2021

Financial Reporting Supervision

# Information Note

# IAS 36 *Impairment of Assets* – information requests from IAASA

IAASA
Irish Auditing & Accounting Supervisory Authority

# MISSION

**To contribute to Ireland having a strong regulatory environment in which to do business by supervising and promoting high quality financial reporting, auditing and effective regulation of the accounting profession in the public interest**

# CONTENTS

**Page**


Key message .......... 1

1. Purpose of this Information Note .......... 1
2. IAS 36 requirements .......... 1
3. Enforcement activity relating to IAS 36 – case studies .......... 2
4. IAASA examinations .......... 3
5. Conclusion .......... 5

APPENDIX – Extracts of IAS 36 requirements .......... 6

# INFORMATION NOTE

## IAS 36 *IMPAIRMENT OF ASSETS* – INFORMATION REQUESTS FROM IAASA

**Key message**

The objective of IAS 36 is to prescribe the procedures that an entity applies to ensure that its assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and IAS 36 requires the entity to recognise an impairment loss.

Given the economic uncertainty caused by COVID-19, IAASA expects that issuers will incorporate higher levels of uncertainty in their impairment testing assumptions. In these circumstances, issuers should recognise the importance to users of financial reports of high quality disclosures regarding impairment reviews.

To assist issuers in providing useful impairment disclosures, IAASA is publishing this Information Note. This Information Note lists the impairment review information requests that IAASA has made to issuers during previous financial statement examinations. Consideration by issuers as to how they might respond to such questioning may assist issuers in providing high quality information to users of their financial reports.

# 1. Purpose of this Information Note

The primary purpose of this Information Note is to provide preparers, auditors and users of financial statements with information to encourage discussion and stimulate debate as to whether or not issuers have adequately considered the requirements of IAS 36.

With the aim of achieving this primary purpose, IAASA is publishing a selection of the IAS 36 information requests that it has made to issuers during recent financial statement examinations.

# 2. IAS 36 requirements

IAS 36 requires an entity to assess at the end of each reporting period whether there is any indication that an asset maybe impaired. If any such indication exists, the entity must estimate the recoverable amount of the asset [IAS 36.9 refers].

Irrespective of whether or not there is any indication of impairment, an entity must also:

(a) test an intangible asset with an indefinite useful life or an intangible asset not yet available for use for impairment annually by comparing its carrying amount with its recoverable amount;

(b) test goodwill acquired in a business combination for impairment annually [IAS 36.10 refers].

IAS 36 defines recoverable amount as the higher of an asset's or cash-generating unit's (CGU) fair value less costs of disposal and its value in use. It is not always necessary to determine both an asset's fair value less cost of disposal and its value in use. If either of these amounts exceed the asset's carrying amount, the asset is not impaired and it is not necessary to estimate the other amount [IAS 36.18 and IAS 36.19 refers]

The Appendix sets out extracts from IAS 36. These extracts relate to topics that IAASA has raised with issuers as part of recent financial reporting examinations.

## 3. Enforcement activity relating to IAS 36 – case studies

As part of its examination of issuers' financial statements of issuers, IAASA has engaged with a number of issuers regarding their IAS 36 disclosures.

The table below summarises the outcome of IAASA's engagement with some issuers in this area.

**TABLE – IAASA ACTIVITY RELATING TO IAS 36 DISCLOSURES**

| | Matter raised | Outcome |
|---|---|---|
| **1.** | Clarification as to whether or not any additional impairment review was carried out as a result of the impairment indicator – the carrying amount of the issuer's net assets is more than its market capitalisation [IAS 36.12(d) refers]. | The directors provided an undertaking to expand the impairment testing disclosures in future periodic financial statements should the issuer's net assets be more than its market capitalisation, to include:<br><br>(a) discussion on the decline in the issuer's market capitalisation which resulted in the market capitalisation being below the carrying amount of net assets;<br><br>(b) description of the method used to determine the recoverable amount;<br><br>(c) additional narrative information including quantification of the significant assumptions used in the issuer's cash flow projections and a discussion on how the key assumptions were determined;<br><br>(d) information on any sensitivity analysis performed and, to the extent applicable, reasons why no sensitivity analysis was performed; and<br><br>(e) an explanation as to why the decline in the issuer's market capitalisation does not result in an impairment. |
| **2.** | Clarification as to whether or not any additional impairment review was carried out as a result of the impairment indicator – the carrying amount of the issuer's net assets is more than its market capitalisation [IAS 36.12(d) refers]. | The directors provided an undertaking to expand the disclosures in relation to impairment testing as appropriate to ensure that the conclusion of the impairment assessment is clear and, in particular, that the disclosures below are expanded in future periodic financial statements to include:<br><br>(a) additional narrative information including quantification of the significant assumptions used in the issuer's cash flow projections;<br><br>(b) information on the sensitivity analysis performed; and |

