Impairment of assets appraised in accordance with IAS 36

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Abstract
The impairment of assets and their impact on business accounting is an important aspect to consider in accounting, affecting also decision-making.
This paper discusses the importance and role of impairment of assets in accounts. It takes into account the losses of impairment of assets and their effects on the preparation and presentation of financial statements. Discusses to what extent the company can improve its decision making process with the development of accounting information produced in accordance with IASB standards, especially regarding the issue of impairment.

Key words: impairment, assets, accounting, company

1. Introduction

In accounting terms there have been significant changes since the adoption by the European Union, of the International Financial Reporting Standards issued by the IASB, such as changes resulting from future use of standards set in the Accounting Standards System (CNS). The impairment of assets is therefore one of the innovative aspects in the Portuguese accounting standards, especially considering the group of companies that do not even take the IAS / IFRS into account.

This background helps to understand the impairment of assets and its impact on business accounting, as an important aspect to consider in accounting, and can also affect decision-making.

IAS 36 - Impairment of Assets is the standard of the IASB (International Accounting Standards Board) which prescribes the procedures that an entity applies to ensure that their assets are not recorded for more than its recoverable value.

In Portugal, the rules governing the issue of impairment are the Official Chart of Accounts (POC)[1] and Accounting Directives (DC)[2] as well as the NCRF 12 - Impairment of assets[3], if approved.

With this 'paper' we want to discuss the importance and role of impairment of assets in the accounts, analyze losses by impairment of assets and their effects on preparation and presentation of financial statements. Discuss to what extent a company can improve its process of decision making with the development of accounting information produced in accordance with IASB standards, especially regarding the issue of impairment.

2. Impairment of Assets

2.1 Objectives, scope and definition

Previously the notion of asset was related to the concept of wealth, which meant that to be considered as such had to be owned by the company. Currently, according to the IASB, an asset is a 'resource controlled by the company as a result of past events and is expected to bring future economic benefits for the company'.

According to the FASB in its Statement Financial Accounting Concepts - SFAC 6, an asset represents the probable future economic benefit obtained or controlled by an entity resulting from past transactions or events.

Shows the following essential features:

- The inclusion of probable future benefit, i.e. the ability to (alone or in combination) contribute directly or indirectly to the generation of future cash flows;
- Having the control and access to asset; and
- Be the result of past transaction or event.

Despite the unanimity regarding the need for the future return on investment of the entity, its measurement is controversial point in the accounting literature. For Hendriksen and Breda (1999), measuring is assigning a numeric value to a characteristic or aspect of any object, such as an

[1] Oficial Accounting Plan.
[2] Accounting Directive.
[3] Accounting standard and Financial Report.

asset or an activity such as production. The purpose of measuring is to find ways of showing the objectives in the presentation of financial information resulting from the accounting structure. The measurement criteria are normally classified in two groups: input values and output values.

As input values are: historical cost, current cost, adjusted current cost, future cost of entry and discounted cost of replacement. The principle criteria for output values are: net selling price, current cash equivalents, settlement securities and discounted values of future cash flows.

The decision regarding the measurement criterion to be used by the organization, aims to show the benefit generated by the asset.

In spite of the choice of the measurement method criteria, it seems the assets are not always shown at their real value. Hence the emergence of instruments such as: monetary correction, revaluation and the impairment, which represents a reduction in the recoverable amount of the asset [DeFond (2002:30), Silva et al (2006:2)]. Impairment occurs when the asset, totally or partially, ceases to provide future economic benefits. The imparity may occur in the case of an individual asset, a set of assets or ‘goodwill’ (Rodrigues, 2005:278).

The impairment is therefore the instrument used to bring the asset to its capacity for real economic return. The impairment is applied to fixed assets (immobilized assets), assets of indefinite useful life, 'goodwill' assets available for sale, and investment in discontinued operations.

The applicable rules are in accordance with the IASB, the 'IAS 36 - impairment of Assets' and, according to FASB, the "SFAS 144 - Accounting for the impairment or Disposal of Long-Lived Assets."

