Top 10 tips for impairment testing

December 2008
The last 12 months have been marked by increasing volatility in global markets. Ripples from the credit crunch are being felt in territories and markets across the world as growth slows.

As the global financial crisis has worsened, the number of companies to collapse and/or be taken over has increased.

Some of the statistics below show how volatile the markets are:

- In October, the FTSE 100 in the UK suffered its biggest one day fall since October 1987. The index closed at its lowest since October 2004.
- The Dow Jones industrial average fell below the 8,000 level for the first time since 2003.
- Germany’s benchmark DAX index tumbled after the collapse of the proposed rescue plan of Hypo Real Estate.
- Tightening credit and less disposable income led to Japanese electronic groups losing value; the Nikkei fell to its lowest point since February 2004.
- The Hong Kong Hang Seng dropped in line with the rest of Asia, closing below 17,000 points for the first time in two years in October, and below 11,000 by November.
- Governments have spent billions of dollars on bailing out financial institutions, led by the US with its $700bn rescue package rising to $1,500bn by November 2008.
- Commodity prices have also been affected by the financial chaos. Oil reached a record high in July of $147 a barrel, falling back down to under $55 in November 2008.

The economic downturn in many countries is likely to worsen as the financial crisis continues. The International Monetary Fund warns in its latest world economic outlook report that the global economy is now showing signs of a marked slowdown in growth. The slowdown will increase the likelihood that impairment charges will need to be taken and appropriate disclosures made. IAS 36, ‘Impairment of assets’, is one of the more complicated standards. This makes getting the accounting and disclosures right more of a challenge.

PwC’s Global Accounting Consulting Services has compiled a list of the top 10 areas to watch out for. They have ranked them in reverse order of importance, working up to their top tip. Each tip is accompanied by an explanation or illustrative example.
10. Start impairment testing early

Do not underestimate how long the impairment testing process takes. It includes identifying impairment indicators, assessing or reassessing the cash flows, determining the discount rates, testing the reasonableness of the assumptions and benchmarking the assumptions with the market.

The process should be begun early. It is not an exercise that can be safely left to the last minute, especially as no one likes nasty surprises. Goodwill does not have to be tested for impairment at the year end; it can be tested earlier. But if any impairment indicator arises between the date of the test and the balance sheet date, the impairment assessment should be updated.

**Example 1**

Entity A, a telecoms company, has both goodwill and intangibles with indefinite useful lives and a 31 December year end. Under IAS 36, ‘Impairment of assets’, these assets are required to be tested annually for impairment irrespective of indicators of impairment (IAS 36 para 10).

The standard states that it is acceptable to perform impairment tests at any time in the financial year, provided they are prepared at the same time each year. Entity A could perform an impairment review using 30 September balances, which would be the same time as it completes its budgeting process for the subsequent year.

Performing the review based on September balances gives the entity sufficient time before the year end to assess the appropriateness of cash flows, the discount rate and assumptions behind the calculation.

In addition, this provides the opportunity for management to ensure that the key areas of judgement involved in the review are appropriately considered and approved. The standard requires that the cash flow projections used are those most recently approved by management.

Management can additionally start to consider the disclosure requirements, which can be extensive, and have skeleton disclosures prepared before the year end ready to import into the annual report.

If any assumptions change or there is a further impairment trigger at the year end, the calculation is required to be updated.

**Example 2**

Entity B, a nightclub operator, has a year end of 28 February 2009 and has goodwill relating to a number of acquisitions on its balance sheet. Management normally prepares the impairment test as at the year end date. There was an unwelcome impairment charge identified late in the annual report production process in the previous year, so the CFO asked whether for the current year management could perform the tests as at 30 November 2008.

IAS 36 paragraph 96 states that the annual impairment may be performed at any time during the annual period, provided the test is performed at the same time every year. Entity B could therefore perform the impairment test as at November 2008, provided that tests in future years are performed in November.

The frequency of impairment testing rule in IAS 36 prevents an entity having a period of greater than 12 months between annual impairment tests. However, it does not prohibit moving the date of annual tests to earlier in the year.
9. Comply with the disclosure requirements

IAS 36 and IAS 1, ‘Presentation of financial statements’, have many disclosure requirements. Market regulators around the world have indentified that some companies are not including all the required disclosures. The disclosure requirements are extensive.

