IAS 36: Impairment and Reversal Indicators for Commodity-Based Companies

Extract, IFRS Discussion Group Report on Meeting – September 5, 2013

IAS 36 *Impairment of Assets* indicates that an entity shall assess at the end of each reporting period whether there is any indication that an impairment loss recognized in prior periods for an asset other than goodwill may no longer exist or may have decreased. Examples of external information that could indicate an impairment reversal include a “significant” increase in market value of the assets or “significant changes with a favourable effect on the entity” such as favourable changes in the “market environment”.

The issues for consideration include:

- the application of significance thresholds to indicators of reversal of impairment;
- the unit of account for impairment reversals (for example, whether costs for a written off conventional well should be reinstated if reversal is due to new unconventional extraction techniques); and
- how improvements in pricing occurring after the reporting period but prior to the release of the financial statements should be considered in assessing impairment indicators.

Issue 1: Significance Thresholds for Indicators of Reversal of Impairment

Subsequent to an impairment loss being recognized for an asset, all other things being equal, an increase in commodity prices could lead to a reversal of the previous impairment loss.

Example

- An asset with a carrying value of $100 million was written down to $75 million based on commodity price declines of approximately 25 per cent.
- In assessing impairment, the company’s policy was to use a 10 per cent decline in forward commodity prices.
- In the reporting period following the write down, the forward prices improve by two per cent.

As the increase in forward prices would lead to an increase in the fair value of the asset, should a portion of the impairment loss automatically be reversed? Should significance thresholds be applied to indicators of reversal of impairment?

The Group's Discussion

Group members observed that the example was meant to clarify the requirements by narrowly focusing on the price changes in the commodity and a simplified fact pattern when all other factors remain the same. In real life, this factor would not be considered in isolation when making these judgments.

Group members noted that the impairment model is not a mark-to-market model and simply having an increase in commodity prices should not necessarily drive a reversal of impairment. Instead, the impairment model includes the concept of significance and requires consideration of a longer-term horizon. Group members observed that a degree of symmetry is desirable between the thresholds for identifying impairments and reversals. Group members noted that there are no bright lines when assessing whether a particular price decline or increase is "significant" to an entity because this judgment depends on the nature of the asset being considered and the specific facts and circumstances.

Group members explained that applying a significance threshold is necessary to identify when "normal volatility" is being experienced rather than an indicator of impairment or reversal. Further, the appropriate threshold will be based on how volatile the commodity is. Although these threshold amounts are relevant indicators, other facts and circumstances must then be considered.

Group members observed disclosures are critical in this area to ensure investors are informed of the thought process and significant judgments. Further, disclosures about accounting policies for these significance thresholds are helpful to investors.

Group members observed that IAS 36 requires entities at the end of each reporting period to assess whether impairment indicators and reversal indicators exist. The requirement to reverse impairments is not an accounting policy choice but a requirement that should be viewed with the same level of rigour as impairments and with a degree of consistency.

The Group did not recommend any further action be taken regarding this issue.

Issue 2: Unit of Account for Impairment Reversals

Group members deferred discussion of this issue to the next agenda item "IAS 36: Reversal of Impairment – Assets Are Added to the CGU."

Issue 3: Subsequent Improvement in Pricing

Subsequent to a reporting period, but prior to the financial statements being released, an improvement in commodity prices may occur that would be below an entity's threshold for significance of price changes for impairment testing.

Should this subsequent event be taken into account when assessing indicators of impairment?

View 3A – Yes, the subsequent event should be taken into account.

Whether an indicator of impairment exists is a management estimate. Improvement in pricing after the end of the reporting period but prior to the financial statements being released indicates that:

- the decline in pricing was a temporary phenomenon; and
- a fundamental issue with the recoverability of the property's carrying amount does not exist.

View 3B – No, the subsequent event should not be taken into account.

The objective of an impairment assessment is to determine the recoverability of a property at the end of the reporting period. Subsequent improvements in the pricing of a commodity are indicative of conditions that arose after the reporting period and should not be factored into the impairment indicator assessment. Such price changes should be considered "non-adjusting" subsequent events under IAS 10 *Events after the Reporting Period*.

The Group's Discussion

Group members observed that the scope of this discussion is limited to the assessment of indicators of impairment and does not relate to the measurement of impairment losses.

Group members noted that View B applies when a new discrete event occurs after the reporting date that drives the changes in commodity prices. However, Group members observed that considering whether subsequent price changes provide additional information about facts that existed at the reporting date is more challenging and requires judgment.

Many Group members expressed support for View B, some noting that viewing such an event as non-adjusting is a good starting point. However, Group members noted that different circumstances might be identified that could change that view and it is not possible to conclude View B will always be the case. As a result, Group members observed that View C, that it depends on the specific facts and circumstances, may be appropriate.

The Group did not recommend any further action be taken regarding this issue.