



UNIVERSITY OF GOTHENBURG
SCHOOL OF BUSINESS, ECONOMICS AND LAW

Application of IAS 36 - Impairment of fixed assets

A qualitative study about the main challenges for companies regarding impairments

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Preface

This thesis is the concluding part of our economic studies, focusing on financial accounting. It is accomplished during spring term 2014 at the University of Gothenburg. The process has been interesting and instructive.

First of all we want to thank our tutor Thomas Polesie, who initially believed in our idea and then continually helped us to improve our analytical approach, by thinking outside the box and looking at the big picture.

The interviews have been fundamental to this study. Hence, we would like to thank the respondents: Anna Sikström at Volvo, Johan Roempke and Johan Sandberg at EY, Helen Olsson Svärdström at PwC and Conny Lysér at KPMG for being helpful and taking their time.

During the process, we have had seminars with other students who write theses within similar area. We would like to thank them for productive meetings and concrete feedback.

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Abstract

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Title: Application of IAS 36 – Impairment of fixed assets; A qualitative study about the main challenges for companies regarding impairments

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Background and Discussion: Impairment has been debated within the professionals. IAS 36 seems to be a challenging area since it is a focus area for NASDAQs annual review of financial reports in 2012. The report shows that application of IAS 36 is beneath contempt. Assessment of whether an asset has declined in value may be highly subjective and impairments may look like a failure and the management can therefore have incentives to report in a certain way. If the value of assets are overestimated, impairment losses can be avoided and the result is affected.

Purpose: The purpose of this thesis is to investigate difficulties for companies when applying IAS 36 for fixed assets, by exploring if there is a gap between the Standard and practice.

Delimitation: This study cover companies in Sweden with accounting in accordance with IFRS and the focus area is impairment of fixed assets. This means that goodwill issues are not deeply investigated and disclosures as well as reversal of impairments are excluded.

Methodology: Data collection has been carried out through a qualitative method. One IFRS expert and four auditors at three different agencies were interviewed.

Conclusions: IAS 36 implicates several difficult areas for companies, explained by the gap between regulation and practice. The main difficulties are recognition of when impairment tests need to be conducted, distinguished the need for impairment losses from the need for changed depreciation time in practice, application of value in use and determination of CGUs. Companies may in some cases unintentionally report errors due to that the Standard can be difficult to apply.

Further research: The following areas would be interesting for further research:

- Accomplish a similar study, but focusing on intangible assets, such as goodwill.
- Investigate why IASB has not changed or simplified IAS 36 in a higher extent and how the regulation can be improved.
- Find out how stakeholders react to impairment losses.
- Conduct a similar study but focusing on an industry, in order to compare companies, for example the printing industry, which is standing in the middle of a structural change.

Keywords: *Impairment, Impairment test, Impairment loss, IFRS, IAS 36, Fixed asset, Assessment, Recoverable amount, Value in use, Discount rate, Cash flows, Fair value, CGU*

Abbreviations

BC – Basis for Conclusions

CGU – Cash Generating Unit

CF – Conceptual Framework

ESMA – European Securities and Markets Authority

EU – European Union

IAS – International Accounting Standard

IAS 36 – International Accounting Standard, Impairment of Assets

IASB – International Accounting Standard Board

IFRS – International Financial Reporting Standards

NASDAQ – National Association of Securities Dealers Automated Quotations

RR 17 – Redovisningsrådets Rekommendation, Nedskrivningar

WACC – Weighted Average Cost of Capital

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1. Introduction

In this chapter we start by explaining the background to the matter in order to clarify why it is a timely topic to investigate. Thereafter some issues regarding impairments of fixed assets are highlighted. This leads to the purpose of the thesis and a research question will be stated, followed by the delimitation of the study. In the end of this chapter the contribution of the thesis and a short description of the disposition are presented.

1.1 Background

High numbers in the balance sheet are often desirable (Polesie, 2014). The purpose of IAS 36 is to ensure that assets are not overvalued (IAS 36:1). Application of the Standard may shift between companies, which can be partly due to the financial position of the companies. A financially strong company can afford to recognise impairments, while an instable company has no fiscal space for impairment losses. A consequence may be that instable companies avoid impairment losses, which means that the assets are overvalued (Polesie, 2014).

Correct valuation is necessary and fundamental regardless of whether it concerns assets, liabilities, revenues or costs (Marton et al. 2012, p.41). Traditionally, assets have been valued based on their acquisition cost, which is relatively easy since it consists of historical data (IASB, CF: pp.100-101). Nowadays, it is getting more common that assets are valued by using fair value, which can be challenging especially since it implicates estimations of the future (Managerial Finance 2010a).

Corporate scandals, such as the one regarding Stora Enso, show problems associated with overvalued assets and negligence of the Standard IAS 36. It also illustrates the need of impairment tests, even when there is not a recession (SVT-play). Although the manipulation of the accounting within Stora Enso is a drastic example, there is a risk of excessively high valuation of assets in other businesses as well, if IAS 36 is not applied correctly.

As early as 2002 Johansson, professor at Stockholm School of Economics and former chairman of the Swedish Council of Accounting, illustrates that impairment tests are inconsistent and that they are based on a large degree of subjectivity. He discusses the issue that an inevitable lack of precision occurs when the carrying amount of an asset is compared with its fair value based on cash flow estimations. He also expresses the opinion that the distribution of operating cash flows between Cash Generating Units creates additional uncertainty, and that the allocation of goodwill to CGUs hardly can be based on objective criteria (Balans 2002, pp.29-35).

In 2010 Gauffin and Thörnsten discuss impairments in conjunction with the financial crises in 2008. Among other things, they conclude that a third of the companies listed on the Stockholm Stock Exchange used a lower discount rate 2008 than the year before, while calculating value in use. A lower discount rate leads to a higher present value and a decreased risk for impairment losses. The use of a lower discount rate can therefore be seen as a bit strange during that time, which in the daily newspapers was mentioned as one of the biggest financial crises since the 1930s. Increased financial risks were not reflected in the companies' impairment tests during 2008. Gauffin and Thörnsten also show that the annual reports reveal that impairment tests are mostly-based on calculations made on the accounting department's computer, rather

than on an analysis of current market conditions. Gauffin and Thörnsten believe that 2008 was a lost year in which IAS 36 does not fully seem to have been applied in Sweden. They also believe that the companies in the future will take impairment tests more seriously, by adapting them to the companies' own activities (Balans 2010a, pp.40, 42).

In a later issue of Balans, Gauffin and Thörnsten published a sequel to the paper mentioned above. They made a similar study, but analysed the financial reports for 2009. The outcome turned out to be almost the same as the year before and they did conclude that there sadly still was a lack of profound reasoning and explanations regarding impairments in the financial reports (Balans 2010b, pp.50, 53).

The impairment area is also highlighted in 2010 by Managerial Finance; a special issue was published focusing on the challenges regarding impairments. The two guest editors Carlin and Finch, professor of financial reporting and senior lecture in accounting, believe that readers who may find interest in these papers are for instance standard setters and practitioners. Carlin and Finch mention that it is getting more common that fair value is applied in the balance sheets. This leads to greater fluctuations in the carrying value of assets and consequently more recognition of impairments due to devaluation of assets (Managerial Finance 2010a).

The application of IAS 36 has still proven to be a challenging accounting area in Sweden. NASDAQ OMX Stockholm controls financial information, established by listed companies in Sweden, in order to secure that it is in accordance with IFRS and the regulations of the stock exchange. One of the focus areas for the review of financial reports in 2012 was IAS 36 *Impairment of Assets* and it will continue to be. The reason is that ESMA, an international organization that coordinates financial inspection within EU, had impairment of assets as one of their focus areas during 2012. NASDAQ's report shows that application of IAS 36 is beneath contempt, which is partly due to a clear lack of essential information regarding impairments (NASDAQ 2012, pp.3, 11, 13).

IASB seeks to reduce the uncertainty of IAS 36 by advocating that the method to assess the need of impairments is applied consistently by companies. Furthermore, the Standard requires a lot of disclosures regarding the estimations and assessments made by the management. Regardless of these requirements companies can, consciously or not, still do different assessments. This means that in practice, the same situation may be presented in different ways at various companies (Marton et al. 2012, p.350). If accounting principles are not consistently applied by companies, the usefulness of the financial reports will be reduced (Pettersson, 2011, p.21).

Finally, it is also remarkably that companies which apply IFRS may increase this year. This is due to that some companies, for varying reasons, do not want to apply the new Swedish regulation K3 and probably will choose IFRS instead (Olsson Svärdström, 2014). Impairment seems to be a challenging area and since it can have a major impact on the financial statements and the application of IAS 36 may differ between companies, it is an interesting topic to investigate.

1.2 Discussion

In this section we will highlight the main issues regarding impairments that can be observed in the literature, previous studies and papers covering the subject. Some reflections from the tutor Polesie enhance the discussion.

The IFRS framework is principle-based, which means that companies shall make professional assessments and interpretations when applying the standards to their specific businesses (Marton et al. 2012, p.7). However, principle-based regulation may in some cases leave too much room for subjectivity, which instead can result in misleading and inconsequent accounting (Pettersson 2011, p.2). Assessment of whether an asset has declined in value may be highly subjective. The management can have incentives to report in a certain way instead of making independent assessments. If the value of assets is overestimated, impairment losses can be avoided, which causes a higher result and vice versa (Marton et al. 2012, p.348).

Financial reports shall reflect the reality as accurately as possible; relevant and correct information for the reporting period shall be specified (Marton et al. 2012, p.32). The management tends to have relatively optimistic expectations, which is natural since there otherwise will not be any reason for continuing the business. However, it may be a risk for valuation of assets is based on expected future cash flows that cannot be fully substantiated. Fair values mixed up with a too large degree of subjective expectations may result in excessively high carrying values.

