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Insights into IAS 36

Presentation and disclosure

Although IAS 36 'Impairment of Assets' is not a new Standard, and many of its requirements are familiar, IAS 36's guidance is detailed, prescriptive and complex in some areas. Given this, it is often challenging to apply in practice.

The articles in our 'Insights into IAS 36' series have been written to assist preparers of financial statements and those charged with the governance of reporting entities understand many of the requirements set out in IAS 36, and re-visit some areas where confusion has been seen in practice.

This article provides a summary of the IAS 36 disclosure requirements and highlights particular areas of focus for regulators, including select illustrative examples for these areas of focus.

Summary of IAS 36 disclosure requirements

IAS 36 prescribes the disclosure requirements when an entity recognises an impairment loss and/or reversal during the reporting period. IAS 36 also requires the disclosure of information used in estimating the recoverable amount where goodwill or indefinite-life intangible assets have been allocated to a cash-generating unit (CGU) (or group of CGUs) for impairment review purposes (whether or not any impairment loss or reversal was recognised). In the rest of this artcle we refer to CGU and this refers to either a singular CGU or a group of CGUs.

The first table summarises the 'categories' of disclosure requirements outlined in IAS 36 while the second table summaries the detailed disclosure requirements for each category. For the purposes of the second table, 'key assumptions' are those to which the asset's (or CGU's) recoverable amount is the most sensitive.

IAS 36 disclosure categories

Section below	Category
1	For each class of assets
2	When a material impairment loss has been recognised or reversed during the period
3	Where goodwill or indefinite-life intangible assets allocated to a CGU is significant in comparison with the entity's total carrying amount of each
4	Where goodwill or indefinite-life intangible assets is allocated across multiple CGUs and the amount allocated is not significant in comparison with the entity's total carrying amount of each
5	Other

Summary of disclosure requirements of IAS 36

Section 1: For each class of assets

IAS 36 disclosure area	Required disclosures
Impairment losses or reversals recognised in profit or loss during the period	• amount of impairment losses recognised in profit or loss during the period • line item(s) of the statement of comprehensive income within which the impairment loss was recognised • amount of reversals of impairment losses recognised in profit or loss during the period • line item(s) of the statement of comprehensive income within which the impairment loss was reversed
Impairment losses or reversals on revalued assets	• amount of impairment losses on revalued assets recognised in OCI during the period • amount of reversals of impairment losses on revalued assets recognised in OCI during the period
If segment information is disclosed	• amount of impairment losses and reversals of impairment losses recognised in profit or loss and OCI during the period for each reportable segment

Section 2: When a material impairment loss has been recognised or reversed during the period

IAS 36 disclosure area	Required disclosures
For each individual asset (including goodwill or a CGU)	• events and circumstances that led to the recognition or reversal of the impairment loss • amount of the impairment loss recognised or reversed • recoverable amount of the asset of CGU (see guidance note below) • whether the recoverable amount of the asset or CGU is fair value less costs of disposal (FVLCOD) or value in use (VIU)
For individual assets	• nature of the assets • asset's reportable segment if the entity reports segment information
For a CGU	• description of the CGU • amount of the impairment loss recognised or reversed by class of assets and by reportable segment (if the entity reports segment information) • description of the current and former way of aggregating assets and the reasons for changing the way the CGU is identified, if changed since the previous estimate of the CGU's recoverable amount
If recoverable amount is FVLCOD	• Level of the fair value hierarchy (see IFRS 13 'Fair Value Measurement') within which the fair value of the asset or CGU is categorised in its entirety (without taking into ac-count whether the 'costs of disposal' are observable) • for fair value measurements categorised within Level 2 and Level 3 of the fair value hierarchy: – a description of the valuation technique(s) used to measure FVLCOD – a change in valuation technique and the reason(s) for making such change, if applicable – each key assumption on which management has based its deter-mination of FVLCOD – discount rate(s) used in the current and previous measurement if FVLCOD is measured using a present value technique
If recoverable amount is VIU	• discount rate(s) used in the current and previous estimate (if any) of VIU
Where an entity does not disclose information above in accordance with IAS 36	• For aggregate impairment losses and reversals recognised during the period: – main classes of assets affected by the impairment losses and reversals – main events and circumstances that led to the recognition of these impairment losses and reversals

Section 3: Where goodwill or indefinite-life intangible assets allocated to a CGU is significant in comparison with the entity's total carrying amount of each