| | Matter raised | Outcome |
|---|---|---|
| | | (c) an explanation as to why the decline in the issuer's market capitalisation does not result in an impairment. |
| | | |
| **3.** | Explanation as to why the full country risk premium for a specified country was not applied to the calculation of the issuer's weighted average cost of capital [IAS 36.A18 refers]. | The directors provided an undertaking to expand the impairment review disclosures in future periodic financial statements to include the breakeven discount rate that would be applicable to result in the recoverable amount of the asset being equal to its carrying amount. |
| | | |
| **4.** | Request to provide to IAASA the growth rate used to extrapolate the cash flow projections for a specific CGU and to provide to IAASA the discount rate(s) applied to the aforementioned cash flow projections [IAS 36.134(e) refers]. | The directors provided an undertaking that the following information would be disclosed in future periodic financial statements:<br><br>(a) the growth rate (for the current and preceding periods) used to extrapolate the cash flow projections for a specific CGU; and<br><br>(b) the discount rate (for the current and preceding periods) applied to the abovementioned cash flow projections. |
| | | |
| **5** | Requests to provide to IAASA:<br><br>(a) a description of each key assumption on which the issuer has based their determination of fair value less costs of disposal for a specific CGU [IAS 36.134(e)(i) refers]; and<br><br>(b) a description of the issuer's approach to determining the value assigned to each key assumption and whether those values reflect past experience or are consistent with external sources of information [IAS 36.134(e)(ii) refers]. | The directors provided an undertaking that the following information would be included in future periodic financial statements:<br><br>(a) each key assumption on which management has based its determination of fair value less costs of disposal; and<br><br>(b) a description of management's approach to determining the value (or values) assigned to each key assumption, whether those values reflect past experience or, if appropriate, are consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information. |

# 4. IAASA examinations

In undertaking examinations of financial reports, IAASA has observed that the extent of compliance with IAS 36 has been and continues to be a recurring topic and has resulted in a number of financial reporting enforcement actions.

During 2017, IAASA published a desktop survey on impairment testing in annual financial statements. This desktop survey included recommendations for issuers when evaluating their impairment test processes and significant judgements used to determine the recoverable amounts of assets.

In order to understand issuers' rationale for their impairment disclosures, IAASA has sought additional information from issuers during its previous financial reporting examination cycles. Set out below is a non-exhaustive list of information requests that IAASA asked of issuers:

- Clarify whether any additional impairment reviews were carried out as a result of the impairment indicator where the market capitalisation of the issuer is below the carrying amount of the net assets; and, if so, provide the results of those impairment reviews.

- Explain the significant variance between the market capitalisation and the carrying amount of the net assets as at the reporting date.

- Describe the methods used to assess the recoverable amount (i.e. value-in-use or fair value less costs of disposal). Describe the key assumptions and how these assumptions were determined for the impairment reviews that were carried out for CGUs.

- Explain how the discount rate used was calculated.

- Confirm whether or not a sensitivity analysis was performed.

- Provide a summary of the results of any sensitivity analysis.

- Provide the amount of headroom that was identified in the impairment reviews carried out.

- Clarify how many CGUs have been identified and confirm whether or not any impairment review was carried out on those CGUs.

- Provide the numerical value of the assumptions applied in the value-in-use calculation for specific CGUs (e.g. growth rate percentage, market share percentage).

- Describe how the values attributed to the key assumptions were determined, together with an explanation as to whether these values were consistent with external sources of information.

- Provide an analysis as to how the weighted average cost of capital was calculated;

- Indicate the date on which the impairment review was carried out on specific CGUs;

- Explain why the specific circumstances, which have resulted in an increase in a specified country's 'country risk', were not appropriate to the specific circumstances of the CGU operating in that country.

- Explain the impact on both (i) the discount rate, and (ii) the recoverable amount of a specific CGU had the full country risk premium for a specified country been used.