During a recession, companies may not have enough financial capacity to recognise impairment losses, since these will affect the result (Marton et al. 2012, p.349). Companies may avoid impairment tests and the recoverable amount is therefore never estimated, which increase the risk of overvalued assets. IAS 36 describes the recoverable amount as the value for which the company can get either from selling the asset or by using it in the business. A consequence may be that the application of IAS 36 differs between firms and within a firm over time, which can reduce both the reliability and the comparability of financial reports.

An issue regarding impairment is the application of value in use, since the assessment is dependent on the subjectivity of the management (IAS 36:33). Estimation of future cash flows implicates difficulties associated with forecasts and their reliability. The choice of discount rate is another factor to take into consideration, but companies do not always evaluate current market conditions and the reasonableness of the discount rate. A lower discount rate than motivated provides higher value in use, which leads to a reduced need for impairment losses (Balans 2010a, p.50).

The determination of CGUs, which is the smallest group of assets that generate independent cash flows (IAS 36:6), is another challenging area within IAS 36 (Marton et al. 2012, p.360). If CGUs are determined at a higher level than necessary, impairments can be avoided. This can simply be explained by combining a profitable asset with an unprofitable asset, and then the CGU will not be a subject to impairment (Managerial Finance 2010b p.8).

Impairments are not always comprehensive in the annual reports, both in terms of amounts and disclosures (Polesie, 2014). This may be due to difficulties with application of IAS 36 or simply that the need of impairment losses is low. Further, impairments may look like a failure, which can result in increased incentives for the management to avoid impairment losses. In Balans, Gauffin and Thörnsten take it further by stating that *“the stock market tends to see impairment losses as a disaster”* (Balans 2010a, p.41).

Knowledge and insight into the business are necessary in order to make correct assessments and estimations regarding impairments, but the more insight and knowledge someone has, the harder it is to be objective and vice versa. Auditors seek to verify the accounting quality by ensuring that regulations are properly applied. The problem is that auditors may not always have enough company specific knowledge to control the reliability of the assessments and estimations.

The current version of IAS 36 has been, more or less, unchanged in a decade (IAS 36). But as this introduction clarifies, companies still face difficulties when applying the Standard. The discussion illustrates that it sometimes can be difficult to transfer the regulation into practice. Hence, it will be interesting to investigate what the main challenges for companies are regarding impairments and how they aim to create faithfully represented accounting in this area.

1.3 Purpose and Research Question

The purpose of this thesis is to investigate difficulties for companies when applying IAS 36 for fixed assets, by exploring if there is a gap between the Standard and practice.

The purpose and the discussion in this thesis have led to the following research question:
- What areas within IAS 36 are especially difficult for companies to apply, since subjective elements occur?

1.4 Delimitation

This study cover companies in Sweden with accounting in accordance with IFRS and the focus area is impairment of fixed assets. This means that goodwill is not deeply investigated, but shortly mentioned in conjunction with CGU. Further, the focus is IAS 36, which means that other standards associated with valuation of fixed assets, such as IFRS 5 and IAS 16, are excluded.

What users of the financial reports find deficient regarding IAS 36 is excluded, disclosures are therefore not analysed, but the fact that financial reporting aims to inform external stakeholders, is kept in mind during the process. Finally, since IAS 36 is a comprehensive standard and the time is limited, reversal of impairments is also excluded.

1.5 Contribution

There may be a gap between regulations and practice within financial accounting. This study highlights the gap concerning impairment of fixed assets and concretely shows challenging areas for companies within IAS 36 in practice. We want to increase the understanding about impairment of fixed assets according to IAS 36, which sometimes remains in the background behind other accounting issues. Fixed assets are traditionally highly valued in the balance sheet, but nowadays, focus tends to shift to intangible assets. However, valuation of fixed assets is still an important accounting area, which this thesis seeks to highlight.

1.6 Disposition

This thesis consists of six chapters; the first of them is this introduction and the following five chapters are described below.

In chapter two the choice of methodology is explained and motivated. First of all, well-known research methods are described and thereafter the choice of data collection, both theoretical and empirical, is justified. Selection of interview respondents is then motivated. In the end of chapter two the analysis model is illustrated and the credibility and relevance of this thesis are discussed.

The theoretical framework is presented in chapter three, which starts with short information concerning harmonization of financial reporting and IASB's Conceptual Framework will be explained. The theoretical framework of this thesis is structured after IAS 36, where important paragraphs are emphasised. Literature, papers and previous studies are incorporated to highlight the issues mentioned in the discussion.

In chapter four, empirical material is presented. Information from conducted interviews and Nasdaq's report is summarised and categorized in order to create a clear picture of IAS 36 in practice.

The theoretical framework and the empirical material are compared with each other in the analysis in chapter five. The differences are discussed in order to clarify an eventual gap between the regulation and practice of IAS 36.

Conclusions based on the analysis can be found in chapter six. This chapter also contains a final discussion, which strives induce wider reflections and leads to suggestions for further work.

2. Methodology

In this chapter the choice of methodology is explained and motivated. First of all, well-known methods used for research are described and thereafter our choice of data collection, both theoretical and empirical, are justified. The choice of interview respondents is motivated, which also includes a short presentation of them. In the end of this chapter the analysis model is illustrated and the credibility and relevance of this thesis are discussed.

2.1 Social Science Methodologies

The aim of this chapter is to present the approach in order to enable readers to evaluate and replicate the study. Evaluation means that readers should be able to examine the choice of method, as well as the relevance of the drawn conclusions. Readers should also be able to verify the results by repeating the method under identical conditions (Backman 2008 pp.40, 42).

2.1.1 Induction

In order to collect, process and summarize information into new knowledge, different social science methodologies can be used. Methodology is a systematic way to explore the reality and there are in general two ways in which new knowledge can be developed, by induction or deduction (Andersen 1998 s.13, 29). Induction, also known as “the road of discovery,” means that the starting point is the empirical material and then general knowledge is created out of this information. This method is meant to create understanding of a phenomenon (Andersen 1998 p.30).

2.1.2 Qualitative Method

Before the analysis can be made, a lot of empirical material such as numbers, statements, observations or experiences, must be collected. This data can either be qualitative or quantitative and the main difference between these two is the use of numbers (Andersen 1998 p.24). Central to the qualitative methods is the ability to observe and describe the problem being studied. The use of statistics, mathematics and formulas are relatively limited and the purpose of the study is primarily to create a better understanding (Andersen 1998 p.32).

Qualitative data can be collected through unstructured or semi-structured interviews or other forms of observational techniques. The degree of structure of an interview depends on if the questions and their sequence are determined in advance, regardless of the situation (Andersen 1998 s.151-152). Semi-structured interviews are used in order to collect information of a phenomenon that already has taken place, is relatively private or when there is no possibility to observe the phenomenon itself. Usually, the researcher has certain theoretical and empirical knowledge concerning the topic, but is otherwise open-minded for new perspectives and new information from the respondent (Andersen 1998 s.162).

The qualitative research process leaves room for flexibility and a lot of variation. Since the different elements, such as observation, analysis and interpretation, often cannot be separated from each other, several processes can advantageously be carried out simultaneously (Backman 2008, p.56).

2.2 Data Collection

The aim of this study is to find out what the main challenges for companies are when applying IAS 36 into their businesses. We seek to create better understanding of the issues regarding the Standard; hence, the most beneficial method is induction by collecting and analysing qualitative data. This can be further motivated since IAS 36 requires a lot of subjective estimations and assessments.

When collecting empirical information, semi-structured interviews constitute the main method. Before the interviews, relevant topics and questions were compiled, based on the issues illustrated, for instance, in previous studies and papers. In order to give the respondents opportunity for preparing for the interviews, the questionnaires were sent to them a few days in advance. Naturally, these documents differed depending on whether these were sent to Volvo or to an auditor (Appendix 1 and 2).

The interviews were held at the respondents' office and lasted for approximately one hour each. Notes were taken during the interviews as well as recordings, with permission, were made with a smart phone. The questions were discussed in no particular order and areas that the respondents found interesting were also discussed, even if they were not stated in the questionnaires.

The theoretical data was collected mainly from IAS 36, in order to create an understanding of the regulation. Further, data was collected from the IASB's web page and Conceptual Framework. Literature, papers and previous studies were used to highlight the issues associated with the impairment area, but also to create an understanding of the phenomenon impairment.

2.2.1 Selection of Respondents

The selection may vary due to the purpose, but also time and cost aspects. For qualitative studies it is not always necessary to conduct a lot of interviews to get a complete picture. Four or five may be a good number since relatively few interviews are preferred in order to keep the material easier to process. When the last interview does not significantly differ from the previous, one additional interviews are not needed (Trost 2010, pp.143-144).

Since it was of great importance to create favourable relations with the respondents and to obtain sufficient information for which valid conclusions can be drawn, telephone interviews were excluded. Therefore, companies with office in the Gothenburg region were of interest.

We started with reviewing the list of Sweden's top 500 businesses (Retriever Business) and selected companies with headquarters in Gothenburg. To get an overview of the difficulties regarding IAS 36 for listed companies in Sweden, companies in various types of industries were of interest, such as shipping and vehicle. Trading companies were excluded, since eventual impairment of the stock is not regulated in IAS 36. The accounting- or financial-managers at the companies were contacted by phone or e-mail. Several companies did not reply and after a reminder was sent with no success, they were rejected. Companies, which did reply, answered that they did not have the time for an interview, except for Volvo, which finally was interviewed. In order to get a broader perspective, get a critical point of view and to notice the main difficulties for companies regarding IAS 36, three interviews with four auditors at different agencies were also conducted.