IAS 36 disclosure area	Required disclosures
General	• carrying amount of goodwill or indefinite-life intangible assets allocated to the CGU (or group of CGUs) • basis on which recoverable amount was determined for the group (FVLCOD or VIU) • if a reasonably possible change in a key assumption on which management has based its determination of the CGU's recoverable amount would cause the carrying amount to exceed its recoverable amount: – amount by which the CGU's recoverable amount exceeds its carrying amount – value assigned to the key assumption – amount by which the value assigned to the key assumption must change in order for the CGU's recoverable amount to be equal to its carrying amount (after incorporating any consequential effects of that change on the other variables used to measure recoverable amount)
Where recoverable amount is based on VIU	• each key assumption on which management has based its cash flow projections for the period covered by the most recent budgets/forecasts • a description of management's approach to determining the value(s) assigned to each key assumption • whether those value(s) reflect past experience or are consistent with external sources of information (if applicable) and, if not, how and why they differ from past experience or external sources of information • period over which management has projected cash flows based on financial budgets/forecasts approved by management • explanation of why a longer period is justified where a period greater than five years is used • growth rate used to extrapolate cash flows projections beyond the period covered by the most recent budgets/forecasts • where the growth rate used to extrapolate cash flow projections exceeds the long-term average growth rate for the products, industries, or country or countries in which the entity operates, or the market to which the CGU is dedicated, the justification for using such growth rate • discount rate(s) applied to the cash flow projections
Where the recoverable amount is based on FVLCOD	• valuation technique(s) used to measure FVLCOD (Entities follow disclosure requirements in IAS 36 instead of IFRS 13 when using FVLCOD (scope exception in IFRS 13)) • where FVLCOD is not measured using a quoted price for an identical unit (or group of units): – each key assumption on which management has based its determination of fair value less cost of disposal – description of management's approach to determining the value (or values) assigned to each key assumption – whether those value(s) reflect past experience or are consistent with external sources of information (if applicable) and, if not, how and why they differ from past experience or external sources of information – level of the fair value hierarchy (see IFRS 13) within which the fair value measurement is categorised in its entirety (without giving regard to the observability of 'costs of disposal') – where there has been a change in valuation technique, the reason(s) for the change • where FVLCOD is measured using discounted cash flow projections, an entity shall disclose the following information: – the period over which management has projected cash flows – the growth rate used to extrapolate cash flow projections – the discount rate(s) applied to the cash flow projections

Section 4: Where goodwill or indefinite-life intangible assets is allocated across multiple CGUs and the amount allocated is not significant in comparison with the entity's total carrying amount of each

IAS 36 disclosure area	Required disclosures
General	• disclose that fact • aggregate carrying amount of the goodwill or indefinite life intangible assets allocated to those units

Where recoverable amounts of any of the CGUs are based on the same key assumption(s) and the aggregate carrying amount of goodwill or indefinite-life intangible assets allocated to them is significant in comparison with the entity's total carrying amount of each	• disclose that fact
	• aggregate carrying amount of goodwill allocated to those CGUs
	• aggregate carrying amount of indefinite-life intangible assets allocated to those CGUs
	• description of management's approach to determining the value assigned to each key assumption
	• whether those value(s) reflect past experience or are consistent with external sources of information (if applicable) and, if not, how and why they differ from past experience or external sources of information
	• if a reasonably possible change in key assumptions would cause the aggregate of the CGUs' carrying amounts to exceed the aggregate of their recoverable amounts:
	  – the amount by which the aggregate of the CGUs' recoverable amount exceeds the aggregate of their carrying amounts
	  – the value(s) assigned to the key assumption(s)
	• amount by which the value assigned to the key assumptions much change in order for the aggregate of the CGUs' recoverable amount to be equal to the aggregate of their carrying amounts (after incorporating any consequential effects of that change on the other variables used to measure recoverable amount)

Section 5: Other

IAS 36 disclosure area	Required (or encouraged where noted) disclosures
For all assets or CGUs where the entity has estimated recoverable amount	Assumptions used to determine the recoverable amount of assets (and CGUs) during the period This disclosure is encouraged, not required, in the case outlined, but this disclosure is required where estimates to measure the recoverable amount of a CGU contains goodwill or indefinite-life intangible assets.
Where any portion of goodwill acquired in a business combination during the period has not been allocated to a CGU at the end of the reporting period	Amount of the unallocated goodwill, together with the reasons why that amount remains unallocated
Where the preceding period's recoverable amount calculation of a CGU is carried forward in accordance with IAS 36	Information required by IAS 36 using the information related to the carried forward calculation of the recoverable amount.