Example:

Our study on impairment of assets, reflects a thorough research of the literature on the subject, with special focus on the rules of IAS (International Accounting Standards) No. 36. This is the standard used in Portugal as set in Regulation No 1606/2002 of 19 July, of the European Parliament and the Council, and subsequent legislation, and also due to the fact that the proposed “Standard Accounting and Financial Reporting (NCRF) No. 12” follows the rules of IASB closely.

2.2 Key aspects of IAS 36 - Impairment of Assets

IAS 36 - Impairment of Assets (2004) is to prescribe the procedures that an entity should apply to ensure that their assets are recorded by an amount that is not greater than the recoverable value (Costa and Alves, 2005: 781). Underlying this is the application of accounting principle of prudence.

The application of IAS 36 falls mainly on the tangible and intangible fixed assets, i.e. tangible and intangible fixed assets, registered and unregistered assets, except for aspects that are covered in a specific IAS, such as: stocks (IAS 2) construction contracts (IAS 11) ; deferred taxes (IAS 12); retirement benefits (IAS 19) Financial instruments (IAS 39) Property Investments (IAS 40); biological assets related to the agricultural activity (IAS 41), some assets related to insurance business (IFRS 4) and non-current assets classified as available for sale (IFRS 5).

2.2.1 Indicators of Impairment

According to Rodrigues (2005:270) there is an impairment loss when the accounting value of the asset exceeds its recoverable amount.

Table I

IMPAIRMENT OF ASSETS			
Cost	1.000	Cost	1.000
Accumulated depreciation	400	Accumulated depreciation	400
Book value	600	Book value	600
Recoverable amount	900	Recoverable amount	400
The asset is not impaired		The asset is impaired	
		Reduce the book value	

The recoverable amount of an asset is the greater of: (1) the net selling price, (2) value in use.

Example:

Table II

IMPAIRMENT OF ASSETS				
			Situation 1	Situation 2
Cost	1.000	Cost	1.000	1.000
Accumulated depreciation	400	Accumulated depreciation	400	400
Book value	600	Book value	600	600
Net selling price	700	Net selling price	200	200
Value in Use	900	Value in Use	500	100
Recoverable amount	900	Recoverable amount	500	200
The asset is not impaired		The asset is impaired (in both situations)		

Net selling price is the value you get from the sale of the property and is the difference between the market price of the asset and the costs of disposal. Net selling price can be objectively determined if there is a sales agreement for a transaction between unrelated parties, or if the asset is traded in an active market. If these conditions are not met, the net selling price estimate is based on the best available information, considering recent transactions of similar assets.

The value in use, according to IAS 36, is the present value of expected future cash flows from an asset or a cash-generating unit. This decision involves judgment and complexity.
The estimate of value in use of an asset involves: (1) the estimate of inputs and outputs of future cash as a result of the continued use of the asset and of its disposal in the end; and (2) the application of an appropriate discount rate to these future cash flows (Rodrigues: 2005, Cairns: 2003).
The estimate of future cash flows should be based on the following:

a) The cash flow projections based on reasonable and sustainable assumptions, representing the manager's best estimate taking into account the existing economic conditions over the remaining useful life of the property. Special attention should be given to external evidence.
b) The projections of cash flows should be included in budgets and forecasts approved by management covering a maximum period of five years unless a longer period can be justified.
c) The projections of cash flows beyond the period covered by the most recent budgets and forecasts, should be estimated by extrapolating the projections based on budgets and forecasts,

using a constant or decreasing growth rate for subsequent years, unless a growth rate increase is justified, which should not exceed the average long term growth rate for the products, industries, or countries where the company operates, or the market in which the asset is used, unless the use of a higher rate can be justified.