The respondents have wide experiences of IFRS and are introduced below:

- Anna Sikström, IFRS expert at Volvo Group, (11th of March, 2014).
- Conny Lysér, auditor at KPMG, (7th of April, 2014).
- Helen Olsson Svärdström, auditor and partner at PwC, (17th of March, 2014).
- Johan Roempke and Johan Sandberg, auditors at EY, (9th of April, 2014). The interview at EY was held with the two respondents together.

2.3 Analysis Model

There are no well-defined methods for analysing qualitative data from case studies; however, there are a few different approaches specified. One strategy is to rely on the theoretical proposition; the starting point is theoretical data and then the empirical material follows the same structure. This method leads to a focus on certain data and rejection of other data (Yin 2003 pp.109, 112).

Analysis based on qualitative data may be facilitated if a rough structure is determined in advance, which means that categorization of themes are prepared before data collection or the observation begins. However, *“the main analysis is often made continuously throughout the data collection [...] to capture a holistic picture with sometimes important underlying causal mechanisms.”* (pp.60-61). The collected data must be organized and structured to make it possible to interpret the material (Backman, 2008, pp.60-61). When analysing the material, similarities and differences between individuals during certain circumstances can be found (Backman, 2008, p.60).

In the analysis, the theoretical framework is set against the empirical material, i.e. theory is compared with practice. Differences are defined and analysed, in order to draw conclusions about the difficulties companies face when applying IAS 36.

2.4 Credibility and Relevance

A qualitative interview strives to answer how the respondent thinks and thus a low degree of standardization is preferred. It is important that the collected information in qualitative studies is relevant and consists of a high degree of credibility. This means that it shall be possible to show that the data is collected in a serious manner and that it is relevant to the purpose of the study. In this context, objectivity is often mentioned, i.e. his or her own opinions and thoughts shall not affect the respondent during the interview. Being completely objective is almost impossible, but it is anyway important not to bias an interview (Trost 2010, p.134).

2.4.1 Primary Sources

The result of this study might have been different if more interviews with companies were conducted, but since the auditors' viewpoint to a great extent matches Sikström's we believe that the outcome has not been affected significantly. The relevance of this thesis may instead be increased, since it probably is easier for auditors than for companies to discuss difficulties for the companies regarding impairments, because the thesis is public. In addition, the auditors provide an overall picture of the main challenges with the application of IAS 36.

As mentioned in chapter one, the viewpoint is the companies'. During the interviews with the auditors we were aware of the perspective and thus targeted the questions to see what difficulties companies may face when applying IAS 36. Furthermore, objectivity has as far as possible been strived.

There are countervailing forces to prevent the management to report in a certain way, for instance, auditors. This is why the auditors have their own section in the end of the empirical compilation.

The questionnaires which were sent to the respondents were written in Swedish, also the interviews were held in Swedish, and afterwards they have been translated into English.

2.4.2 Secondary Sources

In this section we want to highlight and discuss important aspects regarding some of the sources.

The thesis refers to papers from Balans; the journal is published by FAR, which is the Swedish branch organisation for accountants, auditors and advisers (Balans 2014, FAR 2014). Balans intends to bring forward an open and free debate, hence the published material does not have to fully reflect the opinion of the organisation FAR (Balans 2014). Balans does not classify as a scientific magazine. However, we believe that the magazine is well known within the accounting profession; thus, timely and applicable accounting issues are highlighted. Balans is therefore primary used as a source of information to explain the ongoing discussion regarding impairment, but to some extent also in the theoretical framework.

A conceptual paper written by Wayne Lonergan, Sydney, published in a scientific journal in 2010, is of great support to this thesis. Lonergan is a valuation practitioner and former standard setter in Australia and he *"provides a practitioner's viewpoint on asset impairment and a critique of current practice."* (Managerial Finance 2010a). Since Australia has adopted IFRS, the paper is a relevant source. We are aware of the fact that previous national accounting may be relevant to the application of IFRS, mentioned, for instance, in Pettersson's thesis (2011). However, the paper was used to point out issues regarding interpretation and application of IAS 36, which we believe can be applied to Swedish companies as well.

Most of the sources used in this thesis were written in Swedish and therefore the quotes are translated into English.

3. Theoretical Framework

This chapter starts with short information concerning harmonization of financial reporting and the IFRS regulation is explained. The theoretical framework is thereafter structured after IAS 36, where important paragraphs are emphasised. Literature, papers and previous studies are incorporated to highlight the issues mentioned in the discussion.

3.1 IFRS Regulation

The globalization of capital markets has led to a demand for international harmonization of financial reporting. Internationalization of accounting practice will lead to higher availability of relevant financial information and more efficient capital markets (Epstein et al. 2002, pp.9-10).

Companies world-wide establish financial reports in order to give information to their external stakeholders (IASB, CF: preamble). In 2002 The European Union adopted a regulation which obligates all listed companies in EU, from 2005, to establish their consolidated financial reports in accordance with IFRS (Marton et al. 2012, pp.1-2). Except from the members of the EU, additional 90 countries have adopted IFRS, for instance, Australia. The IFRS regulation is established by IASB, an international independent authority, which seeks to harmonize international accounting, in order to reduce differences in practice (IASB 2013).

IASB evolves principle-based regulation, rather than rule-based regulation. The main difference is that principle-based regulation to a higher degree consists of qualitative terms such as “largely,” instead of quantitative terms such as “more than X percent.” Further, principle-based regulation includes less examples and guidance regarding specific situations. In order to create accurate accounting, companies must therefore accomplish professional assessments and interpretations based on the Conceptual Framework (Marton et al. 2012, p.7).

There are 41 different standards within the IFRS regulation and each of them covers more or less a specific accounting area (IASB 2014). But due to social, legal and economic differences, the financial reports are not always fully comparable (IASB, CF: preamble). To prevent this, IASB has developed a Conceptual Framework, which is the basis for development of new standards, as well as serving as guidance for creators, auditors and users of the financial reports. It covers, for example, definitions of the main divisions in financial statements, such as assets, liabilities, owner’s equity, revenues and costs. Circumstances for which a specific standard can be applied, the standard is prior to the Conceptual Framework (IASB, CF: 1-2).

The Conceptual Framework specifies qualitative characteristics that will ensure the usefulness of financial reports to the companies’ stakeholders. These are divided into two groups: fundamental qualitative characteristics and enhancing qualitative characteristics (Marton et al. 2012, p.32).

The following qualitative characteristics are fundamental:

- Relevance
 - Materiality
- Faithful representation
 - Complete
 - Neutral
 - Free from error

The following qualitative characteristics are enhancing:

- Comparability
- Verifiability
- Timeliness
- Understandability

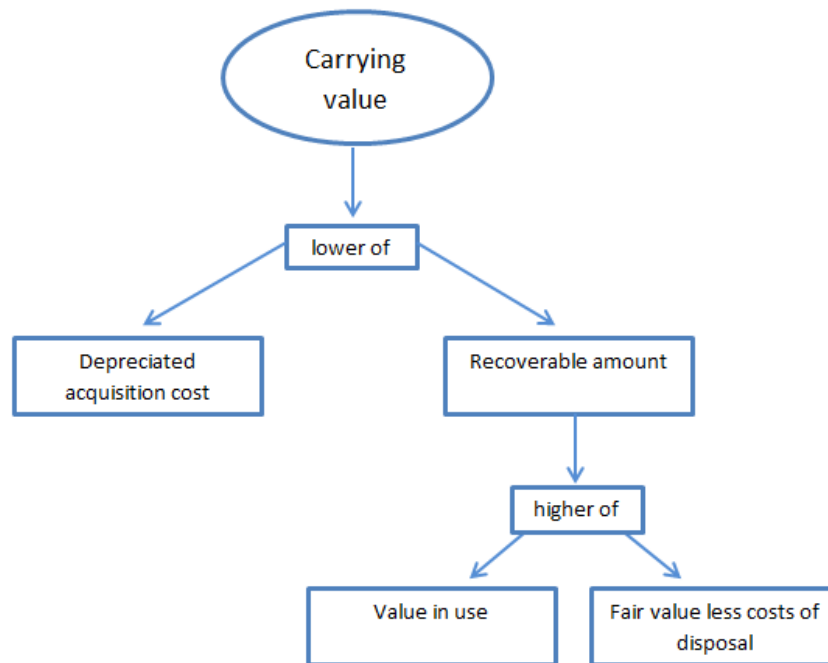
Identifiable and relevant economic events shall be faithfully represented in the financial reports, since the information will be less useful and perhaps misleading to external stakeholders, if the fundamental qualitative characteristics are not fulfilled. The enhancing qualitative characteristics cannot alone lead to useful information (Marton et al. 2012, pp.32-33).

Faithful representation will be further described in this thesis, since it can enhance the analysis of the impairment area. Faithfully represented information is not misleading and it contributes to a better understanding of the management's assessments, which in turn will benefit the users of the company's financial reports. The reporting of an economic event must be complete, neutral and free from errors in order to be faithfully represented. This means that all necessary and relevant information must be included and that it cannot be biased or manipulated. An economic event may not always be represented entirely accurately due to various circumstances, such as when large degrees of subjective estimations occur. However, a clear description of the event increases the probability of faithfully represented accounting (Marton et al. 2012, pp.34-35).

3.2 Introduction to the Impairment Area

The definition of an asset is fundamental and the Conceptual Framework specifies that *"An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity."* (IASB, CF: 49). The value of an asset is initially set by the current market and recognised in the balance sheet, but the value may change over time. E-conomic states that impairment *"is the diminishing in quality, strength, amount, or value of an asset"* (e-conomic, 2014). Impairment tests will show if the carrying values are correct or not (Polesie, 2014).