Application issues (as noted by regulators)

In recent years, regulators around the world have focused on the IAS 36 disclosure requirements, noting areas where financial statements filed with the various regulators 'fall short' in their view. The below table highlights areas of consistent focus by regulators, including common criticism by area of focus, including the following:

Common IAS 36 disclosure criticisms as noted by regulators

IAS 36 disclosure requirement	Criticism by regulators	Illustrative example
Explanation of the events and circumstances that contributed to the impairment loss or reversal	• disclosures were too broad and did not provide entity-specific factors of the main events and circumstances that resulted in the impairment	Example 1
Description of the entity's CGU when it recognises or reverses an impairment loss for the CGU during the period	• disclosures did not provide a description of the CGU or such description lacked substance and/or entity-specific information; therefore, financial statement users did not have sufficient context regarding the impact of the impairment on the overall activities and operations of the entity	Example 2
Explanation of the basis of key assumptions and the valuation approach used to determine the recoverable amount	• disclosures did not always discuss key assumptions and for those that did, many did not contain sufficient detail that would provide meaningful information to investors • key assumptions incorporate more than the discount rate and growth rate, consistent with Illustrative Example 9 in IAS 36 (eg gross margin, government bond rates, exchange rate for the period, raw material price inflation, market share, etc.) • comparative information is required	Example 3
Where goodwill or indefinite life intangibles have been allocated to a CGU, but no impairment has been recognised, reasonably possible changes in assumptions if such changes would cause the unit's carrying amount to exceed its recoverable amount	• disclosures did not always contain a sensitivity analysis and for those that did, there was a lack in consistency of the analyses provided • where equity book value exceeds market capitalisation, some regulators would expect to see a transparent sensitivity analysis • sensitivity analyses should incorporate all key assumptions (beyond discount rate and growth rate)	Example 4

Select illustrative examples

Here we illustrate the areas of common criticism by regulators as highlighted in the table above.

It is not intended to illustrate all of the required disclosures in all circumstances. The form and content of the disclosures will depend on the specific facts and circumstances surrounding each entity's impairment review. Accordingly, these illustrative disclosures should be amended, amplified or abbreviated to reflect such specific circumstances.

The illustrative disclosures presented below are excerpts from the 31 December 20X3 consolidated financial statements of a fictional company: Illustrative Corporation and subsidiaries (the Group). The Group provides consulting on IT and telecommunications systems, in addition to online sales of hardware and software products of the Group's business partners. Select disclosures for the Group are as follows:

Example disclosures	Topic
1	Explanation of the events and circumstances that contributed to the impairment loss or reversal
2	Description of the entity's CGU when it recognises or reverses an impairment loss for the CGU during the period
3	Explanation of the basis of key assumptions and the valuation approach used to determine the recoverable amount
4	Reasonably possible changes in assumptions

Example 1: Explanation of the events and circumstances that contributed to the impairment loss

IAS 36.130(a)

The Group considers both qualitative and quantitative factors when determining whether an asset or CGU may be impaired. The Group noted the following indications of impairment for the consulting segment (considered a CGU for impairment testing purposes) and its internally developed software:

Consulting segment

The forecast was adjusted in 20X2 for the decline in consulting services related to conventional telecommunication solutions. The market shifted considerably towards inter- and intranet based solutions during 20X2 and continued in 20X3. As a result, management expects lower growth and moderately declining profit margins for this segment.

Internally developed software

Alternative software products were developed by a competitor during 20X3 that offer functionality that are not presently incorporated in the Group's products. Management's expectation is that the market will shift considerably towards other alternative software products and will significantly reduce future revenues and profits in the next two to three years.

Example 2: Description of the entity's CGU when it recognises or reverses an impairment loss for the CGU during the period

IAS 36.130(d)(i) For the purposes of assessing impairment, the Group's assets are grouped and reviewed for impairment at the CGU level (determined by management as equivalent to its operating segments). The Group has identified two service lines as its operating segments: consulting and retail. Assets related to each segment and the cash inflows generated by each are separately identifiable and independent of other assets or groups of assets. Internal management reporting is organised to monitor revenues at an operating segment-level basis while management makes strategic decisions about continuing or exiting operations on the basis of operating segment results.

An impairment loss was recognised for the consulting segment during the period.