- Explain why an adjustment of a specified percentage was applied to the headline country risk premium for a specified country.

- Clarify if any country risk elements were included in the cash flow forecasts regarding the calculation of the value-in-use of a specific CGU.

- Explain how the increased political risk in a specified country was incorporated into the calculation of the discount rate.

- Specify the discount rate that would be applicable to result in the recoverable amount of the asset being equal to the carrying amount recognised in the financial statements.

- Explain why the sensitivity analysis presented in the financial statements did not disclose the breakeven discount rate.

- Confirm whether or not the recoverable amount of the Group's investment in the subsidiary undertakings was calculated using the value-in-use technique or the fair value less costs of disposal technique.

- Provide the discount rates used for value-in-use calculations for the specified CGUs, together with comparatives.
- Provide the comparative growth rates used for specified CGUs.
- Describe each key assumption on which the issuer has based its determination of fair value less costs of disposal for a specific CGU.
- Describe the issuer's approach to determining the value assigned to each key assumption and whether those values reflected past experience and were consistent with external sources of information.
- Provide the growth rate used to extrapolate the cash flow projections for a specified CGU.
- Provide the discount rate(s) applied to the cash flow projections.
- Clarify whether or not an impairment test was performed and if not, explain why not.
- Describe how the CGUs were identified and describe how the CGUs were organised to perform the impairment tests.
- Explain why no impairment charge was recognised in instances where the issuer experienced challenging business conditions and in instances where reductions in revenue and increases in losses for certain operations were identified.
- Explain in more detail the facts and circumstances that resulted in the recognition of the impairment charge for a specified CGU.
- Explain how a specified acquisition was integrated within the issuer's operating segments and explain how was the acquisition was incorporated into the issuer's CGUs.

# 5. Conclusion

IAASA continues to focus on and engage with issuers in relation to the application of IAS 36 *Impairment of Assets.*

It is IAASA's expectation that management, boards and audit committees will carefully assess and consider the information requests outlined in this document when determining the financial reporting treatment of impairments – including recognition, measurement, presentation and disclosures – in future financial reports.

# APPENDIX – Extracts of IAS 36 requirements

IAS 36.12(d) states that:

*In assessing whether there is any indication that an asset may be impaired an entity shall consider, as a minimum the following indications:*

*External sources of information*

*….*

*(d) the carrying amount of the net assets of the entity is more than its market capitalisation …*

IAS 36.130(e) states that*:*

*An entity shall disclose the following for an individual asset (including goodwill) or a cash-generating unit, for which an impairment loss has been recognised or reversed during the period:*

*(a) ...*

*(e) the recoverable amount of the asset (cash-generating unit) and whether the recoverable amount of the asset (cash generating unit) is its fair value less costs of disposal or its value-in-use …*

IAS 36.130(g) states that:

*An entity shall disclose the following for an individual asset (including goodwill) or a cash-generating unit, for which an impairment loss has been recognised or reversed during the period:*

*(a) …*

*(g) if the recoverable amount is value-in-use, the discount rate(s) used in the current estimate and previous estimate (if any) of value-in-use ...*

IAS 36.134(e) states that:

*… if fair value less costs of disposal is not measured using a quoted price for an identical unit (group of units), an entity shall disclose the following information:*

*(i) each key assumption on which management has based its determination of fair value less costs of disposal. Key assumptions are those to which the unit's (group of units') recoverable amount is most sensitive.*

*(ii) a description of management's approach to determining the value (or values) assigned to each key assumption, whether those values reflect past experience or, if appropriate, are consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information …*

*… If fair value less costs of disposal is measured using discounted cash flow projections, an entity shall disclose the following information:*

*(iii) the period over which management has projected cash flows.*

*(iv)* the growth rate used to extrapolate cash flow projections.

*(v)* the discount rate(s) applied to the cash flow projections …

IAS 36.A18 states that discount rates must be adjusted*:*

*(a) to reflect the way that the market would assess the specific risks associated with the asset's estimated cash flows; and*

*(b) to exclude risks that are not relevant to the asset's estimated cash flows or for which the estimated cash flows have been adjusted.*

*Consideration should be given to risks such as country risk, currency risk and price risk.*

Irish Auditing & Accounting
Supervisory Authority

Willow House
Millennium Park
Naas
Co Kildare W91 C6KT
Ireland

**Phone:** + 353 45 983600

**Email:** info@iaasa.ie

**www.iaasa.ie**