To calculate the value in use, an entity should consider the following (Rodrigues: 2005; Husmann & Schmidt: 2008):

a) Estimates of future cash flows the entity expects to obtain from the asset;
   b) Expectations about possible variations in value or within the timeframe of future cash flows;
b) The time value of money, represented by the market rate of interest for assets without risk;
c) The value attributed to the inherent uncertainty of the asset and
d) Other factors, such as lack of liquidity, which the market shows in the evaluation of future cash flows the entity expects to obtain from the asset.

2.2.2 Impairment testing

As argued by Husmann & Schmidt (2008:51), tests for impairment of assets shall be made annually for certain types of assets, or when indicators of impairment are shown for the remaining assets.

The assets that must be subject to annual impairment tests are:

a) Intangible assets with indefinite useful life;
b) Intangible assets not yet available for use (in progress) and
c) 'Goodwill' acquired in a business combination.

The remaining assets are subject to testing for impairment, only when there are indications of impairment. Each case should therefore, be checked if there is any indication that an asset may be impaired. If this is the case, then the entity shall estimate the recoverable value of the asset.
IAS 36 considers that when assessing the impairment indicators of an asset, the entity must consider the following [Ernest & Young (2007:1); Husmann & Schmidt (2008:52)]:

Chart I

Imparity indicators	
• Decrease in market value. • Changes in environmental technology, market, economic or legal. • Increase in interest rates. • Net assets greater than the capitalization stock.	• Obsolescence or physical damage. • Changes in the use of the asset. • Cost is higher than the budgeted cost. • Cash flow lower than the budget. • Previous calculations.

In practical terms, it can be said that external sources of information mean that Cairns (2003), Silva et al (2006):

a) During the period, the market value of an asset has decreased significantly more than would be expected as a result of the age or normal use.
b) during the period, or will occur in the near future, significant changes occurred, with an adverse effect on the entity, regarding the technological environment, the market, economic or legal where the entity operates or in the target market of the asset.
c) The market interest rates or other market rates of return on investments increased during the period, and these increases probably affect the discount rate used in calculating the value of using an asset and reduce the recoverable value of the asset.
d) The amount of net assets of the entity is greater than its market capitalization.

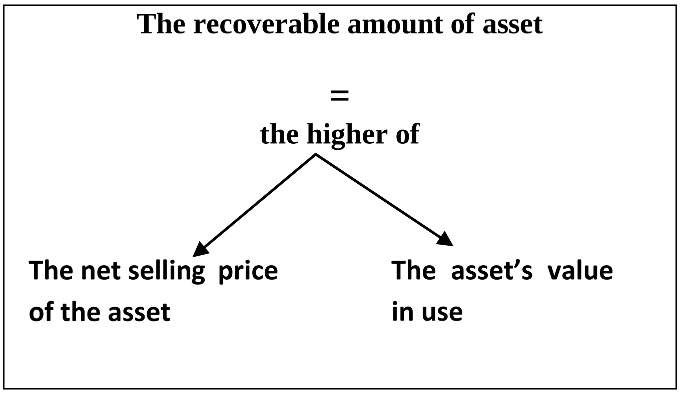
On the other hand, the internal sources of information indicate that:

a) Evidence of obsolescence or physical damage of an asset is available.
b) Significant changes with an adverse effect on the entity occurred during the period, or are expected to occur in the near future, to the extent of how or in what way an asset is used or is expected to be used. These changes include an asset that has become idle, plans to discontinue or restructure the operational unit to which the asset belongs, plans to sell an asset before the previously expected date and reassessment of the life of an asset as finite rather than indefinite.
c) There is evidence in the internal reports indicating that the economic performance of an asset is, or will be, worse than expected.

