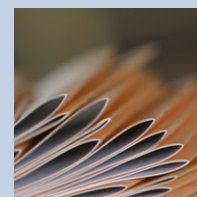


Canadian GAAP - IFRS Comparison Series

Issue 2 – Asset Impairments



From a conceptual standpoint, many of the general principles of IFRS and Canadian GAAP are the same. However, it's the application of those principles that produce the most differences. This series of publications will provide detailed information on the key differences between IFRS and Canadian GAAP.

In this issue, the focus will be on impairments of assets, including goodwill, intangible assets and long-lived assets.

Be advised that this publication is a guide to the differences between Canadian GAAP and IFRS and is not meant to be a comprehensive manual. Please contact a BDO Dunwoody representative for specific details and information.

Introduction

Canadian GAAP and IFRS are similar in the treatment of asset impairments. However, there are four major differences in the requirements, namely:

- (i) Generally, Canadian GAAP uses a two-step impairment testing approach, whereas IFRS's section on asset impairments outlines a one-step approach for impairment testing. The only time this is not the case under Canadian GAAP is in relation to intangible assets with indefinite useful lives (hereinafter referred to as "indefinite lived intangible assets");
- (ii) Canadian GAAP determines an impairment loss as the excess of the carrying amount over the fair value. Impairment loss in IFRS is defined as the excess of the carrying amount over the recoverable amount (the higher of fair value less costs to sell and value in use);
- (iii) Where necessary, Canadian GAAP requires impairment testing to be performed on an asset group (long-lived assets) or at a reporting unit level (goodwill and indefinite lived intangible assets). Impairment testing under IFRS is performed at an individual asset level or, if this cannot be done, at the lowest cash generating unit (CGU) level; and



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- (iv) Canadian GAAP prohibits any reversals of impairment losses. IFRS standards require a reversal of an impairment loss where there has been a change in estimates used to determine the recoverable amount. The only time this is not the case is in relation to Goodwill.

Intangible Assets Not Subject to Amortization

The requirements of Canadian GAAP and IFRS for testing indefinite lived intangible assets and intangible assets with finite or definite useful lives (hereinafter referred to as “definite lived intangible assets”) that are not available for use for impairments are similar. However, two areas of major difference exists between Canadian GAAP and IFRS, the first in relation to the frequency of testing, and the second in relation to how the test is performed.

Canadian GAAP	IFRS
Indefinite Lived Intangible Assets	
<p>In relation to Goodwill and Other Intangible Assets Canadian GAAP requires an annual impairment assessment for intangible assets with an indefinite useful life.</p>	<p>Similarly, IFRS requires annual testing for impairment although this requirement is not always necessary. When the seller meets specific criteria, they may use an asset’s most recent (preceding period’s) detailed calculation of its recoverable amount in the impairment test.</p> <p>Broadly, the criteria are:</p> <ul style="list-style-type: none"> - since the most recent recoverable amount calculation, there have been no significant changes in the assets and liabilities of the CGU that the intangible asset belongs to; - the most recently calculated recoverable amount substantially exceeded the asset’s carrying amount; and - after assessing events and circumstances since the most recent recoverable amount calculation, there is only a remote chance that the recoverable amount calculation would be less than the asset’s carrying amount. <p>These criteria are very similar to the exclusion under Canadian GAAP in relation to annual impairment testing of goodwill.</p>
<p>Testing for impairment of indefinite lived intangible assets is a one-step process - compare the carrying amount with the fair value of the asset.</p> <p>If the carrying amount exceeds the fair value, an impairment loss is recorded for the excess amount.</p>	<p>A one-step impairment test is also used - compare the recoverable amount of the asset with the carrying amount of the asset.</p> <p>If the carrying amount exceeds the recoverable amount, then write down the carrying amount to the recoverable amount.</p>