Example 3: Explanation of the basis of key assumptions and the valuation approach used to determine the recoverable amount

IAS 36.80 For the purpose of annual impairment testing, goodwill is allocated to the operating segments expected to benefit from the synergies of the business combinations in which the goodwill arises as set out below, and is compared to its recoverable value:

IAS 36.134(a)

Goodwill allocated to operating segments	31 December 20X3	31 December 20X2
Retail	4,796	2,493
Consulting	245	1,044
	5,041	**3,537**

IAS 36.134(c-d)
IAS 36.130(e)

The recoverable amount of each segment was determined based on value-in-use calculations, covering a detailed three-year forecast, followed by an extrapolation of expected cash flows for the remaining useful lives using a declining growth rate determined by management. The present value of the expected cash flows of each segment is determined by applying a suitable discount rate reflecting current market assessments of the time value of money and risks specific to the segment.

Recoverable amount of each operating segment	31 December 20X3	31 December 20X2
Retail	41,835	30,679
Consulting	62,562	48,354

Excerpt from the discussion of the Retail Segment

IAS 36.134(d)(i)
IAS 36.130(d)(ii)

The recoverable amount of the retail segment was determined based on value-in-use calculations. The following paragraphs describe the key assumptions on which management has based its cash flow projections for the period covered by the most recent budgets/forecasts and a description of management's approach to determining the value(s) assigned to each key assumption:

Key assumptions

Management's key assumptions include:

- stable profit margins, based on past experience in this market (consistent with 20X2). The Group's management believes that this is the best available input for forecasting this mature market. Cash flow projections reflect stable profit margins achieved immediately before the budget period. No expected efficiency improvements have been taken into account and prices and wages reflect publicly available forecasts of inflation for the industry.
- forward exchange rates (USD/GBP) based on the average market forward exchange rate for the budget period (consistent with 20X2). Management obtains quoted rates from external sources of information. The exchange rate is estimated to be consistent with the average market forward exchange rate over the budget period.
- budgeted market share based on the average market share for the previous two periods, increased by the historical growth rate. Management anticipates that market share will continue to grow by 2-3% per year for the next 5 years (2-3% estimated in 20X2) due to its continued success in Europe.

Example 3: Explanation of the basis of key assumptions and the valuation approach used to determine the recoverable amount (cont.)

Cash flow projections

IAS 36.134(d)(iii) Cash flow projections are based on management's approved three-year budgets, followed by an extrapolation of expected cash flows for the remaining useful lives using growth rates determined by management as outlined below:

	Growth rates		Discount rates	
	20X3	20X2	20X3	20X2
Retail	3.0%	3.0%	9.3%	9.5%
Consulting	0.1%	0.5%	10.9%	10.1%

Growth rates

The growth rates reflect the long-term average growth rates for the product lines and industries of the segments (all publicly available). The growth rate for the retail segment exceeds the overall long-term average growth rates for Europe because this sector is expected to continue to grow at above-average rates for the foreseeable future.

Discount rates

The present value of the expected cash flows of each segment is determined by applying a suitable discount rate. The discount rate was derived based on weighted average cost of capital (WACC) for comparable entities in the IT industry, based on market data. The discount rates reflect appropriate adjustments relating to market risk and specific risk factors of each segment (incorporating adjustments for geographic location and currency risk). Management considered cash flows for the consulting segment to be more volatile due to the number of new consulting entities emerging in this space. Further, management considered the maturity and stability of the retail segment when determining the appropriate adjustments to this rate.

Example 4: Reasonably possible change in assumptions

After considering all key assumptions, management considers that a reasonably possible change in only the following assumptions would cause the Retail segment's carrying amount to exceed its recoverable amount:

Discount rate

If the discount rate currently used of 9.3% (9.5% 20X2) decreased by 2.4% (after incorporating any consequential effects of the change on other inputs used in the recoverable amount estimate), the CGU's recoverable amount would be equal to its carrying amount. This analysis incorporated reasonable changes in other key inputs into the discount rate including foreign currency, market risk premium, and the cost of debt.

Stable profit margins

If the assumed profit margins deviate by more than 5% (after incorporating any consequential effects of the change on other inputs used in the recoverable amount estimate), the CGU's recoverable amount would be equal to its carrying amount.

How we can help

We hope you find the information in this article helpful in giving you some insight into IAS 36. If you would like to discuss any of the points raised, please speak to your usual Grant Thornton contact or visit **www.grantthornton.global/locations** to find your local member firm.

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