Common omissions include the discount rates applied; the long-term growth rate assumptions in a discounted cash flow model for both value in use and fair value less cost to sell; and a description of the key assumptions made and what these have been based on. Key assumptions are those to which the recoverable amount is most sensitive; for example, assumptions on revenue growth, profit margins and discount rates.

In the UK, the Financial Reporting Review Panel (FRRP), the regulator with review responsibilities for company financial statements, has stated that the impairment disclosures are among the weakest areas in financial statements. The FRRP stated in their report that, ‘[IAS 36] raised more questions than most regarding the adequacy of disclosures’.

The most frequent omissions identified by the FRRP are as follows:

- Key assumptions on which management bases its cash flow projections (IAS 36.134(d)(i)).
- The period over which cash flows are projected by management, with an explanation if a period of more than 5 years is used (IAS 36.134(d)(iii)).
- The growth rate used to extrapolate cash flow projections beyond the period covered by the most recent budgets/forecasts, and justification of any growth rate that exceeds the relevant long-term average growth rate (IAS 36.134(d)(iv)).

Additional sensitivity disclosures are required for significant goodwill or indefinite-lived intangible asset balances if a reasonably possible change in a key assumption causes the carrying amount to exceed its recoverable amount (IAS 36.134(f)).

Given the current volatile markets, management should pay extra attention to sensitivity analysis; this is an area that requires considerable thought. The following example illustrates the level of additional sensitivities-related disclosure that is required.

Example

Management of Entity C has carried out an impairment test on cash-generating units (CGUs) with allocated goodwill of C125 million, which represents 50% of total goodwill. It has identified that the recoverable amount is higher than the carrying amount, but only by a small amount. The recoverable amount is C10 million or 3% higher than carrying amount.

A sensitivity analysis was performed where the following changes in key assumptions resulted in the recoverable amount falling to an amount equal to the carrying amount:

<table>
<thead>
<tr>
<th>Original assumption</th>
<th>Sensitivity analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross margin</td>
<td>25% → 24%</td>
</tr>
<tr>
<td>Growth rate</td>
<td>5% → 4.7%</td>
</tr>
<tr>
<td>Discount rate</td>
<td>12% → 12.3%</td>
</tr>
</tbody>
</table>

These potential changes in key assumptions fall well within historic variations experienced by the business and are therefore considered reasonably possible. What are the additional disclosure requirements that are triggered?

Many disclosures are already required, including descriptions of the CGUs, the approach to impairment testing and forecasts, and what they have been based on. Below is a list of the additional disclosures required:
The amount of headroom – that is, the amount by which the recoverable amount exceeds the carrying value (C10 million).

The values assigned to the key assumptions used in the sensitivity analysis (gross margin 25%, revenue growth rate 5%, discount rate 12%).

The amounts by which the key assumptions would have to change where the change would result in the recoverable amount equaling the carrying amount (gross margin fall by 1%, growth rate fall by 0.3%, discount rate increase by 0.3%).

The aggregate carrying amount of goodwill allocated to the CGU(s) (C125m), and the aggregate carrying amount of intangible assets with indefinite useful lives allocated to the CGU(s).

Values assigned to key assumptions may be regarded as sensitive by management, but there are no disclosure exemptions.

8. Allocate goodwill to the appropriate CGUs

Goodwill does not generate cash flows independently from other assets or groups of assets, so the recoverable amount of goodwill as an individual asset cannot be determined. However, goodwill often contributes to the cash flows of individual or multiple CGUs. Therefore, goodwill acquired in a business combination is allocated from the acquisition date to each of the acquirer’s CGUs or groups of CGUs that are expected to benefit from the synergies of the business combination.

Determining the recoverable amount of the goodwill then becomes part of determining the recoverable amount of the CGU or CGUs to which it has been allocated. It is important to think about how the goodwill is going to be subsequently tested for impairment before finalising the allocation process. The following example illustrates how an entity may allocate goodwill.

Example

Entity D acquired 100% of entity E, and C15m goodwill was recognised. Entity D has identified four CGUs (one existing CGU and three CGUs from the acquired entity), which are expected to benefit from the synergies of the combination.

Entity D’s management is proposing to allocate goodwill to these CGUs based on their expected profits. This method of allocation is not appropriate. Expected profits should not be used as the basis for allocating goodwill, because CGU relative profits will change on the basis of prices set by the CGU management and because such an allocation process takes no account of the benefits that the acquisition will bring to each existing CGU.