Definite Lived Intangible Assets Not Available for Use	
<p>Under Section 3063 an impairment assessment is required, for definite lived intangible assets not available for use to be made, whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.</p> <p>These intangible assets are treated the same as any other intangible assets with a definite life.</p>	<p>IFRS requires annual testing for impairment of a definite lived intangible asset not available for use.</p> <p>The impairment test can be performed at any time during an annual period, provided it is performed at the same time every year.</p>
<p>Under Canadian GAAP, testing for impairment is a two-step process:</p> <p>i) compare the carrying amount of the asset group to the expected undiscounted cash flows for that asset group; and</p> <p>ii) if the carrying amount is more than the undiscounted cash flows, then compare the carrying amount to the fair value and record an impairment loss if the carrying amount is more than the fair value.</p>	<p>Unlike Canadian GAAP, IFRS testing is only one step - compare the recoverable amount of the asset with the carrying amount of the asset.</p> <p>If the carrying amount exceeds the recoverable amount, then write down to the recoverable amount.</p>

Long-lived Assets

The requirements of Canadian GAAP and IFRS for testing long-lived assets for impairment are similar. However, three areas of major difference exist between Canadian GAAP and IFRS, broadly:

- (i) the frequency or when to test for impairment;
- (ii) the level that the impairment test is performed at; and
- (iii) the approach taken for the impairment test.

Canadian GAAP	IFRS
<p>A long-lived asset should be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.</p>	<p>Similar to Canadian GAAP, under IFRS an entity is required to assess at each reporting date whether there is any indication of impairment. However, although the indicators are similar, the differences between CGUs and asset groups will impact at what level the indicators should be considered.</p>
<p>The recognition and measurement of an impairment loss requires a long-lived asset to be grouped with other assets and liabilities to form an asset group.</p> <p>This is the lowest level of assets and liabilities for which net cash flows (cash inflows less related cash outflows) are identifiable and independent.</p>	<p>The assessment of impairment under IFRS is determined at the individual asset level or, if this cannot be done, allocated to a CGU and tested at the CGU level. The identification of CGUs is one of the most important decisions an entity is required to make in relation to IFRS impairment testing.</p> <p>A CGU is the smallest identifiable group of assets generating cash inflows that are largely independent</p>

	<p>of the cash inflows from other assets or groups of assets. The identification of CGUs is based on cash inflows rather than net cash flows. However the identification may also look at how internal management monitors or reports operational results (e.g. on a store by store or region by region basis).</p> <p>As a result of looking only at cash inflows (and not net cash flows), the grouping of assets for impairment testing may be significantly different under IFRS. Some entities may identify CGUs that are similar or the same as an asset group for Canadian GAAP, while other entities will identify additional CGUs under IFRS.</p> <p>When identifying a CGU, an entity may need to allocate a portion of an asset's carrying amount to a CGU. For example, goodwill or corporate assets such as a research department may contribute to the cash inflows of various groups of assets. Therefore, the entity may need to apportion the carrying amount of the research department across the relevant CGUs.</p>
<p>An impairment loss of an asset group is allocated on a pro rata basis excluding goodwill, corporate assets and indefinite lived intangible assets. The carrying amounts of the assets should not be reduced below their individual fair values (if known).</p>	<p>Any CGU impairment loss is allocated first to reduce goodwill to zero, then pro rata to other assets of the CGU (based on carrying amounts), except that carrying amounts of other assets should not be reduced below the higher of:</p> <ul style="list-style-type: none"> i) fair value less cost to sell; ii) value in use; and iii) zero.
<p>Testing for impairment is a two-step process:</p> <ul style="list-style-type: none"> i) compare the carrying amount of the asset group to the expected undiscounted cash flows for that asset group; and ii) if the carrying amount is more than the undiscounted cash flows, compare the carrying amount to the fair value and record an impairment loss if the carrying amount is more than the fair value. 	<p>Unlike Canadian GAAP, IFRS uses a one-step test - if any indication of impairment exists, then compare the recoverable amount of the asset with the carrying amount of the asset.</p> <p>If the carrying amount exceeds the recoverable amount, then write down to the recoverable amount.</p> <p>We believe this one-step method will result in more impairments being recognized under IFRS than would be recognized under Canadian GAAP.</p>

Goodwill

The requirements of Canadian GAAP and IFRS for testing goodwill for impairments are similar. However, two major differences exist, broadly:

- (i) at what level the test is performed; and
- (ii) the approach taken.