Are there indicators that the asset may be impaired? In this case, consider the internal and external indicators of impairment, as follows:

1. If the amount exceeds the recoverable amount recorded: use the greater of the two: the net selling price or the value of use of the property;
2. If the estimate of recoverable amount is less than the amount recorded, reduce the recorded amount to the recoverable amount. That is:

Chart II



2.2.3 Measurement of the recoverable amount (net selling price versus value in use)

Based in the previous reasoning we can show the following examples:

Table III

Accumulated depreciation		400
Book value		600
Coluna1	Coluna2	Coluna3
Net selling price	200	
Value in Use	500	
Recoverable amount	500	
Impairment loss		100
Recorded amount		500

Table IV

IMPAIRMENT OF ASSETS		
Cost		1.000
Accumulated depreciation		400
Book value		600
Net selling price	200	
Value in Use	100	
Recoverable amount	200	
Impairment loss		400
Carrying amount		200

2.2.4 Recognition and measurement of loss of an impairment

In accordance with IAS 36, if and only if, the recoverable amount of an asset is lower than its net book value, the recorded amount of the asset should be reduced to its recoverable amount. This reduction is a loss on impairment of assets.
An impairment loss of an asset should immediately be considered an expense, unless the asset is accounted for by a revalued amount under another IAS such as IAS 16, for example. An impairment loss of a revalued asset should be treated as a reduction of the revaluation in accordance with that other IAS.
Once you have recognized an impairment loss of an asset, the cost of depreciation of that asset should be adjusted for future periods, according to the revised book value, considering the residual value, if any, on a systematic basis over the remaining useful life the asset.

2.2.5 cash-generating units

As referred in Ernest & Young (2007), the test for impairment should, where possible, be made for individual assets. But if this is not possible, IAS 36 requires the company to determine the recoverable amount for the cash generating unit to which the asset belongs, and such unit is the smallest identifiable group of assets that generates income in continued use, and are totally independent from cash flows from other assets or groups of assets.

The units generating income (or cash) must be consistently identified from period to period, for the same asset or groups of assets, unless a change is justified.
The recoverable value of a cash-generating unit is the higher of the net value of output of the cash generating unit and its value in use and must be determined in a similar manner to that of individual assets.

2.2.6 Goodwill

According to Costa and Alves (2005:719), ' goodwill ' is positive when the value of the transaction (purchase price) exceeds the fair value of identifiable assets and liabilities that were acquired / assumed on the transaction date. Positive 'goodwill' is considered the most intangible of the intangible assets; it can only be identified with the company as a whole.
The 'goodwill' acquired in a business combination shall, from the date of purchase, be allocated to each cash-generating units or group of cash-generating units, the purchaser, which are expected to benefit from the concentration synergies.
When the 'goodwill' is related to a cash-generating unit, but has not been allocated to that unit, the unit must be tested for impairment whenever there is an indication that it may be impaired.
When 'goodwill' is related to a cash-generating unit, such unit must be tested annually for impairment and whenever there is an indication that it may be impaired.
Rodrigues (2005:272) argues that the test for impairment may be made at any time during the year, provided that the test is performed every year at the same time.
The test for impairment of various cash-generating units can be made at different times. However, if part or all of the 'goodwill' acquired in a business during the financial year has been allocated to a

cash-generating unit, this unit must be tested for impairment before the end of that year.

2.2.7 Reversal of loss of impairment

According to IAS 36, if there is any indication that an impairment loss is found in previous periods for an asset other than goodwill, at the date of each report, may no longer exist or has decreased, the entity must estimate its new recoverable amount and make the necessary adjustments.

Therefore, the following will be considered:

a) If the asset has been revalued and recorded as income in financial statements that year;
b) If the asset has been revalued, the 'revaluation reserves' should be credited.

Depreciation must be adjusted again, throughout the useful life, according to the new recoverable amount.

