other than goodwill, may no longer exist or may have decreased. The external indicators may include significant favourable changes in the asset's value and market conditions. The internal indicators may include significant favourable changes in the asset's use and performance. If, as a result, the estimates used to determine an asset's or a CGU's recoverable amount have improved since the last impairment loss was recognised, the impairment loss that was previously recognised for the asset, other than goodwill, is reversed. That is, an impairment reversal cannot be recognised merely from the passage of time or improvement in the general market condition.

When an impairment reversal is recognised, the adjusted carrying amount of the asset may not exceed the carrying amount of the asset that would have been determined had no impairment loss been previously recognised. The asset's remaining useful life, the depreciation (amortisation) method or the residual value needs to be reviewed and adjusted if there is an indication that impairment may no longer exist, even if no impairment loss is reversed.

IAS 36 specifically prohibits the reversal of impairment losses for goodwill.

Textbox 4: Primary differences compared with US GAAP

Under US GAAP, the reversal of previously recognised impairment losses is prohibited for long-lived assets (including definite-lived intangibles) to be held and used, as well as any impairment recorded for indefinite-lived intangibles and goodwill.

Disclosures

IAS 36 requires extensive disclosures in respect of the impairment tests performed and impairments recognised. The disclosures are even more extensive for goodwill than for the impairment of other assets. The key disclosure requirements are the following:

- The amounts of impairments recognised and reversed and the events and circumstances that were the cause thereof
- The amount of goodwill per CGU or group of CGUs
- The valuation method applied: FVLCS or VIU and its approach in determining the appropriate assumptions
- The key assumptions applied in the valuation, including the growth and discount rate used
- A sensitivity analysis, when a reasonably possible change in a key assumption would result in an impairment, including the ‘headroom’ in the impairment calculation and the amount by which the assumption would need to change to result in an impairment.
First-time adopters of IFRS

First-time adopters of IFRS are required by IFRS 1 First-Time Adoption of International Financial Reporting Standards, to test all goodwill carried in the balance sheet at the date of transition for impairment when business combinations occurring prior to transition have not been retrospectively restated, regardless of whether there are any indications of impairment. For other assets, first-time adopters should perform an impairment test under IAS 36 if there is any indication at the date of transition that the respective assets are impaired. Care needs to be taken to appropriately assess for impairment when business combinations have been retrospectively restated. Any impairment loss at the date of transition will be recorded as an adjustment to retained earnings.

These impairment tests are based on conditions that exist at transition date. If an entity recognises or reverses an impairment loss at transition date, the disclosures required are the same as those that the entity would have made had it recognised those impairment losses or reversals in the period beginning with the date of transition to IFRS.

For first-time adopters, IAS 36 may bring with it many changes in practice in the way the entity will need to deal with impairment of assets. Entities that are anticipating adopting IFRS should carefully assess the impact of IAS 36 to avoid any surprises when adoption is required. The rigours and extent of impairment testing may well result in the need for additional independent expertise to assist with the required valuations. Table 1 includes suggested actions that entities should consider when adopting IFRS.

Table 1: Key actions when applying IAS 36

- Consider whether an indicator of impairment exists for each relevant asset. If an indicator exists, determine the recoverable amount of that asset.
- Identify which assets have specifically identifiable cash flows and which are parts of CGUs.
- Review existing goodwill and allocate it to CGUs. Allocate new goodwill to cash-generating units from the acquisition date.
- Identify which corporate assets are allocated to CGU and to what extent.
- Assess recoverable amount for goodwill, indefinite-lived intangible assets and intangible assets not yet available for use. For all other assets, recoverable amount is determined when there are indicators of impairment as of that date.
- Identify any impairment losses recognised under previous GAAP and additional impairment losses recognised on transition to IFRS for potential reversals in the future (though special consideration needs to be applied when, for example, the deemed cost exemption is applied).
- As part of determining the VIU:
  - Assess reasonableness of the current year assumptions by comparing the assumptions with historical performance and available market data
  - Review forecasts for inclusion of the most recent information and for exclusion of cash inflows or outflows from future performance enhancements or restructurings to which the entity is not yet committed
  - Assess assumptions regarding growth rates and discount rates
  - Review all of the factors identified by IAS 36 for inclusion in the valuation model
- Consider whether changes to internal financial reporting are required to enable identification of additional disclosure items
- Factor annual impairment testing for goodwill, indefinite-lived intangible assets and intangible assets not yet available for use into the reporting timetable, organising appropriate valuations experts as necessary. Determine optimal time for impairment assessment.
- Consider the requirements of IAS 36 and IFRS 3 Business Combinations together in assessing the accounting implications of impending acquisitions on future results – if previous GAAP, for example, allowed amortisation of goodwill, the cessation thereof upon adopting IFRS, could result in increased impairment charges impacting future results.
Conclusion

Impairments are a key element of the financial reporting process, whether or not an entity is a first-time adopter of IFRS. The process of assessing impairment may be complex and time consuming. It is essential that the owners of the process, typically the finance team, plan early and have access to the right skills such as business modelling and forecasting.

Selection of the most appropriate approach, model and assumptions may be dependent on having sufficient knowledge of the operational and financial prospects of the business and the industry in which it operates. Therefore, senior executives should be involved to provide support, input and critically review outcomes.

“Executive support and input is critical to manage stakeholders’ expectations. Impairment is not just an accounting exercise; it is an assessment of the business.”

We have discussed only the basic requirements of IAS 36 in this publication. For further reading, we recommend our publication IAS 36: Practical Issues, which discusses practical issues in applying IAS 36, available on ey.com/ifs.
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EYG no. AU0593

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