Canadian GAAP	IFRS
<p>Goodwill is tested for impairment at a reporting unit level. This is at an operating segment or one level below (component). A component is used where discrete financial information is available and regularly reviewed by management.</p>	<p>All assets, including goodwill, are allocated to a CGU.</p> <p>Goodwill may be allocated to groups of CGU's that together are no larger than a segment based on the entity's primary or secondary reporting format determined in accordance with IFRS 8 – Operating Segments. This CGU grouping level will commonly be less aggregated than a reporting unit.</p>
<p>In Canadian GAAP, unless specific criteria are met, goodwill should be assessed annually for recoverability. Testing should be performed more frequently whenever events or changes in circumstances indicate that the reporting unit may be impaired.</p> <p>The following criteria relieves a seller of having to test for goodwill annually:</p> <ul style="list-style-type: none"> - there is no significant change in the assets and liabilities of the reporting unit since the most recent fair value calculation; - the most recently calculated fair value amount substantially exceeded the carrying amount; and - after assessing recent events and circumstances since the most recent fair value calculation, there is only a remote chance that the carrying amount would exceed the fair value. 	<p>Similar to Canadian GAAP, annual testing for impairment of goodwill is required, with additional testing required whenever events or changes in circumstances indicate that the CGU may be impaired.</p> <p>The CGU's most recent (preceding period's) detailed calculation of its recoverable amount may be used in the impairment test.</p> <p>Broadly, the criteria are:</p> <ul style="list-style-type: none"> - since the most recent recoverable amount calculation, there is no significant change in the assets and liabilities of the CGU; - the most recently calculated recoverable amount substantially exceeded the CGU's carrying amount; and - after assessing events and circumstances since the most recent recoverable amount calculation, there is only a remote chance that the recoverable amount calculation would be less than the asset's carrying amount.
<p>Testing for impairment is a two-step process:</p> <ol style="list-style-type: none"> i) compare the carrying amount of the reporting unit to the fair value of the reporting unit. ii) if the carrying amount is more than the fair value of the reporting unit, then compare the carrying amount of goodwill to the implied fair value of the goodwill and record an impairment loss if the carrying amount is more than the implied fair value. <p>The implied fair value of the goodwill is calculated based on the value of goodwill that would be allocated if the reporting unit was acquired in a current business combination (i.e. goodwill is treated as a residual).</p>	<p>A one-step impairment test is required under IFRS.</p> <p>The entity shall estimate the recoverable amount of the CGU that the goodwill has been allocated to and compare this with the carrying amount of that CGU.</p> <p>If the carrying amount of the CGU exceeds the recoverable amount of the CGU, then recognize an impairment loss.</p> <p>Any CGU impairment loss is allocated first to reduce goodwill to zero, then pro rata to other assets of the CGU (based on carrying amounts), except that the carrying amounts of other assets should not be reduced below the higher of:</p> <ol style="list-style-type: none"> i) fair value less cost to sell; ii) value in use; and iii) zero.

Measuring an Impairment Loss

The bases for recognizing an impairment loss are slightly different under Canadian GAAP and IFRS. As mentioned above, Canadian GAAP compares the carrying amount with the fair value for an asset group or reporting unit (implied fair value). IFRS compares the carrying amount with the recoverable amount. The recoverable amount is defined as the higher of the fair value less cost to sell and the value in use.

Canadian GAAP	IFRS
<p>The fair value used in the calculation of impairment losses is the amount obtainable from the sale of an asset in an arms length transaction between knowledgeable, willing parties under no compulsion to act (i.e. market driven valuation).</p>	<p>The fair value less cost to sell is used in the calculation of the recoverable amount and is the amount obtainable from the sale of an asset or a CGU in an arms length transaction between knowledgeable and willing parties, less the costs of disposal.</p> <p>Value in use is used in the calculation of the recoverable amount and is the present value of the future cash flows expected from the asset or CGU (i.e. entity-specific valuation). The methodology for calculating value in use includes:</p> <ul style="list-style-type: none">- future cash flows are estimated for the asset or CGU in its current condition;- pre-tax cash flows and discount rates are used; and- the discount rate to be applied is the market's assessment of the time value of money, adjusted for asset-specific or CGU-specific risks. <p>Unlike Canadian GAAP undiscounted cash flows are not considered in any impairment test. This will likely result in more impairment losses being recorded under IFRS than would be required under Canadian GAAP.</p>

Impairment Indicators

In both Canadian GAAP and IFRS, similar suggested indicators of impairment are included. These indicators are both external (the environment that the entity operates in) and internal (the entity's own operating environment). Under both Canadian GAAP and IFRS, these are suggested indicators only; therefore an entity may look at other indications to assess if the carrying amount of an asset is recoverable or not.