If the impairment test shows that an impairment loss is required, it shall be made by the amount equal to the difference between its recoverable amount and the carrying value. Hence, the value of the asset decreases in the balance sheet and is recognised as a loss in the income statement. When a company has reported an impairment loss, the future recognition of the asset will be affected and next years' depreciations shall be allocated to the asset's remaining useful life (IAS 36:59-60, 63). The following picture, inspired by GlobalSpec (2014), highlights when impairment loss is required.



IAS 36 is an international accounting standard established by IASB that specifies the accounting and disclosure requirements for impairment of assets (IASB 2014; IAS 36). Before the implementation of IAS 36, impairment was mentioned in IAS 16 *Property, Plant and Equipment*. However, IAS 16 did not include particular guidance regarding when to test for impairment or how to measure it. Since companies in general found it difficult dealing with any decrease in the value of long-lived assets, the adoption of IAS 36 as international guidance was needed (Epstein et al. 2002, p.306). The first version of IAS 36 was implemented in 1998. The current form of the Standard was updated by IASB in 2004 (IAS 36:139, 141).

The objective of IAS 36 is to ensure that assets are carried at no more than their recoverable amount, which is the higher of fair value less costs of disposal and value in use. The Standard also describes when a company shall reverse an impairment loss and leave disclosures (IAS 36:1). IAS 36 shall be applied for all types of assets, except from those that are regulated by a specific standard, for example, IAS 2 *Inventories* (IAS 36:2). The term “asset” is used, but these requirements are applicable to both individual assets and CGUs, according to the Standard. CGU is described in a separate section.

3.3 Indications of Impairments

IAS 36 specifies when recoverable amount for assets shall be determined. At the end of every reporting period the company shall consider whether there is any indication that an asset may be impaired. If any indication exist, the company is required to conduct impairment tests by estimating the asset's recoverable amount (IAS 36:9). At least, the following indications shall be considered (IAS 36:12):

“External sources of information:

- (a) Decline in market value of certain type of asset.*
- (b) Significant changes in technology, market, economy, legal environment.*
- (c) Increase in market interest rates.*
- (d) The carrying amount of the net assets of the entity is more than its market capitalisation.*

Internal sources of information:

(e) Obsolescence or physical damage of an asset.

(f) Significant changes in the set-up of operations (restricting, discontinued operations, reassessment of useful life etc.).

(g) Internal reporting indicates lower economic performance of an asset.”

(Summary of IAS 36:12, Sikström 2013).

In addition to the indications mentioned above, more industry- or company-specific factors may be devised for the assessment of impairment by the reporting company. The internal indications are usually more difficult to interpret than the external; for instance, information regarding cash flows may be rather subjective (Epstein et al. 2002 pp.307-308).

The indications shall relate to events during the reporting period. The demand for a company's product may gradually decline over several years, but it is not certain that the negative trend is an indication of impairment during a single reporting period. However, this shall not be seen as a reason to avoid impairment test. When the accumulated decline is sufficient to constitute an indication, the recoverable amount shall be estimated (Balans 2001, p.36). IAS 36 does not allow the company to wait with an impairment test to see, for example, how the economy will develop and thus, if the decline is permanent or not (Marton et al. 2012, p.353).

For a listed company an important indication is presented if the carrying amount of the net assets exceeds its market capitalization for a sufficient period. In an efficient market it is normally assumed that the market capitalization reflects investors' assessment of the net value of the company's future cash flow. If investors believe that this value is less than the current value of the company's assets, the market is either misinformed or the company's assets are simply unable to create their calculated cash flows. But in the short term, many other factors than the company's expected future cash flows may affect the market capitalization and temporary decline does not necessarily mean that current values are too high (Balans 2001 p.36).

Worth noticing is that even if an impairment loss is recognised or not, the company must also consider if the remaining useful life, the depreciation method and the residual value of the asset needs to be changed (IAS 36:17). Depreciation of fixed assets is regulated by IAS 16 (IAS 16:1).

3.4 Measuring Recoverable Amount

IAS 36 describes how recoverable amount of an asset shall be calculated. If either fair value less costs of disposal, or value in use exceed the asset's carrying amount, there is no need to calculate both of them. Hence, regardless of what the other value is, an impairment loss will not be necessary (IAS 36:19).

3.4.1 Fair Value Less Costs of Disposal

This value is the price that a company can sell an asset for, less selling and settlement costs that are directly associated with the sale, such as stamp duties, legal costs and the costs of moving the asset (IAS 36:28) In order to obtain fair value, the asset shall be able to be traded on a market at a reliable price; for example, binding agreement between unrelated parties, or an active market for the asset must exist (Marton et al. 2012, p.355). However, if this is not the case, the company is allowed to estimate a price by observing transactions that have recently been conducted with similar assets within the same industry. Wear and tear

as well as age are factors that should be taken into consideration and that may adjust the price (Marton et al. 2012, p.355).

Loneragan (2010) highlights that it may be difficult to obtain fair value less costs of disposal for complex machineries. Especially, company-specific and second-hand machines imply increased uncertainty, since it often involves substantial installation or removal costs and large buy/sell spreads. Loneragan emphasises that the valuation of machineries is therefore subjective and consequently provides scope for gaming (Managerial finance 2010b p.9).

Assets for which there is no basis for a reliable estimation of net selling price, the value in use shall be calculated to obtain the recoverable amount (IAS 36:20).

3.4.2 Value in Use

Value in use is the present value of the future cash flows which an asset is expected to generate. Since uncertainty regarding future conditions always exists, value in use may be difficult to calculate. The company shall also estimate a discount rate in order to obtain the present value of the future cash flows (Marton et al. 2012, p.355). IAS 36 provides comprehensive guidelines to help companies with application of value in use.

When calculating value in use the company must consider the possibility of variations in the amount or timing of the estimated future cash flows; hence, some sort of risk factor must be calculated due to the uncertainty inherent in the asset (IAS 36:30). *"This can be reflected either as adjustments to the future cash flows or as adjustments to the discount rate."* (IAS 36:32).

Estimations of future cash flows shall reflect the management's best assessments of future economic conditions. This shall be based on the most recent financial budgets and forecasts, approved by the management, for a normal period of up to five years (IAS 36:33). A longer time period is not recommended, since it leads to increased uncertainties (Marton et al. 2012, p.355). According to the Standard the assumptions shall be reasonable and supportable and especially external factors are important to take into consideration (IAS 36:33).

Future cash flows shall be estimated based on the current condition of the asset. Hence, payments in order to maintain current capacity, cash flows from the business and any cash flows from the asset if sold within the forecast period must be included (Marton et al. 2012, p.356). This means that improvement of the asset's performance or restructuring that the company not yet is obligated to implement should not be included (IAS 36:44). These planned actions are often a part of the companies' budgets and business plans; thus, these have to be adjusted to serve as a base for calculation of value in use and there is a risk that this will be both artificial and complex. Furthermore this could lead to that an impairment loss is required in one reporting period, only to be reversed in the next (Balans 2001, p.37).

3.4.2.1 The Discount Rate

The discount rate shall be a pre-tax rate and reflect both the time value of money and risks specific to the asset, for which the future cash flow estimates have not been adjusted (IAS 36:55). The reason for why the discount rate shall be a pre-tax rate is to avoid iterative calculation. Iterative calculation may occur if the company has included future cash flows after taxes into its forecast. Taxes are affected by potential impairment losses, which in turn often depend on the discount rate (Balans 2001, p.37). The higher the discount rate is, the lower the cash flows will be and thus the value of the asset will decrease (Marton et al.

2012, p.356). An asset's cash flows are largely based on internal assessments, but the discount rate shall as far as possible be based on market assessments (IAS 36:30, 56).

IASB specifies in Basis for Conclusions why a pre-tax discount rate shall be used. For instance, it is to prevent double-counting and differences which may arise between the carrying amount and tax base. Further, a post-tax discount rate would require more comprehensive calculation of value in use (IAS 36:BCZ81-BCZ85).

Annex A in IAS 36 provides additional guidance regarding how to calculate value in use, for example, the discount rate is described. When it is not possible to derive the discount rate based on market data, there are other methods. The following three options are mentioned (IAS 36:A16, A17):

- The company's WACC, which is lenders' interest requirements and shareholder's dividend requirements.
- The company's incremental borrowing rate.
- Other market borrowing rates.

According to Lonergan (2010), technical difficulties arise when value in use is calculated. The majority of listed companies in Australia apply value in use to determine the recoverable amount. This is partly *"due to a combination of the lack of clarity as to what value in use really means [...] the lack of a Conceptual Framework around value in use and its potential for gaming."* (p.3). Further, Lonergan emphasises that it is difficult to determine the pre-tax discount rate, especially for assets such as machinery with varying annual cash flows (Managerial Finance 2010b, pp.3-4). Should the company chose a lower discount rate than motivated this will result in overvaluation of cash flows and impairment will be understated, if they even occur at all (Marton et al. 2012, p.357).

3.5 Cash Generating Units

IAS 36 defines a CGU as *"...the smallest identifiable group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets."* (IAS 36:6). The Standard allows classification of CGU due to practical reasons. It is common that an asset, for example, a machine, is included in a production unit with several other machines and cannot therefore generate revenues on its own. It is not possible to calculate an individual recoverable amount for such assets; instead, it shall be calculated for the whole unit. The impairment test occurs thus at a higher level (IAS 36:66-67).