The increase in the value of an asset, not 'goodwill', attributable to a reversal of an impairment loss shall not exceed the previous accounting value, net of depreciation or amortization, if there had been no reduction in the accounting value of assets in years (Ernst & Young, 2004:4).
The reversal of impairment losses of assets, other than 'goodwill', should be recorded immediately in the profit and loss accounts except if the asset has been revalued according to another Standard (for example, the model of fair value used in IAS 16, the measurement of tangible fixed assets). In such a case the reversal of impairment loss should be treated as an increase in revaluation, as required by this Standard.
The reversal of impairment losses for cash-generating units must be allocated to the assets of the unit, except for the 'goodwill', on a pro rata basis in relation to the accounting value of these assets. The allocation cannot cause an increase in book value of assets above the lower of: (1) its recoverable amount and (2) the book value calculated as if there had been no loss in previous periods [Rodrigues, 2005:278; Ernest & Young, 2004:4].
Note that the reversal of impairment is only permitted in IAS 36 but is prohibited for purposes of U.S. GAAP. The FASB does not allow the reversal of impairment, opposing therefore, the rules of the IASB.
IAS 36 forbids the acceptance of the reversal of impairment losses of ‘goodwill’. The reversal of goodwill refers to goodwill generated internally, which cannot be accepted.

2.2.8 Disclosure

IAS 36 requires the following disclosures:

a) Impairment losses recorded in the income statement during the period and the items of expenditure in which such losses were recorded;
b) Reversals of impairment losses recorded in the income statement during the period and the items in the income statement in which those impairment losses were reversed;
c) Impairment losses on revalued assets have been recorded directly in equity;
d) Reversals of impairment losses on revalued assets have been recorded directly in equity.

If the entity reports the information by segments in accordance with IAS 14 - Segment Reporting should report the following for each segment reported based on the primary format for reporting of an entity:

a. The amount of impairment losses stated in profit or loss and directly in equity during the period;
b. The amount of reversals of impairment losses stated in profit and loss statement and directly in equity during the period.

If the value of the impairment losses accepted or reversed is relevant, the following should be disclosed:

a) The events and circumstances that led to the recognition or reversal of impairment loss;
b) The values of the impairment losses recognized or reversed;
c) For an individual asset: the nature of the asset and the entity information for reporting segments in accordance with IAS 14, the reported segment to which the asset belongs, based on the primary reporting format;
d) For a cash-generating unit: description of the cash-generating unit, amount of

impairment loss recognized or reversed by class of assets and, if the entity information for reporting segments in accordance with IAS 14, reported segment based on the format of the entity's primary reporting, and if the aggregation of assets for identifying the cash-generating unit has changed, you should describe the current and the previous form of such a merger and the reasons for the change;

e) If the recoverable amount the asset is the net value of output or its value in use;
f) If the recoverable amount is the value in use, the basis used to determine the fair value less sale costs;
g) If the recoverable amount is the value in use, the discount rate used in current and previous estimate of value of use.

2.2.9 Future Developments

The revised IAS 36 brings many changes in practice and in ways the authorities have to handle the impairment of assets.

Both the entities already using IFRS as well as those that will use it for the first time should assess carefully the impact of IAS 36 to avoid any unpleasant surprises when they have to use it. The depth and extent of the impairment tests may well result in the need to use independent experts to assist them with the necessary assessments. The planning to adopt the revised IAS 36 requires a set of key actions that the authorities should not overlook.

3. The Portuguese accounting benchmark

3.1 The impairment in the light of the Official Accounts Plan (POC)

There are some differences between the standards of the IASB and the Portuguese accounting reference, which will be pointed out.

a) The IAS 36 requires that, tests of impairment of intangible assets with indefinite useful life, of intangible assets not yet available for use (in progress) and of 'goodwill', be done annually. The rest of the assets should be assessed at the date of each report, if there are indications of impairment of assets. In case of evidence, the recoverable amount of assets should be estimated, to ascertain the existence or not of the impaired assets.

   According to the POC (the Official Plan of Accounts), in paragraph 5.4.4, we need to evaluate whether there is impairment of tangible and intangible fixed assets. However, they do not show indicators of impairment. On the other hand, the DC (Accounting Guideline No. 7) indicates that the recovery test should be conducted annually. Also, the DC 16 states that the revaluation of tangible fixed assets should take into account the purchasing power of money and / or the fair value as defined in DC 13.

b) As to the recoverable amount of an individual asset, IAS 36 requires that if it is not possible to estimate the recoverable amount of an individual asset, you should determine the recoverable amount of a cash-generating unit to which the asset belongs. Both the POC and the DC omit this field.

c) IAS 36 provides detailed information on calculating the value of use. The POC has no provision on the subject.

d) Regarding the reversal of impairment, IAS 36 requires a number of conditions, the POC and DC do not have a ruling on this matter.

e) As the disclosures, IAS 36 requires disclosure of impairment losses and their reversals, indicating the amounts involved events and circumstances that were in their origin and other information. The POC and DC do not require this disclosure.