Entity D’s management should identify a non-arbitrary, reasonable and consistent basis to allocate goodwill to the CGUs. Such identification will be primarily based on where the synergies are expected or where the assets that cannot be separately recognised from goodwill are located.

One practical way management could allocate goodwill to CGUs is based on the relative discounted cash flows of the CGUs, especially as this is how it will be subsequently tested for impairment.

The goodwill that arose on acquisition of Entity E is expected to create synergies of C32 million across all four CGUs; therefore, management should allocate the goodwill across the four units.

The discounted cash flow calculations of synergies arising for the four units are as follows:

<table>
<thead>
<tr>
<th>Unit</th>
<th>Discounted cash flow (Cm)</th>
<th>%</th>
<th>Goodwill allocation (Cm)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A1</td>
<td>10</td>
<td>31%</td>
<td>4.7</td>
</tr>
<tr>
<td>B2</td>
<td>7</td>
<td>22%</td>
<td>3.3</td>
</tr>
<tr>
<td>B3</td>
<td>9</td>
<td>28%</td>
<td>4.2</td>
</tr>
<tr>
<td>B1</td>
<td>6</td>
<td>19%</td>
<td>2.8</td>
</tr>
</tbody>
</table>
7. Watch foreign currency cash flows

Foreign currency cash flows are common and are required to be dealt with in a specific way by IAS 36.

Entity F is determining future cash flows for an impairment test of a CGU containing fixed assets, in accordance with IAS 36. How are future exchange rate movements taken into account, when the cash flows are to be received substantially in foreign currencies and will occur over five years?

The future cash flows are estimated in the currency in which they will be generated and then discounted at an appropriate rate for that currency. This discount rate may not be easy to determine, as it is likely to be different from the rate used for the remainder of the present value calculation, as it is country and currency-risk specific.

The present value of the foreign currency cash flows are then translated at the spot rate at the date when the impairment review is being performed. A more reliable estimate of future exchange rates than the current rate cannot be made. IAS 36 prohibits use of the forward rate existing at date of the impairment review.

If there is a forward foreign exchange contract in place, this will meet the definition of a derivative and is measured at fair value in accordance with IAS 39. Inclusion of the contracted rate in the cash flows for the fixed asset impairment tests would mean that the cash flow effects of the foreign exchange contract would be double-counted, being both in the impairment testing for the fixed asset as well as supporting the financial asset or liability on the balance sheet relating to the derivative.

Example

A CGU of entity G based in the UK. It has 50% of its sales operations in the US and 50% in the UK. Management has prepared its discounted cash flows for impairment testing in the foreign currency for the portion of sales relating to the US.

During the year, following a short-term rise in rates, management decided to enter into a forward contract to sell dollars arising from sales at a fixed rate. The contracted forward contract rate is £1 = $2.05. Since entering into the contract, exchange rates have fallen, and the current spot rate is £1 = $1.90.

Translating the forecast foreign currency cash inflows using the spot rate of $1.90 as required by IAS 36, the entity does not have an impairment of the CGU.

However, at the current spot rate, the forward contract is ‘under water’, and there would be a liability in the balance sheet for the derivative. Applying IAS 36, the impairment testing incorporates spot rates into the calculation of the recoverable amount of the CGU, which reveals no loss. However, a loss to the entity arises from entering into the derivative, committing the entity to convert dollars to sterling at a rate that is less favourable than the current market rate at the year end, and this loss is attributed to the derivative. The loss has therefore been allocated to the instrument that has given rise to it.
6. Compare like with like

Make sure the cash flows being tested are consistent with the assets being tested. Watch for consistency when including or excluding working capital from the CGU. Also make sure that the forecast cash flows make allowance for investment in working capital if the business is expected to grow.

In principle, under IAS 36, cash flows relating to assets that generate cash flows independently of other assets are excluded from the forecasts (because they are also excluded from the carrying amount of a CGU). Examples include financial assets such as receivables.

Similarly, cash outflows relating to obligations that have already been recognised as liabilities are excluded, as the related liability is excluded from the CGU. This ensures that like is compared with like. Examples of such liabilities include payables, pensions and provisions.

Cash flows should exclude cash flows relating to financing (which include interest payments), as liabilities are excluded from the carrying amount and because the cost of capital is taken into account by discounting the cash flows.