Companies must determine the levels of CGUs and IAS 36 gives examples that can serve as guidance during the assessment procedure. An important factor for the management to take into consideration is how the business is controlled, for example, by product lines, business areas or regional areas. Another factor is decision of continued use or settlement of the company's assets and business lines (IAS 36:69). Companies may find it difficult to determine levels of CGUs smaller than the whole business, especially if the business is integrated. To prevent excessively high levels of CGUs and avoidance of impairments, the Standard advocates as low level as possible for CGUs (Marton et al. 2012, p.360).

Lonergan (2010) emphasises that *"the potential for gaming by selective asset reallocation in or out of a CGU is obvious."* (p.7). Companies can defer or avoid impairments for the reporting period by changing their defined CGUs. They may, for example, combine a less profitable CGU with a profitable CGU, to setoff the loss, by simply ensuring that the total value of the CGU does not have a recoverable amount, less than its

carrying value. Lonergan mentions that there are no rules in IAS 36 that prevent companies from changing their definitions of CGUs each year (Managerial Finance 2010b pp.7-8). But in contrast the Standard states that if a change is not justified, allocation of CGUs shall be defined in a similar way from time to time (IAS 36:72).

Pettersson's study (2011) of shipping companies, which will be described below, shows that assessments of CGUs are widely shifting, which in turn affects possible impairment losses. Companies that specify the levels of CGU usually define it per ship. The companies with the whole fleet as one CGU report no impairment losses. In this context, Pettersson points out that there are incentives for the management to define their whole fleet as one CGU, in order to avoid impairments by unauthorized setoff (Pettersson 2011, pp.70, 92).

3.5.1 Goodwill Associated with CGUs

Goodwill is described as the value of expected future cash flows that cannot be separately identified, such as commercial synergies or skilled workforce (Marton et al. 2012, p.362). Goodwill due to business combinations shall be recognised in the balance sheet (IAS 38:48).

The useful life of goodwill cannot be determined and thus goodwill is not a subject for depreciation; companies are therefore obligated to accomplish annual impairment tests (IAS 36:10b). Since goodwill cannot generate revenues on its own it shall be allocated to one or several CGUs and the annual impairment test must be done for the CGUs as a whole (IAS 36:90). Impairment losses are required, when the carrying amount including goodwill, exceeds the recoverable amount. For a CGU with allocated goodwill, the carrying amount of goodwill must be fully impaired, before impairment losses shall be recognised to the fixed assets (IAS 36:104).

3.6 Previous Studies

Tillämpning av RR 17: I vilken utsträckning ger RR 17 utrymme för subjektiva bedömningar? University of Lund, Magisteruppsats 2003, Pernilla Fransson, Sandra Hallberg, Maria Lindberg.

The thesis aims to investigate companies in the forest industry and how they apply the Swedish impairment regulation, RR 17, to their businesses (p.1). Since RR 17 is based on IAS 36 (BFN, RR 17:1) and the perspective of the thesis is the companies', it is of interest.

The conclusions, among other, are that the companies do not consider all of the indications specified in RR 17, while considering if an impairment loss is necessary. Primarily indications based on internal reporting are considered. It is remarkable that one of the investigated companies considers that there is no need to conduct impairment test as long as their market capitalization exceeds its own equity. Overall, the companies find it difficult to calculate value in use, since the calculation is highly dependent on subjective assessments. In this context, companies do also find it difficult to obtain the discount rate. This is because the discount rate to a great extent depends on changes in interest rates, inflation and risk. The study shows that the companies in general use one discount rate within the whole business, even if different segments or geographical markets rarely are associated with the same risks (pp.71-73).

The study is approximately ten years old and therefore it is relevant to see the development in practice. As mentioned in the theoretical framework, company groups in EU are since 2005 obligated to establish their accounting in accordance with IFRS. Hence, it is of interest to accomplish a similar study, but focusing on IFRS-companies.

Redovisning av fartyg i Europeiska rederier – En studie av jämförbarhet. University of Gothenburg, Licentiatuppsats 2011, Anna Karin Pettersson.

Pettersson's study covers valuation of assets, which will be supportive for this thesis. Her study is extensive, with 58 shipping companies examined (p.27), which gives a reliable base. In order to find out how comparable the annual reports are, Pettersson has investigated how shipping companies in Europe reported their vessels in 2007 and 2008. Focus of the study is valuation methods, depreciation, impairment and leasing of vessels. All of these accounting areas require the management's assessment (Abstract).

Pettersson has investigated the impairment area by analysing the amount of impairment losses, disclosures for both CGUs and the recoverable amount for the vessels. She points out that most of the shipping companies apply value in use, in order to determine the recoverable amount. She believes that this may be due to the fact that the available market values of the vessels is lower than value in use, or market values are not reliable because of the uncertainty that characterized the market in 2008 (pp.32, 68, 72).

One of the main conclusions is that there are large differences in practice regarding how the shipping companies report their vessels. Another conclusion is that country affiliation is relevant, especially for depreciation. Pettersson emphasises that managements' incentives may affect the reporting, which can explain differences in practice (Abstract). Neither country affiliation nor segment can explain the conducted impairment losses. However, recognition of impairments is limited in relation to the number of companies in the study, which may explain the results (p.92). The study highlights impairment as one area where it is important that a uniform practice evolves, since the value of vessels tends to fluctuate a lot (p.97).

A significant difference between this thesis and Pettersson's thesis is that she has based her study on annual reports and disclosures, while this study is based on interviews. The intention with the interviews is to collect information that cannot be found in the annual reports, which may be an advantage in this subjective area.

Värdering av tillgångar enligt IAS 36/RR 17. University of Gothenburg, Magisteruppsats 2009, Therese Bremertz, Parisa Badeie.

The purpose of the thesis is to investigate auditor's difficulties when reviewing impairment tests and it also shows the problems which may arise between the auditor and the management (p.4). Empirical material collection was made primarily by semi-structured interviews with auditors (p.9). In this thesis a similar study is accomplished, but the perspective is the companies' instead of the auditors' and the empirical material is likewise largely based on interviews with auditors. Since this thesis covering the same area but from another angle, it is interesting to roughly mention their findings and this thesis will expand the investigating of the impairment area.

A conclusion of the thesis is that *"it may be difficult for the auditor to point out that impairment loss is needed, due to the framework IAS 36 is based on subjective assessments."* (Abstract). The issues associated with the Standard lead to uncertainty, especially in the estimations of forecasts (Abstract). Another finding is that the auditors find it most difficult to verify the calculated cash flows and the discount rate. Further, the level of CGUs might be difficult to assess as an external part (pp.60-61). However, the interviewed auditors overall experience that they have enough industry knowledge to conduct adequate reviews. One of them explains that he does not commit an assignment if he feels that his knowledge is insufficient. Another auditor mentions that regardless of how much knowledge an auditor has, there is always an information disadvantage compared to the managements' (p.51).

4. Empirical Material

In this chapter the empirical material is presented, which is mainly based on interviews, but the report by NASDAQ is also incorporated. The information is summarised and categorized primarily after the structure in the theoretical framework and the aim is to create a consistent and clear picture of IAS 36 in practice. In order to clarify the issues related to subjectivity that the Standard requires, the auditors' perspective is shortly highlighted at the end of this chapter.

First of all, a brief presentation of the interview respondents:

- Anna Sikström, IFRS expert at Volvo Group. Sikström is a part of a team that develops accounting policies and review Volvo's accounting guide. The team also supports the organisation regarding accounting issues and interpretation of the accounting standards. Before Sikström started to work at Volvo in 2007, she worked as an auditor for several years.
- Conny Lysér, auditor at KPMG since 1989, has experiences from the real estate industry.
- Helen Olsson Svärdström, auditor and partner at PwC. She has been an auditor since 1985, and has had long-term assignments in the shipping industry, for example, she was auditor for Transatlantic during 2000-2007.
- Johan Roempke, auditor at EY since 1995, currently focusing on the branch of wind- and nuclear power.
- Johan Sandberg, auditor at EY since 2005, with experiences from the automobile branch.

4.1 Introduction to the Impairment Area

Impairment is one of the most difficult accounting areas due to its complexity (Sikström). The difficulty regarding IAS 36 is not the interpretation but the application. The scope of subjective elements and assumptions about the future makes the application challenging for companies, for instance, valuation of cash flows, choice of discount rate and forecasts. Companies do not think about potential impairment tests of fixed assets on a daily basis (Lysér; Roempke & Sandberg). When impairment test becomes necessary, it is usually difficult to identify which assets should be included, all of the respondents are consistent about that.

Valuation based on assumptions about the future is always hard, according to Olsson Svärdström. She points out that it is easier for companies than for the auditors to estimate the future, because they know the industry better. Roempke and Sandberg mention that specialists, such as corporate and asset appraisers, are required to conduct impairment tests. In the end it will never be completely right, since it is based on assumptions about the future.

4.2 Indications for Impairment Test

If a company struggles with its profitability, recognition of impairment losses are not always necessary, according to Lysér. He means that IAS 36 is structured after a long-term approach; thus, strong indications or reasons are required in order to conduct impairment tests. This can be amplified by Volvo; Sikström mentions that there is no routine to conduct annual impairment test for fixed assets, as it is for intangible assets. Only if there is any indication that a fixed asset may be impaired, an impairment test is conducted

during the following month's reporting. Olsson Svårdström agrees with Lysér and Sikström; companies do not recognise impairment losses directly when an indication occurs. They consider the decision well and ponder all parameters, since the accounting should not be too volatile.