Reversal of Impairment Losses

The requirements under Canadian GAAP and IFRS are very different with respect to reversal of impairment losses. Other than assets held for sale, Canadian GAAP prohibits any reversal of impairment losses. Except in relation to goodwill, Under IFRS, reversal of impairment losses is required where there has been a change in estimates used to determine the recoverable amount. Further to this, the carrying amount after any impairment loss reversal is restricted to the asset's carrying amount that would have been determined if no impairment loss had been recognized in prior years (i.e. net of amortization or depreciation).

Under both Canadian GAAP and IFRS, an entity is prohibited from reversing any goodwill impairment losses. As a result of this prohibition, a reversal of an impairment loss for a cash-generating unit is allocated differently than the allocation of the original impairment loss. The reversal of an impairment loss is allocated pro rata to the assets of the unit, excluding goodwill, using the assets' carrying amounts.

Interim Reporting (IFRIC 10 - Interim Financial Reporting and Impairment)

Guidelines were established under IFRIC 10 by the International Financial Reporting Interpretations Committee (IFRIC), a committee that has a similar role to the role of the Emerging Issues Committee in Canadian GAAP. Under IFRS, while a seller is prohibited from reversing any goodwill impairment loss, IFRS also requires an entity to apply the same accounting policies in its interim financial statements as are applied in its annual financial statements. The frequency of an entity's reporting (annually, semi-annually, or quarterly) should not affect the measurement of its annual results (i.e. interim measurements should be on a year-to-date basis). This could be interpreted as allowing a reversal of goodwill impairment losses in subsequent periods (e.g. annual financial statements) where conditions may have changed such that an impairment loss would have been less or not required at all, had the impairment assessment been made only at the year end.

IFRIC 10 was issued to clarify the IFRS accounting treatment and prohibits an entity from reversing an impairment loss recognized in a previous interim period for goodwill.

First Time Adoption Issues (IFRS 1 – IG 39 to IG 43)

The date of transition to IFRS is defined as "The beginning of the earliest period for which an entity presents full comparative information under IFRSs in its first IFRS financial statements." At that point in time, an entity is required to apply IAS 36. Therefore, in preparing an entity's opening IFRS balance sheet, an entity is required to determine whether any impairment loss exists at that date, and where required, to measure any impairment loss.

At that time, the entity is also required to review any previously recorded impairment losses and reverse any impairment losses that no longer exist at the date of transition (other than in relation to goodwill). Where the opening IFRS balance sheet reflects impairment losses, made under either Canadian GAAP or IFRS, any later reversal of those impairment losses is recorded in the income statement, except in certain cases where the entity is required to treat the reversal as a revaluation.

Guidance is also available on the estimates to be used in determining any impairment loss or reversal of an impairment loss at the date of transition. These estimates should be consistent with estimates made at the date of transition under the previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were in error. These estimates should not reflect conditions arising after transition.

The Future of Impairments under IFRS

The International Accounting Standards Board (IASB) is conducting a research project on convergence with the Financial Accounting Standards Board (FASB) rules on impairment. A final product on this project would likely replace the current standard. However, we do not anticipate this project will be completed by 2011.

Conclusion

In general, the principles related to impairment under Canadian GAAP and IFRS are similar. However, major differences exist between the two standards in four areas, broadly:

- i) the frequency or when to test an asset for impairment;
- ii) the level that the impairment test is performed at – a CGU compared to an asset group or reporting unit; and
- iii) the approach taken for the impairment test; and iv) except for goodwill, reversals of previously recognized impairment losses are required.

If you require further guidance on asset impairment testing under IFRS or any other IFRS information or reference sources, please contact your local BDO Dunwoody LLP office or visit www.bdo.ca/ifrs.