Ihre Ansprechpartner

Sehr geehrte Damen und Herren,

für Rückfragen zu der beigefügten Publikation „In brief“ zur Thematik
“Top 5 Tips for Impairment Reviews of Non-Financial Assets”
stehen Ihnen folgende Ansprechpartner gerne zur Verfügung:

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In brief
A look at current financial reporting issues

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Top 5 Tips for Impairment Reviews of Non-Financial Assets

Issue

Recent months have been marked by increased volatility in global markets, falling oil prices, political unrest, high unemployment and a slower than expected recovery in the Eurozone. Growth from certain markets such as Brazil and China is lower than might have been expected a year ago. This environment could lead to revised budgets and forecasts with an expectation of lower cash flows from existing non-financial assets. It could also lead to an increased likelihood of recognising an impairment charge or at the very least carrying out an impairment review in accordance with IAS 36. Furthermore, impairment continues to be an area of concern for regulators as they continue to push for increased transparency in disclosures. As a reminder, this in-brief highlights the top 5 tips to focus on when completing your impairment review for non-financial assets.

Top 5 Tips

1 — *Cash flows must be reasonable and supportable*

- Forecast revenue growth
  - How does this compare to historical growth and to forecast industry growth?
- Forecast profitability and cash flow
  - How does this compare to historical profitability, the profitability of peers and to market commentary?
  - How does capex compare to depreciation over the forecast period? For Value In Use ('VIU'), capex should be maintenance capex whereas Fair Value Less Costs of Disposal should also reflect enhancement capex.
- Where provisions have been booked centrally, ensure these are appropriately allocated to cash generating units to avoid overstating discounted cash flow ('DCF') valuations.
- Forecasts need to be based on the latest management approved budgets or forecasts. Forecasts prepared months ago may need to be revised.
- Key assumptions in the cash flows need to be disclosed. Sensitivity analysis is even more relevant when the markets are volatile.

2 — *Use cross-checks to gain comfort*

- Check that the final answer makes sense by comparison to external market data.
- Consider earnings multiples implied by the DCF valuation compared with observed comparable market multiples.

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- If a listed entity, then the sum of the groups' cash generating unit's recoverable amounts (adjusted for net debt) should be compared to quoted market capitalisation; if market capitalisation is significantly lower than recoverable amount, challenge the assumptions.

3 Carrying value

- Compare like with like. Ensure that the assets and liabilities within the carrying value are consistent with those supporting the cash flows.
- Operating cash flows relate to the entire business therefore carrying value should comprise all of the net operating assets i.e. not just goodwill! Financial liabilities should not be deducted from net operating assets if testing goodwill.

4 Terminal value

- Cash flows should represent a level that is sustainable into the longer term
- Where a business is cyclical in nature, this should reflect more of a mid-point in its economic cycle.
- Consider whether long-term growth rate is reasonable given long-term inflation expectations.
- Nominal long-term growth rates in excess of long-term nominal GDP growth imply the business will eventually grow larger than the economy itself. This is unlikely to be appropriate.
- Consider whether a more prudent view is relevant given current economic conditions.

5 Discount rates

- A reduction in the risk free rate based on government bonds is unlikely to lead to an overall reduction in WACC. An increase in country risk and risk associated with equity's is likely to offset this risk.
- Given that cash flows should reflect operating activities, discount rates should generally be based on WACC, not cost of equity.
- The rate should be appropriate to the country in which the asset or cash-generating unit operates and in the currency it derives its major cash flows.