Many entities preparing cash flow forecasts for the purposes of impairment testing base the forecasts on the underlying cash flow forecasts for the business. These include cash flows from the settlement of working capital balances at the year end. IAS 36 permits these entities to leave the forecasts unadjusted, as long as the carrying value of the CGU is increased by the amount of the working capital assets and reduced by the value of the working capital liabilities.

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**Decision tree – cash flow forecasts**

**Do forecast cash flows include cash inflows for the settlement of trade debtors outstanding at the impairment test date?**

- **Yes**
  - This will result in higher net cash inflows.
  - Trade debtors should be included in the carrying value of the CGU.

- **No**
  - This will result in lower net cash inflows.
  - Trade debtors should be excluded from the carrying value of the CGU.

**Do forecast cash flows include cash outflows for the settlement of today’s trade creditors?**

- **Yes**
  - This will result in lower net cash inflows.
  - Trade creditors should be included in the carrying value of the CGU.

- **No**
  - This will result in higher net cash inflows.
  - Trade creditors should be excluded from the carrying value of the CGU.
5. Reconcile the conclusion to the current environment

When you’ve finished your detailed calculations, ensure as a cross-check that the final answer makes sense by comparison to external market data.

The current economic climate assumptions that were reasonable a year ago are possibly no longer reasonable. For example, a lack of availability of credit would result in many planned investments being cut back, impacting on growth prospects.

Consumer confidence is falling as the economic outlook deteriorates, and this is having an impact on consumer spending. Reduced spending is affecting many industries, not just banking and property. Cash flow growth assumptions should therefore be reviewed carefully and compared to up-to-date economic growth forecasts.

It is possible to obtain analyst reports for most market sectors. These should be considered as evidence to support growth assumptions. It would also be worth reviewing comparable deals and multiples implied in these deals versus the implied multiples and valuations inherent in any impairment test discounted cash flow calculations.

Example

Entity H, a construction company, has prepared its discounted cash flow calculations for impairment testing as at 30 June 2008 (year end). Management has based its value-in-use calculation on a number of key assumptions (including a rapid recovery from the current downturn). The model produces a recoverable amount that is 10 times forecast earnings for 2009. The calculation indicates that there is no impairment.

A competitor to Entity H was recently sold at a price equivalent to a multiple of five times 2009 forecast earnings, a considerable drop from 12 months ago when they were quoted at a share price that valued them at a multiple of 12 times forecast earnings.

Property prices in the local market the past year have dropped considerably. With the experts predicting no recovery until after 2011, the slump in the housing market has severe implications for the wider construction industry.

Considering the external market data from a number of sources, it seems that Entity H’s management is being optimistic in its calculation. A lower recoverable amount would be more reasonable and supportable.

If the assumptions used by management remain inconsistent with external information, management will be required to disclose how and why it thinks it is appropriate to adopt these assumptions (IAS 36 para 134 (d)(ii)).
4. Pay attention to market capitalisation

Market capitalisation below net asset value is an explicit trigger for an impairment test; calculations of recoverable amount are required. If the market capitalisation is lower than a value-in-use calculation, a reasonable challenge to the appropriateness of the assumptions made is justified, as it is unusual for the value in use of an asset to significantly exceed the fair value less costs to sell. The fair value less costs to sell for the entire business attributed by external sources is indicated by market capitalisation.

Example

Listed entity J has a subsidiary K, which is a retailer of fashionable women’s wear with a year end of 31 December. The group has been struggling for the past six months and is concerned about potential impairment of its net assets of C70m.

<table>
<thead>
<tr>
<th>Date</th>
<th>Market capitalisation</th>
</tr>
</thead>
<tbody>
<tr>
<td>31 December 2007</td>
<td>C80m</td>
</tr>
<tr>
<td>31 March 2008</td>
<td>C69m</td>
</tr>
<tr>
<td>30 June 2008</td>
<td>C40m</td>
</tr>
</tbody>
</table>

The market capitalisation exceeds the carrying value of the net assets at the year end date, so there is no specific need for an impairment test, unless there were other impairment triggers identified.

The fall in market capitalisation value at 31 March 2008 would be an indicator of impairment under IAS 36 paragraph 12(d), and management would be required to perform an impairment test. The value-in-use calculation prepared by management supported the net assets, and no impairment was deemed required at this stage.

