

Time to focus on asset impairment disclosures

What is the issue?

More entities are likely to record asset impairments under the new standards at June 2008. The changes to market conditions have given rise to more impairment indicators, which forces entities to conduct an impairment test on their assets following the requirements of AASB 136 *Impairment of Assets (AASB 136)*.

Entities with goodwill and non amortising intangible assets (such as brands and licenses) will also need to test their assets for impairment, but for them it is an annual requirement. AASB 136 sets out a formidable list of disclosure requirements, which management should be careful not to overlook. ASIC has noted that compliance with AASB 136 has been variable in past years, and it is something they will focus on this year.

Who does it impact?

Entities that **a)** conduct an annual impairment test (regardless of whether an impairment charge is recorded); and **b)** record an impairment charge, particularly where that charge is material.

What do entities need to be aware of?

The disclosure requirements for testing an asset for impairment are extensive. The disclosures required need to be comprehensive; boilerplate disclosures of a generalised nature are not adequate.

Those entities that carry goodwill and non amortising intangible assets on their balance sheet must conduct an annual impairment test. Regardless of any impairment, these entities must make detailed disclosures about the assumptions and estimates management used in conducting the test. Some entities have questioned whether they need to meet all of the disclosure requirements because others in their industry haven't disclosed such information or because the disclosures require information that is "commercial in confidence". Entities are reminded that an exemption from the disclosure requirements will not be given on these grounds.

Where an impairment of an asset has occurred, sufficient disclosure about the procedures applied by management are required so that users can understand the basis on which the decision was made to write down the asset. As this decision is based on estimates, disclosure can be extensive to ensure there is fair presentation of the bases and assumptions on which those estimates were made.

What do entities need to do?

Tick all the disclosure boxes to ensure that your entity's disclosure requirements are met. Regulators have pointed to several gaps in the disclosures provided by entities in the past and ASIC will expect full compliance this year. For example, entities that have taken impairment charges in the year must disclose the circumstances that gave rise to the impairment.

Entities conducting an annual impairment test of goodwill and non amortising intangible assets should ensure their disclosures are complete. Make sure the key assumptions on which management bases its cash flow projections are clearly described. Key assumptions are those with a significant impact on future cash flows (such as an entity's gross margin growth rate and discount rate). While AASB 136 doesn't require disclosure of the values assigned to these key assumptions, entities must disclose management's approach to determining the values. For example, an entity might disclose that the values assigned to the gross margin reflect past experience plus efficiency improvements expected from restructuring activities.

These entities must also disclose the period over which cash flows are projected by management. Entities will need to provide further explanation if management's forecasts are used for a period of more than five years. Cash flow projections until the end of the useful life of the asset should be estimated by extrapolating management's most recent cash flow projections (that is, up to a five year period). However, any growth rate that exceeds the relevant long term average growth rate should be justified.

Given the current economic climate, some entities may have little headroom following their asset impairment test. These entities should make additional sensitivity disclosures where a 'reasonably possible' change in a key assumption would reduce the recoverable amount of an asset to equal its carrying amount. For example, an entity might disclose that a 1% increase in the pre-tax discount rate would reduce its recoverable amount to equal its carrying amount.

Entities should be clear about whether the impairment test is based on fair value or the value in use calculation. Fair value may be determined using discounted cash flow projections. However, the estimates and assumptions must be 'market based' (such as market based growth rates and discount rates) rather than 'entity specific' rates (such as those based on management's estimates). The value in use calculation is based on the expected cash inflows and outflows from continuing use of the asset.

PwC insight: More disclosure now, more disclosure to come

The disclosure requirements of AASB 136 have been expanded by the IASB's 2008 Annual Improvements project, which applies to entities with periods beginning on or after 1 January 2009. Under this project, entities that have determined the recoverable amount of groups of assets, which include significant goodwill and intangible asset balances using fair value (based on discounted cash flow projections), will need to give the same disclosures as if they had applied the value in use calculation. This means more work for entities.

We encourage entities to get their disclosures right this year, so that they can cope with the increased disclosure requirements that are on the way.

Earlier this month the International Financial Reporting and Interpretations Committee (IFRIC) released two interpretations that will impact certain entities in future reporting periods.



IFRIC 16 Hedges of a net investment in a hedging operation, which clarifies and confirms current guidance in this area. The relevance and impact of this interpretation is discussed below.



IFRIC 15 Agreements for the construction of real estate, which clarifies how entities that construct real estate (either directly or via subcontractors) should account for the associated revenue and expenses. The interpretation applies to entities with annual periods beginning on or after 1 January 2009. Retrospective application is required. It will affect all real estate developers that construct real estate such as units, apartments, houses, and other commercial developments. This issue will be covered in the next edition of *IFRS in brief*, which will be distributed on Thursday 24 July.

Changes to hedging a net investment

What is the issue?

The IFRIC has issued an interpretation to clarify the guidance on accounting for hedges of a net investment in a foreign operation (that is, a subsidiary, associate or joint venture that operates in a different country or currency to the reporting entity). The interpretation applies to entities with annual periods beginning on or after 1 October 2008.

Impact on profit and loss	✓
Impact on balance sheet	✓
Impact on disclosures	✓
Impact on stakeholder communication	✓

Who does it impact?

Entities that hedge the foreign currency risk arising from their net investments in foreign operations.

What does the interpretation clarify and how does it affect current practice?

Clarification	Impact on current practice
Only the risks that arise between the functional currency of the parent entity and the functional currency of the foreign operation can be hedged.	Significant impact on hedge accounting in some cases. Entities should discontinue hedging relationships where presentation currency was designated as the hedged risk or, where possible, redesignate the hedge based on functional currency risk.
The hedging instrument in a hedge of a net investment in a foreign operation can be held by any entity or entities within the group.	No expected impact on existing hedging relationships. However, it confirms that there is flexibility for an entity to hold the hedging instrument in an entity other than the parent entity of the foreign investment (such as in a treasury centre entity or sister company).

Resources to help you keep up to date with IFRS developments

- **IFRS News** summarises news from the International Accounting Standards Board (IASB) and International Financial Reporting and Interpretations Committee (IFRIC). It is published monthly at www.pwc.com/ifrsnews
- **AASB Action Alert** covers the activities of the Australian Accounting Standards Board and how it will respond to recent IASB pronouncements. It is usually published monthly and is available at www.aasb.com.au
- **IASB Update** covers the activities of the IASB and decisions reached at its most recent meeting. It is usually published monthly and is available at www.iasb.org
- **IFRIC Update** covers the activities of IFRIC and tentative decisions reached at its most recent meeting. It is usually published every two months and is available at www.iasb.org