

Corporate update—May 2009



Impairment reviews

It is a requirement that fixed assets and goodwill are carried in the balance sheet at no more than their recoverable amount.

At the moment, with the economy as it is, it could well be the case that many companies have assets worth considerably less than their net book values. In this case, it may well be necessary to consider an adjustment for impairment, although there is no automatic obligation to carry out an impairment review under UK GAAP.

Initially, it is important to ascertain whether there are any indications of impairment. For example, during the accounting period, has there been a significant fall in market value, or have there been operating losses or operating cash outflows?

The assets which are most likely to be affected at the moment are:

- property, particularly that bought within the last few years. This excludes investment property, as this is revalued annually;
- goodwill arising on the purchase of a business (or subsidiary, in the case of group accounts).

This is seen particularly if the price paid for the business was based on future levels of profitability that are not now being achieved;

- investments in subsidiaries whose operations have been especially hit by the current economic crisis and in particular those investments made within the last two or three years .

Recoverable amount

The recoverable amount of an asset is the higher of the amounts that can be raised through selling the asset or continuing to use it in the business (value in use).

There is no impairment if the amount for which an asset can be sold exceeds its net book value.

If the value in use exceeds the net book value then it does not matter that the estimated selling price is less than net book value, and in this case, there is no impairment.

The best place to start in determining impairment, where there are indications of impairment, is in considering the estimated selling price. Only if the selling price is less than net book value, should the value

in use be considered.

Value in use

Value in use is calculated as the present value of the future cash flows obtainable from the continued use of an asset. There are three main factors to be considered:

- the 'income generating unit' (IGU) which is the asset or group of related assets;
- the anticipated future cash flows generated by the assets or IGU;
- a suitable discount rate.

Identifying the asset or IGU is a fairly simple matter. However, it is more problematic to identify and calculate the cash flows relating to the asset or IGU and to predict their future pattern.

The information required to do this may also be needed by the directors to ascertain that their business is a going concern, to satisfy the bank or to evaluate future payments due to the previous owners (such as for goodwill or investments). So, although the data is difficult to come by, it can be put to use for a number of different tasks.

Impairment losses

Any reduction from net book value to recoverable amount is accounted for as

a charge against profit unless the relevant asset had previously been revalued. In this case, if the effect of the impairment reverses a previous valuation as a result of changing market prices, it is debited to the revaluation reserve and appears as part of the Statement of Total Recognised Gains and Losses. Any fall in value below historical cost is charged to the profit and loss account.

It is customary to include profit and loss impairment charges along with the depreciation or amortisation on the relevant asset. Any impairment not shown on the face of the profit and loss account must be disclosed (either separately or in aggregate) in the notes to the financial statements.

The amount of any impairment should be shown as a separate line within the depreciation or amortisation section of the fixed asset or goodwill note, not deducted from cost. The same principle should also be applied to investments so that changes in cost arising from additions or disposals are separated from impairment adjustments.

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