Case Study Impairment Test under IAS 36 Impairment of Assets

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About Me

- I am living near by Salzburg, Austria
- Lecturer for Finance & Controlling at University of Applied Sciences Upper Austria, based in Steyr, Austria, since 2008
- I have been working 10+ years for KPMG and Deloitte advising listed companies in Austria and Germany mainly on financial reporting
- I have been working 10+ years as Vice President Finance of a listed company in Austria (Lenzing AG / chemicals)
- Currently, I am acting as the CFO of a holding company in Vienna which is the core shareholder of 3 listed companies headquartered in Austria
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Case Study Goals

- Giving insights into the practical application of IAS 36 Impairment of Assets
  - Practical example
  - Discussion of practical hints

- Practising technical accounting English
  - IFRS is written originally in English
  - IFRS is especially made for a listed company *(società quotata)* which want to raise funds (equity or debt); for international investors you have to use English

Description of Case (1/3)

- The company CaffèdiTrieste is based in Trieste, Italy, and prepares its Group financial statements *(bilancio)* for fiscal year (FY) 2021 according to International Financial Reporting Standards (IFRS). CaffèdiTrieste produces and sells high quality coffee. The company is listed on the Milan Stock Exchange *(Borsa Italiana)*.
- By 30 September 2021 CaffèdiTrieste acquired another coffee producer which operates under the brand „CaffèdiTrieste“ since 1 October 2021. The acquired operation runs one factory in Vienna (Austria) and another factory in Munich (*Monaco di Baviera*, Germany).
- During the acquisition a goodwill *(avviamento)* amounting to 5 mn. EUR was generated. The goodwill was allocated with 40% to the cash generating unit (CGU) Vienna and 60% to the cash generating unit (CGU) Munich due to the anticipated synergies.

Description of Case (2/3)

- As at 31 December 2021 the book values *(valore bilancio)* of the assets *(attività)* of CGU Munich and CGU Vienna amounted to 15 mn. EUR and 10 mn. EUR (excluding goodwill).
- The CGUs are very specific. Therefore, it is not possible to determine a reliable market price (no fair value less cost of disposal = *valore di mercato* can be determined).
- For the value-in-use-determination (*valore d'uso* determination) the company prepares a financial plan (please see the following slide) and uses a discount rate of 9%

- **TASK: Determine the necessary impairment loss and recognize it under IFRSs.**

Description of Case (3/3)

Financial plan of CaffèdiTrieste as at 31/12/2021 (T=0)					
in EUR		**CGU Munich**		**CGU Vienna**	
Year	**Basis**	**Cashflow**	**Discounted**	**Cashflow**	**Discounted**
T+1	Budget	1.000	917	1.000	917
T+2	Mid-term-plan	1.350	1.136	1.400	1.178
T+3	Mid-term-plan	1.500	1.158	1.700	1.313
T+4	Mid-term-plan	1.650	1.169	1.900	1.346
T+5	Mid-term-plan	1.800	1.170	2.000	1.300
T+6	Previous year - 5%	1.710	1.020	1.900	1.133
T+7	Previous year - 5%	1.625	889	1.805	987
T+8	Previous year - 5%	1.543	775	1.715	861
T+9	Previous year - 5%	1.466	675	1.629	750
T+10	Previous year - 5%	1.393	588	1.548	654
	Gain from sale of CGU	18.000	7.603	12.000	5.069
Cashflow		**33.037**		**28.597**	
Value-in-use			**17.100**		**15.508**

Solution

- **CGU Munich**
  - Book value: 15 + goodwill 3 (= 5 * 60%) = 18 mn. EUR
  - Value-in-use: 17.1 mn. EUR
  - Impairment loss: 0.9 mn. EUR
  - Journal entry:
    - DEBIT RECORD: Impairment losses (profit-or-loss item) 0.9 mn. EUR
    - CREDIT RECORD: Goodwill (statement of financial position = balance sheet item) 0.9 mn. EUR

- **CGU Vienna**
  - Book value: 10 + goodwill 2 (= 5 * 40%) = 12 mn. EUR
  - Value-in-use: 15.5 mn. EUR
  - Impairment loss: -
  - Journal entry: -

Practical Hints (1/2)

- Definition of CGUs
  - Is not „black-or-white“; in practice the companies tend to create bigger CGUs
    - Reason: impairment loss is less likely, easier to compile figures
- Planning assumptions
  - Have to be approved by the Board of Management and Supervisory Board
  - Have to be consistent with internal plans
  - Certified public accountants and governmental bodies (e. g. enforcement panel) challenge the planning assumptions heavily, especially aiganst current figures
  - Have to have a reasonable basis; it is not enough to say „I think this is right“, it has to be proven by evidence (e. g. studies)
- Discount rate
  - Often a WACC (weighted average cost of capital) is used
- Big companies calculate the impairment tests already during the budgeting phase (not after the reporting date) in order to avoid surprises

Practical Hints (2/2)

- Impairment test needs a lot of estimations (e. g. current interest rates, trends on sales, inflation etc.) → wide range of values
- The rules for impairment test are very sophisticated, you need experts‘ knowledge in company valuation
- Users of IFRSs think this is one of the most complicated areas under IFRSs
- Auditors find frequently mistakes
- The test has to be performed yearly and in addition in case of indicators (so called „triggering events“)
  - In practice you have to think regularly about it, especially in the last years, and normally at least quarterly (Covid crisis, energy and raw materials crises)
- Impairment losses are not predicable, they come especially in economic downturns