The provisions of the POC are provided for extraordinary depreciation, which are intended to reflect permanent differences between the recoverable amount of an asset and the value at which it is registered. No further information is given on the indicators of the situation or how the recoverable amount was calculated in an objective and verifiable manner.

Given this difficulty, it must rely on a supplementary to the provisions of IAS 36 - Impairment of assets in areas that is not provided for in national legislation. Regarding indicators, we need to use those already mentioned above, i.e., those with an external source and those of internal origin already explained in section 2.2.1.

3.2 The Impairment of assets under the CNS System - Accounting Standards

The IASB model adopted in the European Union is according to Guimarães (2007) the closest to meeting the objectives recommended in the System Accounting Standards, meeting the different requirements of financial reporting, permitting horizontal and vertical intercommunication and the making of adjustments more flexible.

In the document entitled 'Models of Financial Statements - Notes and link to NCRF' available on the site of the Accounting Standards Committee, there are several references to the concept of impairment, including the following items:

Table V

Heading	Reference to Impairment
Tangible fixed assets	The amounts are net of depreciation and accumulated impairment losses
Goodwill	Accounting treatment provided for NCRF 12, among other norms.
Intangible assets	The amounts are net of depreciation and accumulated impairment losses
Non-current assets held for sale	The amounts are net of depreciation and accumulated impairment losses
Clients	The amounts are net of accumulated impairment losses
Impairment of Debts Receivable (losses / reversals)	Includes net changes during the period for the estimates of losses and reversals of impairments
Impairment of non-depreciable / redeemable (losses / reversals)	Includes net changes during the period for the estimates of losses and reversals of impairments
Impairment of depreciable assets / redeemable (losses / reversals)	Includes net changes during the period for the estimates of losses and reversals of impairments

3.3 The NCRF 12 - Impairment of Assets

In the introduction to the Standard Accounting and Financial Reporting (NCRF) 12 - Impairment of Assets, states that it is based on International Accounting Standard, IAS 36 - Impairment of Assets, adopted by Regulation (EC) No 2236/2004, of 29 December. As we develop the main aspects of IAS 36 and due to the similarity between the standards it is not necessary to address them again.

Apparently, there are no significant differences between the standards of the IASB and Portuguese accounting benchmark for impairment losses. However, as paragraph 5.4.4 of the POC has not had practical application in the conversion of accounts, the registration of assets should be analyzed to identify assets with significant accounting value, which no longer qualify as an asset.

4. Conclusions

IAS 36 will contribute to further clarification in finding the recoverable value - realizable value and value in use, on a systematic basis to periodically review this value and the calculation of the impairment loss and the possibility of reversion of this loss.

On the other hand, the POC provides the opportunity for extra repayments, when at the date of the balance sheet, the value of tangible and intangible assets have a lower value than that recorded in the accounts, and if this difference is considered permanent. The depreciation should be annulled, if the situation is reversed. In these cases the POC is not very clear.

The reversal set by IAS 36, contrary to SFAS No. 144, shows the return on assets better, because it allows the adjusting of the accounting records of the asset to its real economic value for the entity.

IAS 36 is a difficult standard to apply because of the complexity that involves calculating the use value of assets. Other problems may arise, such as the frequency with which the recoverable amount should be measured, determining the appropriate discount rate or the assurance that the recoverable amount and the accounting value are always compared in relation to the same asset or cash-generating unit.

The financial statement of an entity reflects a true and fair financial position, profit and loss accounts and cash flows. Accountants need to give due attention to the impairment losses, as explained above.

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