Reorganization, inefficiency, replacement of a product line, old or broken machinery and reduced demand are examples of indications that assets may be impaired, according to the respondents. Lysér states that internal sources of information have great importance in the determination of impairment for machinery. Sikström believes that the internal indications probably have greater impact than the external at Volvo, since a lot of the fixed assets are company specific. She also mentions that internal and external indications can be incorporated into each other; for instance, if the external indication reduced demand is identified, internal indications, such as inefficiency, usually can be identified as well. This is supported by Olsson Svårdström who mention that the external and internal indications are interacting with each other. Further, Lysér states that companies mainly consider the indications mentioned in IAS 36, instead of more company specific indications, due to the fact that the Standard's indications are principle and can be applied to various businesses. The external indications regarding impairments are significant, for example, in the shipping industry and the companies usually get help from external experts when valuate the vessels (Olsson Svårdström).

Recession could be a reason for determining the recoverable amount, in order to see if impairment losses are necessary (Lysér, Sikström). However, all of the respondents mention that assets usually have a useful life which will continue after a recession. Therefore, recognition of impairment losses will not always be required during a recession. However, both companies and auditors are more accurate in their assessments, during a recession or whenever strong indications of impairments occur. If the indications are very small or absent, impairment test is not conducted. Analysts and other stakeholders are not interested in the impairment area, during a boom. Therefore, companies are not as accurate during normal market conditions, as they are in a recession (Olsson Svårdström).

Another indication is that a company makes losses. Hence, it is a risk that the assets are overvalued, but whatever the indications are, the question is which assets that should be included in impairment test, for instance, a whole production line or a machine? (Roempke & Sandberg).

4.2.1 Delay of Impairment Losses

There may be a delay of impairment losses, since the accounting would be too volatile if large losses are reported, only to be reversed later (Lysér; Roempke & Sandberg). The delay in the impairment area could be illustrated by the financial crisis; in the third quarter of 2008 several companies reported their best results ever. However, it did not last for long and in the fourth quarter many companies reported their worst results. This was a remarkable phenomenon; companies, auditors and analysts did not know if the fourth quarter was temporary or whether the decline would last. Naturally, there was a slight delay with recognition of impairment losses for some companies (Sikström). *"It is easy to be wise after the event"* (Sandberg). During that time the companies only had limited information and it was not obvious how they should behave. The delay of impairment losses can be further illustrated by companies' forecasts. Companies tend strongly to believe in their products, which can complicate the assessment of impairments. However, it may be difficult for companies to justify the choice of not reporting impairment losses after several years of losses in its business (Roempke & Sandberg).

4.2.2 Impairment Loss or Depreciation

The distinction between impairment and depreciation is important to discuss and communicate within the company, according to Sikström. She mentions that, for instance, due to more extensive wear and tear than expected, it may be difficult to separate the need for an impairment loss and the need for changed depreciation time. However, Volvo often accelerate the depreciation, rather than recognise an impairment loss. Likewise, Olsson Svärdström explains that if the useful life of an asset changes, accelerated depreciation may in many cases reflect the reality more fully, than an impairment loss would do. This was exemplified by Sandström and Roempke; if a particular production technique will be restricted by law in five years, the useful life and depreciation of related assets are adjusted, rather than recognition of an impairment loss.

Sikström clarifies that impairment tests are required if the changed circumstances are more or less unpredictable. She contends that it is only when an asset becomes unprofitable, that impairment testing becomes necessary. The auditors are consistent about what the main difference is between the need for changed depreciation time and the need for impairment loss. An impairment loss is usually a consequence of unexpected events, while changes in depreciation time arise from long-term structural changes. However, operating properties are an exception and Olsson Svärdström explicates the motion that the useful life rarely changes; hence, changes in depreciation time, instead of recognition of impairments, seldom occur in this area. Further, Sikström points out that another important difference between the need for changed depreciation time and the need for impairment loss is that an impairment loss during particular circumstances may be reversed, but a depreciation never can be reversed. Roempke and Sandberg also mention that reporting one big cost, instead of several smaller costs later on seldom is preferable.

Impairment losses at Volvo have during the past few years been almost insignificant in relation to total assets (Volvo's annual reports, 2007-2012). Sikström implies that this is because their business area, trucks, is quite a slow moving industry, which means that they are able to adjust their operations and prepare for market declines. Lysér amplifies this by mentioning that impairment of invariable assets is not necessary to a great extent. Sikström exemplifies this by mention that Volvo usually sell or reorganize a part of the industry, or if possible continue the manufacturing process and increase the stock, instead of being forced to recognise impairment losses. Eventual depreciation of the stock or loss due to disposal of a business-line is not regulated in IAS 36; therefore, impairments in that context will not be relevant according to Sikström.

Another reason for why impairment losses usually are not that comprehensive in financial reports may be that the annual depreciation of an asset usually covers a slight decline of an asset's value (Olsson Svärdström).

4.3 Decision and Routines for Impairment Tests

Sikström emphasises the importance of principle-based regulation in order to avoid misinterpretation during the impairment process. Volvo has their own accounting guide and policies based on the IFRS regulation. The accounting guidance includes a slightly simplified version of IAS 36 and is adapted to the business. However, examples are few since more extensive exemplification of accounting issues may lead to micromanagement, as well as to employees trying to get the economic events to match the examples, rather than observing what actually should be reported.

At Volvo, the impairment area is a local process but with central involvement. Normally, local units identify the need for impairment for assets, but approval of impairment losses is then made centrally within the company group. This is due to the fact that assessments of impairment should be equal within the company group; for instance, a standard machine should be equivalently assessed regardless of the location. In addition, it is common for assets to be transferred within the company group which mean that the value of assets will remain; thus, recognition of impairment losses is not necessary (Sikström). Lysér agrees with Sikström, that in order to avoid impairment losses, companies usually transfer an asset to another part of the business. Another motive for central involvement, according to Sikström, is to avoid double-counting by isolating cash flows during the impairment process. Further, local units may not know the company's strategies, which lead to inaccurate assessments and this indicates the importance of central control in order to get fair measurements.

It can be difficult to assess whether an impairment loss is necessary or not. Hence it is important to consider all parameters to get a reliable decision base (Olsson Svärdröm). Further difficulties arise in the assessment of impairment, since the auditors emphasise that companies which do not conduct annual impairment tests, normally do not have routines for the impairment process. Lysér exemplifies this by mentioning that smaller units within a company do not always have enough competence to conduct reliable impairment tests. Should the impairment not concern assets of sufficiently high value, it may be difficult for the smaller units to get help with the process centrally.

4.4 Measuring the Recoverable Amount

Volvo applies both fair value less costs of disposal and value in use in order to estimate the recoverable amount, since the assets are of a different nature (Sikström). Value in use is usually more complex to calculate than net selling price, according to Roempke and Sandström.

4.4.1 Fair Value Less Costs of Disposal

The auditors explain that companies seek advice from external appraisers when applying fair value less costs of disposal for relatively standardised and high valued assets. During Olsson Svärdröm's time as auditor at TransAtlantic, the company took help from two external vessel appraisers with great knowledge of the industry. The external appraisers assessed the industry as a whole, but in order to adjust after the business and thus get a more accurate valuation, the company considered the actual condition; for instance, the traffic of vessels was significant. Lysér emphasises that assets with enormous values, such as vessels and operating properties, motivate external appraisers; the costs are not significant in relation to the value of the asset. Further, when machines and equipment are the major items in the balance sheet, companies do their own calculations, since it can be difficult and expensive to use external appraisers.

For more company-specific assets it is not always possible to estimate reliable net selling price or the market value may be very low. In these cases it is more advantageous and accurate to apply value in use (Roempke & Sandberg). Sikström mentions that Volvo usually does not want to sell company-specific assets to externals, in order to protect their technology from competitors. Thus, there is no fair value and value in use is applied in these situations.

4.4.2 Value in Use

NASDAQ's inspection in 2012 of 63 companies shows that most of them apply value in use in order to determine the recoverable amount (p.15). A custom built factory or machine may not always have a market value, but the assets can still be valuable to the company. As long as the assets generate sufficient cash flows, value in use will be a reliable base for the determination of a recoverable amount (Roempke & Sandberg). According to Sikström, one of the most challenging processes regarding impairment of fixed assets is to identify and isolate cash flows.

4.4.2.1 Forecasts

When calculating value in use, Volvo applies the same forecasts as the company use for internal management. The company is controlled by these forecasts and Sikström contends that if these forecasts were not reliable, the company would have gone bankrupt long ago, since it is impossible to run a company on over-estimated forecasts. The auditors also mention that the forecasts used for internal management often are the base when calculating value in use. These forecasts are not always up to five years, which IAS 36 advocates. It is time-consuming and difficult to adjust forecasts and the companies do not always adjust the forecasts before calculating value in use (Olsson Svärdröm; Roempke & Sandberg).

An important factor to consider while adjusting the forecasts is, according to Roempke and Sandberg, the current condition of the asset. They have experienced that potential improvements of assets are included in the internal forecasts and that the forecasts are not always adjusted while calculating value in use.

4.4.2.2 The Discount Rate

All the respondents consider the discount rate as a tricky area, and that one of the most common ways to estimate and calculate the discount rate is to apply WACC. Roempke and Sandberg mention that WACC could be calculated as an interval and the level of WACC is often standardized within a branch. They do also mention that market risks often are reflected in the discount rate, rather than within the cash flows. In contrast, Lysér believes that companies seldom take specific market risks into account, when estimating the discount rate.

Volvo apply WACC, which is quite steady over time since it is partly based on a 10-year government bond yield. Their borrowing is made at a high level within the organisation and thus the calculation of WACC is also made at such high level. According to Sikström there are natural reasons for this. Since the most common impairment loss within the company group is goodwill, which occurs for global segments, the discount rate needs to be set at a global level as well. Roempke and Sandberg clarify the motion that company groups often use a global discount rate. To some extent companies use a few different discount rates in order to reflect risks in different geographical markets.