The further significant fall in market capitalisation at 30 June would require the assets to be tested for impairment again.

A lower market capitalisation than net asset value is a trigger for an impairment test, but it does not necessarily mean that assets are impaired or indicate how much the impairment charge should be. However, where management determines a recoverable amount that is above market capitalisation, the result should be scrutinised to check that the assumptions are reasonable and supportable in the light of the available external evidence.

Disclosures of the basis for determining key assumptions is required, together with a justification where key assumptions differ from those indicated by external sources of information.
3. Scrutinise the discount rate

Watch out for illogical discount rates. Risk-free interest rates set by central banks are falling in many territories, but other factors affect discount rates in impairment calculations. These include corporate lending rates, cost of capital and risks associated with cash flows, which are all increasing in the current volatile environment and may well result in an increase in the discount rate.

Many companies use the capital asset pricing model to determine the discount rate. Many of the inputs into this model will have changed given current market conditions. For example, with many national base rates reduced, the risk-free rate of government bonds will have fallen in many territories. However, risk premiums have risen, which may more than offset this fall.

**UK rates**

<table>
<thead>
<tr>
<th></th>
<th>Risk-free rate</th>
<th>LIBOR</th>
</tr>
</thead>
<tbody>
<tr>
<td>30 June 2007</td>
<td>5.75%</td>
<td>5.60%</td>
</tr>
<tr>
<td>30 June 2008</td>
<td>5.00%</td>
<td>5.85%</td>
</tr>
</tbody>
</table>

The above data illustrates that while the UK risk-free rate has fallen over the past 12-month period, the LIBOR rate (the rate at which banks lend to one another) has increased. This alone could increase the discount rate that an entity applies without considering any other factors such as the perceived riskiness of the CGU, which may have risen too.

Remember also that the discount rate used is the rate that reflects the specific risks of the asset or CGU. Different CGUs may warrant different discount rates. The discount rate should not be adjusted for risks that have already been considered in projecting future cash flows. In most cases, however, discounted cash flow calculations based on approved budgets will not have been risk-adjusted, so the discount rate should not be reduced. Management should also consider country risk, currency risk and cash flow risk. Different rates should be used for different future periods with different risks where appropriate.

Finally, the current lack of availability of funds for lending may mean that the company may not have optimal gearing; this may impact the weighted average discount rate. Management should carefully review the inputs.

**Example**

A group’s businesses include a water utility and a biotechnology subsidiary. The water utility has a lower risk profile than the biotechnology subsidiary. The biotechnology subsidiary was financed entirely by debt at formation; the water utility was financed by debt and equity. The debt is secured on the assets of the entire group.

The divisions are separate CGUs. The discount rate used to test the biotechnology assets for impairment should be derived individually. It will be greater than the rate used for the water utility due to the greater risk in the biotechnology sector. The rate to be used is not driven by the actual cost of capital attributed to the CGU by virtue of the financing structure adopted by this specific entity (which being entirely debt-financed is likely to be low), but should be a risk-adjusted rate, specific to the assets being tested for impairment.
2. Value in use should comply with the standard

In calculating value in use, future cash flows should be estimated for assets in their current condition.

Key constraints concerning the assumptions that can be made in value-in-use-compliant cash flow forecasts relates to future restructuring or reorganisations and capital investment. The costs and benefits of a future restructuring should not be recognised in the cash flow forecasts, unless the entity is committed to the restructuring and the related provisions have been made. The costs and benefits of future expenditure that is intended to improve or enhance the assets or business should be excluded from the forecast cash flows.

The practical implication of this is that the cash flow forecasts for a value-in-use test may differ from the cash flows in the board-approved budgets for future years. For example, where management has approved restructuring plans, the most recent formally approved budgets are likely to include both the costs and benefits of the planned restructuring. However, accounting for the restructuring provision may be delayed until post-balance sheet if the plans have not been communicated to those impacted by it in sufficient detail. In this case, forecasts would need to be adjusted to remove the related costs and benefits of the restructuring.

Example

The assets of a CGU are being reviewed for impairment at 31 December 20X1. The carrying value of the CGU's net assets is C6,500,000 (excluding any restructuring provision).

