

IFRS News

Shedding light on the IASB's activities*

IAS 36, Impairment of Assets – supplement • May 2007

IAS 36 Impairment – Frequently asked questions

This supplement is the second in the series highlighting frequently asked questions (FAQs) relating to the impairment process. It addresses when impairment tests need to be conducted – ie, how frequently and at what stage in the annual accounts process an asset need to be tested for impairment and how the tests differ depending on the nature of the assets. It also looks at impairment indicators.

Frequency of impairment tests

Question 1

How frequently should an asset be tested for impairment?

Answer 1

The frequency depends on the nature of the assets being tested. The standard requires all assets to be tested when there is an indicator of impairment. In addition, the following assets need to be tested annually even if no indicator of impairment exists: goodwill, indefinite-lived intangible assets and intangible assets not yet ready for use.

Question 2

Should an entity perform the impairment test at interim balance sheet dates?

Answer 2

At each reporting date, including interim balance sheet dates, an entity is required to assess whether there has been any indication that an asset is impaired. If such an indicator exists, the asset must be tested for impairment.

Question 3

How does an entity identify impairment indicators?

Answer 3

Impairment indicators can be internal (specific to the entity), such as sales below budgeted levels, or external, such as increases in market interest rates. Management should have an active process for considering factors affecting its business. Each entity typically has systems of management reporting in place that will assist in this process – for example, a commentary on the results of the month from management,

which will identify the significant events in the month in question.

Example

A branch of a business in southern France, located close to a chemical factory, was largely destroyed in an explosion. The insurance assessors are examining the damage, and management is confident that the full cost of the rebuild plus compensation for loss of profits will be received.

Is the asset impaired, given that it will be replaced?

Solution

Yes, the asset is impaired, as it has been destroyed. The replacement will be a new asset; the costs of construction are capitalised when it is built. Insurance proceeds for the rebuilding cost are credited to income. The impairment loss is charged in the current period. Any insurance proceeds for the fixed asset and compensation for loss of profit can only be recognised when the recovery from the insurers is virtually certain.

Question 4

Should management analyse the individual performance of individual assets or cash-generating units (CGUs), even when the company is profitable overall?

Answer 4

Management should consider the economic performance of the individual assets or CGUs to assess whether the asset or CGU is performing in line with expectations. The fact that an entity is profitable as a whole does not mean that an individual asset or CGU is not impaired.

Example

Entity A produces equipment and has for some time been the market leader. Its chief competitor, B, has recently developed a new product that is widely acknowledged as being superior to that of A.

Entity A's management has not performed an impairment review of its plant on the grounds that annual production and sales are ahead of budget. Should the entity perform an impairment test?

Solution

Entity A should review its plant for impairment. The change in the market for its product is an indicator of impairment, as it can have a significant impact on the value of the plant based on the economic benefit to be obtained from its continued use.

The fact that sales are ahead of budget is not sufficient to conclude that there is no impairment. Management should assess the impact of this new competing product on demand for its existing product and on expected future cash flows.

Timing of impairment tests

Question 5

When should an entity conduct annual impairment tests on goodwill and other intangible assets with indefinite useful lives?

Answer 5

Annual impairment tests may be performed at any time during the financial year, provided that the testing is performed at the same time in subsequent periods. Different assets may be tested at different times of the year.

Question 6

What are the advantages and disadvantages of performing an impairment test before the year end?

Answer 6

The advantages are:

- the testing could be performed at a time when more resources are available to complete the tests;
- the annual impairment test process could be aligned with the budgeting process, which provides the data for value in use tests; and
- any potential impairments and related disclosures could be assessed before the year-end accounts preparation process.

However, the risk with performing a test before the year end is that the impairment test will need to be re-performed if there is a subsequent trigger event.

Question 7

How soon does goodwill acquired in a business combination need to be tested after an acquisition?

Answer 7

Goodwill should be tested for impairment in the year of acquisition. However, the standard also states that if the initial allocation of goodwill cannot be completed within the year of acquisition, that initial allocation should be completed before the end of the first financial year beginning after the acquisition date. Goodwill should be tested once the allocation is completed within the imposed time limit. For example, if a December year-end entity makes an acquisition in January 2006, the maximum period allowed to complete the allocation of goodwill is December 2007.

Question 8

New goodwill arises from an acquisition that is allocated to a CGU (or group of CGUs) with pre-existing goodwill. If this occurs subsequent to the annual goodwill impairment testing date, how does it affect the CGU (or group of CGUs) to which the additional goodwill has been allocated?

Answer 8

Such a CGU (or group of CGUs) is re-tested for impairment before the end of the current year, in addition to the annual goodwill impairment testing.

Example

An acquisition takes place in January 2006; the allocation of goodwill arising from this acquisition was completed in September 2006. The entity's annual goodwill impairment testing is performed in March of each year. When should the entity test goodwill for impairment?

Solution

The CGU (or group of CGUs) with the new goodwill allocated is tested for impairment before the end of the current period, December 2006 (see diagram right.)