The discount rate is usually a post-tax rate, which is more or less an accepted procedure (Olsson Svärdröm; Roempke & Sandberg). Olsson Svärdröm contends that the reason for this is that the taxes shall be paid and thus will always affect cash flows. Since taxes are widely shifting between countries and impairment tests often occur at a high level within the company, the post-tax discount rate will result in more accurate accounting, than if the discount rate would have been a pre-tax rate. In contrast, Lysér emphasises that it is not very common to use a post-tax rate.

It appears that the estimation of the discount rate is one of the most challenging areas, based on NASDAQ's inspection in 2012. 43 companies were examined in this particular area; four companies did not specify if

the discount rate was pre-tax- or post-tax. Five companies did use a post-tax discount rate and some companies did specify the discount rate as an interval, which in many cases gives too broad picture (NASDAQ 2012, p.16).

4.5 Cash Generating Units

Lysér and Sikström emphasise the fact that one of the trickiest areas regarding impairment is to isolate cash flows in order to identify CGUs. Further, Lysér mentions that it is complicated to determine sufficiently low levels of CGUs. In contrast, Olsson Svårdström's point of view is that the CGUs of fixed assets may be divided into unnecessary low levels. NASDAQ (2012 p.15) shows that many companies do not divide CGU on a level as low as possible. The information is presented on the same level as for the companies' reported segments. Lysér contends that the CGUs often are divided automatically at the same levels as the companies' segments, subsidiaries or geographical markets, coinciding with the internal management. Further, he mentions that this may lead to excessively high levels of CGUs and consequently risks of missing impairments. For example, machinery within a segment may be impaired, but as long as the whole CGU does not show any signs of impairment, the machinery will not be included in impairment test.

The respondents emphasise that the determination of CGUs also has impact on valuation of goodwill. Impairment tests for goodwill occur on a high level within the company group, hence the value of underlying fixed assets and thus CGUs are calculated which may affect goodwill in an impairment test.

4.6 The Auditors' Perspective

IAS 36 consists of many assessments which may be very subjective; it is a complex standard and thus difficult to both apply and review, according to Roempke and Sandberg. They question the competence of smaller companies regarding the impairment area. Companies do not always take advantage of specialists, such as corporate and assets appraisers, which in turn will increase the risk for inaccurate measurements and thus avoidance of impairment losses.

The auditors highlight that it is hard to evaluate whether the management has made the best assessment according to the Standard. They assess, for instance, the reasonableness of the estimated future cash flows and the choice of discount rate. Roempke and Sandberg mention that to ensure the reliability of the assessments, they evaluate the accuracy of forecasts compared to the outcome of previous years. Moreover, it is hard to evaluate the management's assessments when the company has recently started, since the auditors cannot control the forecasts' reliability by observing previous data.

Lysér emphasises that the impairment area is not seen as an opportunity to bias or manipulate the accounting. Companies that apply IFRS are usually large and therefore transparent. He mentions that transparent accounting can be seen as self-preservation, which means that companies are well aware of the fact that manipulation does not pay off in the long run. Further, avoidance of impairment losses may result in postponement of costs. In contrast, Roempke and Sandberg highlight that there is a risk that the management has incentives to report in a certain way. However, they are aware of this during their risk analysis, but it is otherwise difficult to prove manipulation of the accounting in reality.

5. Analysis

In this chapter the theoretical framework and the empirical material are compared with each other, the differences are discussed in order to clarify possible gap. The gap between the regulation and application of IAS 36 indicates difficulties for companies.

5.1 Indications for Impairment Test

IAS 36 specifies several external and internal indications that an asset may be impaired; these are a minimum that a company shall take into consideration at each reporting period. However, the empirical material shows that companies do not have routines regarding impairment test of fixed assets and impairment tests are primary conducted when obvious indications occur. Furthermore, companies do not reflect all of the indications in the regulation while considering if an impairment loss is necessary, which is consistent with the thesis from Lund (2003). The result of this study shows that it can be difficult for companies to know when to test for impairments. Since IAS 36 does not requires annual impairment tests of fixed assets and thus companies have no routines, companies may incorrectly wait with impairment tests to see how the environment will develop. Important factors of changed conditions may also be missed, if not all of the indications are taken into consideration. If necessary impairment tests are rejected, consciously or not, there is a risk of overvalued assets.

The theoretical framework described that more industry- or company-specific factors may be considered in addition to the indications specified in IAS 36. According to Lysér, the Standard's indications are primary reflected, which is consistent with Sikström who could not clarify any company- specific indications at Volvo. This amplifies that the area is difficult for companies to apply.

5.1.1 Delay in the Impairment Area

IAS 36 clarifies the motion that companies are not permitted to postpone impairment tests in order to ensure that the impairments are permanent. But the empirical material shows that it takes time to trigger an impairment test, companies do not always conduct an impairment test immediately if any indication is presented. Moreover, companies are not as careful when considering the indications during normal market conditions as in a recession. A delay in the reporting of impairments seems to be accepted, in order to counteract volatility in the accounting.

It is clear that there is a gap between the regulation and practice within this area, which shows that it is difficult for companies to know when impairments are necessary to report. However, less volatility in the financial statements may increase the relevance for stakeholders in the long run, but, on the other hand, the regulation must be consistently applied in order to be comparable between companies and within a company over time.

5.1.2 Impairment Loss or Depreciation

The theoretical framework mentions that whether an impairment loss is recognised or not, the company must consider the remaining useful life and the depreciation method. Depreciation is regulated by IAS 16, but companies still have to consider it while applying IAS 36, since depreciation and impairment are closely linked. It is important to remember that the two standards have different effects on the financial state-

ments. The theoretical framework mentions that for issues which fall between two standards, the Conceptual Framework has a major impact. Whether impairment loss or changes in depreciation describe the economic event best can be determined by investigating to what degree the qualitative characteristics are met, for instance faithful representation. In theory it does not seem like there is a difficulty to distinguish these, but it is not always easy to draw that line in practice.

It is hard to show that it is a gap between regulation and practice in this area, but it is nevertheless an interesting area to reflect upon. After the interviews we got the impression that companies try to avoid impairment losses, since they occur less frequently than depreciation and therefore can be seen as startling or failure. If companies accelerate the depreciation instead of recognise impairment losses intentionally the accounting is not faithfully represented since the costs are postponed. The total cost will in the end be the same, but the accrual will be inaccurate.

It is worth mentioning that previous studies within the theoretical framework do not mention that the boundary between depreciation and impairment may be difficult in practice. This may be due to other areas within IAS 36 that are more difficult to apply. Based on our study, it is clear that this area requires a large degree of subjective assessments and the distinction between impairment and depreciation is a tricky area in practice.

5.2 The Recoverable Amount

5.2.1 Fair Value Less Costs of Disposal

The theoretical framework indicates that it is difficult to obtain net selling price for company-specific assets, since there is no active market for such assets. However, if there is no market for an asset, the fair value less costs of disposal probably is almost insignificant and the discounted cash flows would better reflect the value of the asset to the company.

None of the respondents highlighted that this area is particularly hard to apply. Since companies may get help from external appraisers when estimating net selling price, this value does not have to be difficult to determine. Furthermore, external appraisers prevent an excessively high degree of subjectivity, which contradicts Lonergan's statement that net selling price provides scope for gaming. But it does not always pay off to take advantage of external appraisers, according to Lysér. Anyhow, it is easier for externals to control fair value less costs of disposal than value in use, since fair value is more objective.

5.2.2 Value in Use

Both the theoretical and the empirical material show that value in use is often applied by companies, which is a challenging area due to its subjectivity and estimation about the future. This process consists of several steps, which together shall reflect the value of the asset to the company.

The empirical material shows that companies usually base their calculations of future cash flows on the same forecasts as for their internal management. Naturally, the management seeks to control the company as efficiently as possible and therefore these forecasts can be seen as reliable. However, companies tend to deviate from IAS 36, since these forecasts are not adjusted before the calculation of value in use. For instance, structural changes which are not yet obligated are included, as well as improvement of assets can incorrectly be a part of the forecasts. The theoretical framework describes that it may be both artificial and

complex to adjust forecasts to obey the Standard. Basing the estimations of future cash flows on internal forecasts may increase its credibility, but if they are not adjusted it is a clear deviation from IAS 36. Companies find it difficult to identify and isolate cash flows, which may complicate adjustments of the forecasts and it may also lead to additional subjectivity. The question is if the forecasts really become more reliably if they are adjusted according to IAS 36. On the other hand it is complicated for external reviewers, such as auditors, to control the reliability of estimated cash flows, since it may be very subjective.

5.2.2.2 Discount Rate

IAS 36 states that the discount rate shall be a pre-tax rate; despite that, companies usually apply a post-tax rate. Lysér's view is a bit different from the other auditors', since he states that companies often apply a pre-tax rate, while the other auditors mention that the application of a post-tax rate is a more or less accepted procedure. However, it is not important how many companies use a post-tax rate, but important is the fact that a post-tax rate occurs in practice, which shows that there is a gap between the regulation and the application of IAS 36.

The risk assessment and the consideration of the reasonableness of the discount rate amplify that it is a difference between regulation and practice, within this area. The empirical material shows that company groups often estimate their WACC on a global level. To what degree market risks are reflected in the discount rate and whether the discount rate as far as possible is based on market assessments can therefore be questioned. However, it may be difficult and complicated to estimate several WACCs within a company group. An interesting reflection is if several WACCs actually would result in more faithfully representation, since it also means additional uncertainties.