Management's approved budgets at 31 December 20X1 include restructuring costs of C350,000 to be incurred; the restructuring is expected to generate cost savings of C100,000 per annum. Formal budgets have been prepared for the three years to 31 December 20X4; thereafter a zero growth rate is assumed for the purpose of the impairment review, because market conditions are extremely competitive and this is expected to continue for the foreseeable future. The VIU including reorganisation costs and benefits is C6,514,000; and excluding them, C6,273,000.

The impairment calculations at 31 December 20X1 will differ according to whether or not provision for the restructuring costs is recognised in the financial statements. This will depend on whether the requirements of IAS 37 have been met for recognition.

Provision for restructuring costs recognised at 31 December 20X1

If provision has been made for restructuring costs, the costs and benefits of the restructuring are taken into account in determining the CGU's value in use. The post-restructuring value in use (C6,514,000) exceeds the CGU's carrying value (C6,500,000 less restructuring provision C350,000). There is therefore no impairment of the CGU's assets.

The financial statements in the year to 31 December 20X1 reflect the following charges:

<table>
<thead>
<tr>
<th>Restructuring provision</th>
<th>C350,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Impairment loss</td>
<td>Nil</td>
</tr>
</tbody>
</table>

No provision for restructuring costs recognised at 31 December 20X1

If no provision for restructuring costs is permitted by IAS 37, the costs and benefits of the restructuring should be stripped out of the projections in determining the CGU's value in use. The CGU's carrying value (C6,500,000) exceeds its pre-restructuring value in use (C6,273,000). There is therefore an impairment loss of C227,000.
In the year to 31 December 20X1, the financial statements reflect the following charges:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Impairment loss</td>
<td>£227,000</td>
</tr>
<tr>
<td>Restructuring provision</td>
<td>Nil</td>
</tr>
</tbody>
</table>

In future years, once the additional spending and restructuring have taken place, the efficiency savings may mean the value in use exceeds the impaired carrying value. However, this does not mean that the impairment should not be booked in the year to 31 December 20X1. The standard requires the impairment to be booked, and any subsequent impairment reversals can only be made in the year when the restructuring has been accounted for and where recoverable amount increases as a result of the restructuring (IAS 36 para 111).
1. Cash flows in the impairment calculations should be reasonable and supportable

Forecasts prepared months ago (for example, before the full effects of an economic downturn became clear) may need to be revised. Forecasts need to be based on the latest management-approved budgets or forecasts, but these do need to be made the basis of reasonable and supportable assumptions that represent management’s best estimate of the economic circumstances that will prevail over the remaining life of the asset or CGU.

Greater weight should be given to external evidence. For example, the cash flows/forecasts should be compared with analysts’ forecasts for the sector and the views of other third-party experts and economic forecasters. Where they are not consistent, explanations will be required.

Example

Entity L is a manufacturer and retailer of household furniture. For many years, management has estimated for impairment purposes, in the company’s cash flow projections, growth of 4.5% for the next year and 6% for the following two years. This gives a value-in-use estimate that exceeds carrying value; no impairment charge is required. Growth in recent years has been broadly in line with these estimates.

In assessing whether the assumptions are reasonable for the next few years, these growth assumptions could firstly be compared to the overall market GDP growth, which is predicted to be only approximately 1.25% in 20X9 based on current market data. This is an indicator that suggests the assumptions may be optimistic.

In addition, management looks at market data available on consumer spending. Considerable growth in discretionary spending is unlikely given the high personal debt levels, tighter credit conditions and sharply increasing household energy, petrol and food bills.

A recent summary of independent economic forecasts supports this, indicating that personal consumption is expected to rise 1.8% this year, with no growth in 20X9. Management has observed that historic sales growth patterns vary in line with personal consumption.

Other macroeconomic data could be considered in assessing the reasonableness of forecasts. For example, after years of rapid house price increases, the local housing market is now struggling; significant price falls are affecting consumer confidence and demand for new houses. The total number of new homes being constructed is expected to fall 40% over the next three years compared with average levels over the last three years. Historical industry and company data suggests that falls in new house construction cause a decline in demand for furniture.

Other data to consider include any sector specific forecasts. Management subscribes to an industry body that provides comprehensive forecasts for the sector. Management has recently received a revised forecast, which suggests demand will fall 1% in the next 12 months, with no growth for the subsequent two years.

Management has decided to revise its forecasts of volume growth in line with market expectations of no growth for the next three years. This gives rise to an impairment of purchased goodwill.