Ihre Ansprechpartner

Sehr geehrte Damen und Herren,

für Rückfragen zu der beigefügten Publikation „In brief" zur Thematik „IAS 36; Impact of a decommissioning liability in determining the recoverable amount of a CGU" stehen Ihnen folgende Ansprechpartner gerne zur Verfügung:

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In brief
A look at current financial reporting issues

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IAS 36; Impact of a decommissioning liability in determining the recoverable amount of a CGU

Issue

Most liabilities are ignored when calculating recoverable amounts in impairment testing. However certain liabilities, such as decommissioning and restoration liabilities cannot be separated from the related assets. This presents challenges when applying both the 'fair value less costs of disposal' (FVLCOD) approach and the 'value in use' (VIU) approach. The IFRS Interpretations Committee (IC) considered how to apply the current guidance to a VIU calculation. The IC declined to take the issue on to the agenda as the guidance on VIU is clear, therefore neither an Interpretation nor an amendment to IAS 36 was necessary.

Impact

The scope of the IC agenda decision is limited to VIU calculations and particularly to the guidance in IAS 36 *Impairment of Assets*, paragraph 78. The standard requires the carrying amount of a recognised liability to be deducted from both the carrying amount of a CGU and the amount determined under VIU without the cash outflows associated with the liability. The IC observed this approach makes the comparison of the carrying amount and the recoverable amount meaningful. The agenda decision does not address how to incorporate the decommissioning obligation in a FVLCOD approach. We look at the challenges that arise in practice under VIU and FVLCOD below.

Insight

Who is affected?

The agenda decision is not relevant to the majority of liabilities, only those where the liability cannot be separated from the asset because a purchaser could not, or would not, acquire the asset or business without the liability. Thus debt, working capital liabilities, deferred tax and other provisions are not relevant. The most common form of a non-separable liability is a decommissioning or restoration provision. These are most frequently seen in the mining, oil and gas and power generation industries although they appear elsewhere as well. They are usually associated with long-lived assets.

How does it work in practice in VIU?

The recoverable amount of the asset is determined under the VIU cash flow model approach described in IAS 36 *Impairment of Assets* in paragraphs 30 through 57. The VIU cash flow model excludes the cash outflows for decommissioning provision. The recorded amount of the provision is deducted from the amount determined in the VIU model to produce a net recoverable amount. The net recoverable amount is then compared to the carrying amount of the cash generating unit including the decommissioning provision under IAS 37.

It is not appropriate to include the cash outflows for the decommissioning obligation in the VIU cash flow model. The model uses a discount rate that is specific to the assets being tested, reflects the time value of money and the return investors would require to invest in the asset. The performance of the asset will have a number of uncertainties associated with it; demand, price and operational risk among others.

The cash outflows associated with the decommissioning obligation have different uncertainties associated with them, but these are more around amount and timing rather than occurrence or performance risk. Future sales might be uncertain but the need to restore at the end of the asset's life is not. The effect of discounting these cash outflows using the asset rate rather than the risk free rate required by IAS 37 is likely to materially decrease the amount of the liability; this effect is known as the 'discount rate cushion'.

How does it work in practice in FVLCOD?

The impairment standard has little specific guidance on determining FVLCOD generally and none on using how to use FVLCOD as the recoverable amount for a cash generating unit with a non-separable liability. Fair value is almost always developed using a cash flow model to produce an enterprise value unless there is a binding offer in place to sell the relevant asset or business. Fair value is defined in IAS 36 as the price that would be paid to sell an asset or assume a liability. The challenge arises both from the different approaches that might be taken to measure assets and liabilities at fair value as well as the practical approach often used by valuers.

Valuation practice is to produce a single cash flow model that produces a fair value for the business (cash generating unit) that includes the cash outflows for the liability. This approach is consistent with how a market participant would think about determining the fair value of the business. The core asset may have a very long life and decommissioning or restoration is many years in the future. Cash outflows for an obligation that will commence in twenty years in the future would seldom be specifically modelled, even by a party looking to buy the assets, but would be incorporated in a terminal value in the cash flow model.

However, if the mine or power plant is coming to the end of its life and the cash flows are imminent (say expected to begin within the next five years or the period covered by the specific projections) then a market participant may take a different approach to consider at what price it is willing to transact for the assets and the non-separable liabilities.

An alternative approach would be to calculate the fair value of the asset excluding the cash outflows to satisfy the liability and discount those using a market participant discount rate. Separately, the liability would be calculated using market participant assumptions, rather than an IAS 37 approach. The liability measurement should reflect the amount the entity would need to pay a third party to assume the obligation, this would include a profit margin to the third party, plus a margin for estimation risk (that it might be underestimated) and similar market participant type assumptions. This is likely to produce a higher value for the liability than under IAS 37. The amount determined for the liability would then be deducted from the amount determined for the asset to produce a 'net' fair value.

The recoverable amount determined under FVLCOD under either of the valuation approaches described is then compared to the carrying amount of the CGU including the decommissioning obligation measured under IAS 37.

Questions

If you have further accounting questions then please contact your usual PwC technical contacts.