The empirical material shows that a discount rate often is stated for many years, which can result in misleading cash flows if risks are reflected in the discount rate, since cyclical variations are not reflected significantly. Further, risks associated with the asset may increase during a recession and therefore it is not reasonable that discounted cash flows increase due to lower market interest rates. Companies do not seem to take the general market situation and risks associated with the asset into account. They do not literally overrule the Standard, but a lower discount rate may result in misleading impairment tests and thus avoidance of impairment losses.

5.3 Cash Generating Units

When a company has clarified that strong indications occur and thus conduct an impairment test, difficulties arise in the assessment of which asset or assets that should be included. IAS 36 states that a CGU shall be defined on the lowest possible level. The empirical material shows that companies do not reflect the level of their CGUs on a daily basis and the CGUs are usually defined at the same levels as the companies' markets or segments. Thus it is doubtful whether the CGUs are determined at the lowest possible level. Even if IAS 36 consists of detailed information regarding CGUs it might be difficult or at least time-consuming to identify them on lower levels than already existing markets or segments. The determination of CGUs at the same level as the company's markets or segments may increase the reliability since they already exists, but, on the other, hand it may lead to avoidance of impairment losses.

Companies shall accomplish professional assessments and interpretations, since IAS 36 is principle-based. However, the theoretical framework describes that the accounting might be biased if the management has incentives to defer or avoid impairments due to excessively high levels of CGU. Further, Lonergan means

that there are no rules in IAS 36 that prevent companies to change their definitions of CGUs each year. IAS 36 states that allocation of CGUs shall be defined in a similar way from time to time, unless a change is justified. If companies have reliable decision support to motivate a changed definition of a CGU, it does not have to be an issue as Lonergan point out. An important question is if companies let their CGUs be on too high levels because they want to avoid impairment losses, or if it is due to difficulties to identify lower levels.

Goodwill is a complex area and will not be analyzed deeply, but it is interesting to mention that the determination of CGUs is affecting the valuation of goodwill. The theoretical framework describes that goodwill shall be allocated to one or several CGUs. Consequently, if the CGUs are determined at excessively high levels or not considered well enough, it will affect eventual impairment of goodwill as well.

5.4 Difficulties or Biased Information

Difficulties regarding the impairment area may result in that the management take advantage of the regulation, since IAS 36 specifies that the estimations shall be based on the management's best assessments, which may be more or less subjective. The theoretical framework highlights that subjective elements within IAS 36 increase the risk of inaccurate measurements due to managements' incentives, but if the management has a genuine desire to report correctly it does not have to be a problem. The scope for subjectivity can cause problems if the management intends to report in a particular way to achieve a specific goal, for example, in order to keep bonuses or dividends on a high and steady level. If this is the case, it is not the best assessment and thus information is not faithfully represented. However, the empirical material shows that impairment is not an area that is used to manipulate the accounting; companies have learned from others that the business is highly affected if biased accounting is detected. Nevertheless, it is difficult to detect manipulation of the accounting in reality. On the other hand, companies may in some cases unintentionally report errors due to the difficulties in application of IAS 36. Difficult areas tend to be resource- and time-consuming, which also may explain the gap between regulation and practice.

6. Conclusions and Final Discussion

In this chapter the conclusions which can be drawn based on the analysis are presented, followed by a final discussion. The final discussion strives to place the subject in a broader perspective and induce wider reflections, which leads to suggestions for further work.

6.1 Conclusions

The areas in which practice tends to deviate from the IFRS regulation and hence can be seen as difficult for companies to apply are:

- Recognising when impairment tests need to be conducted.
- Differences in practice between recognition of impairment losses and need of changed depreciation time.
- Application of the value in use including estimation of the discount rate.
- Determining levels of CGUs.

Although companies do not reflect all of the indications specified in IAS 36, the regulation is principle-based and thus both allows and requires the management to make its own assessments. IAS 36 does not require companies to conduct annual impairment tests for fixed assets, hence they usually do not have routines regarding the impairment process. It is time-consuming to conduct impairment tests and normally strong indications is required. However, there may be a risk that assets are overvalued if necessary impairment tests are neglected.

In theory it is not hard to understand the difference between impairment losses and depreciation of assets, but in practice there is a fine line between these two accounting methods. For events that fall between two standards, the Conceptual Framework has a major impact. Whether impairment loss or changes in depreciation describe the economic event best can be determined by investigating to what degree the qualitative characteristics are met, for instance, faithful representation. It is clear that this area requires a large degree of subjective assessments and can be seen as a tricky area.

Calculation of value in use including the discount rate deviates in several ways from IAS 36. The estimated future cash flows shall be based on reliable reports, which they mostly are since the same forecasts also are used for the financial management. Moreover, the forecasts shall be based on the assets' current condition, but the forecasts are not always adjusted. Further, the discount rate shall be a pre-tax rate, reflect risks that have not been reflected in the cash flows and as far as possible be based on market assessments. It is common for companies to use a post-tax discount rate, which is set on a global level within the company group; hence, it is doubtful if the discount rate as far as possible is based on current market conditions. The fact that the deviation from IAS 36 regarding the discount rate seems to be accepted within the profession indicates that this is a problematic area.

The theoretical framework describes that there are room for manipulation of the accounting when determining CGUs, but this study shows that it might be difficult for companies to identify them on lower levels than their already existing markets or segments. Identification of CGUs at the same level as their markets or

segments may increase the reliability, since the segments already exists, but, on the other hand, it may lead to, consciously or not, avoidance of impairment losses.

In summary, IAS 36 implicates several difficult areas, which are explained by the gap between regulation and practice. The scope for subjectivity can cause problems if the management intends to report in a certain way, but the impairment area is not used to bias the accounting. However, companies may, in some cases, unintentionally report errors due to that the Standard can be difficult to apply.

6.2 Final Discussion

The difficulties regarding IAS 36 may be due to that the Standard requires subjective assessments, which leads to a situation when companies do not apply the regulation equally. The framework is principle-based and designed to cover possible events for different industries. It is a simplification of the reality, thus a tension between standard setters and practitioners occurs; the standard setters advocate something, but the companies may in practice do something else. Since it is challenging to apply IAS 36, certain practices have been developed within this area. Furthermore, the gap between regulation and practice in several areas may be due to that the reality changes faster than the accounting regulation.

Although the importance of intangible assets will continue to be of great importance, companies will always have fixed assets. Debates in recent years have primarily highlight impairment of intangible assets such as goodwill, however impairment of fixed assets is still an interesting area. It can be perceived that valuation of fixed assets is not as problematic as valuation of intangible assets, but the two types of assets can both be based on expected future economic benefits, hence, the same difficulties may arise. Moreover, fixed assets may be complicated to assess since annual impairment tests are not required and thus it is hard for companies to know exactly when the Standard is applicable.

Basing carrying values of fixed assets on future benefits, instead of according to historical figures, may be problematic. In such cases, it is the estimated future benefit of the assets that is shown in the balance sheet, rather than the value of the material. Consequently, the figures in the balance sheet may not be fully substantiated.

There are difficult areas within IAS 36, but overall companies seems to do what is right. It is interesting to consider how faithfully represented the accounting is if a company does not have financial capacity for impairments and therefore, consciously or not, ignores to recognise impairment losses. Companies tend to strongly believes in their products and businesses, hence an impairment loss is against their basic instincts. However, impairments do not has to be a disaster, since companies have faced possible weaknesses by for instance efficiency their business in order to be more profitable in the future.

At last, IAS 36 is principle-based, which means that avoid differences between companies is inevitable when applying the Standard. The question is if maybe principle-based regulation overall is the main difficulty for companies.

6.3 Further Research

It would be interesting to accomplish a similar study, but focusing on intangible assets, such as goodwill. Goodwill is well debated since recognised impairment of goodwill is not allowed to be reversed. Further, IAS 36 requires annual impairment tests for intangible assets in contrast to fixed assets. However, fixed assets are visible, thus, it is interesting to investigate what kind of evidence that are behind intangible assets in the balance sheet. The questions are which routines companies have and what difficulties they face.

There has been more than a decade since the thesis from Lund (2003) was published, which highlighted that companies struggle with the impairment area according to RR 17. This study amplifies that companies face difficulties regarding IAS 36. Companies tends to deviate from the Standard within some areas, which indicate possible weaknesses in the regulation. However, IAS 36 will during the coming years not go through such extensive changes as other standards, such as IAS 17 *Leases*. Last year, IASB published an exposure draft regarding recoverable amount disclosures for assets, and there has not been any further proposed amendments to IAS 36 (IASB 2013). The questions are why IASB has not changed or simplified IAS 36 to a higher extent and how can the regulation be improved?

Recognition of impairment losses may significantly vary between companies and within a company over time, for instance due to financial capacity or difficulties with the application. Therefore it would be interesting to investigate how stakeholders react to impairment losses, for instance study how the market capitalization are affected. One theory could be that stakeholders associate impairment losses with companies that make bad investments or have a deficient business plan. On the other hand it may be seen as that companies which recognise impairment losses have remedied their weaknesses and further on will be a healthier company. Probably, several factors have great importance to the stakeholders and it would be interesting to find out how they are affected by these.

At last, it would also be interesting to conduct a similar study but focusing on what the main differences between companies within the same industry are. During the interview with Svärðström, it appeared that the printing industry is standing in the middle of some sort of structural change. Hence, it would be interesting to investigate application of IAS 36 within this industry.

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Appendices

Appendix 1: Questionnaire – Auditors

The purpose of the thesis is to investigate what companies find difficult when applying IAS 36. Main focus is fixed assets, hence, goodwill issues will not be deeply investigated. We want to explore if there is a gap between the Standard and practice.

Worth mentioning, is that the questions below only shall be seen as suggested discussion areas and that we gladly discuss other areas that you find interest in regarding IAS 36.

General questions

What areas do you find most difficult while applying IAS 36? Do you think that the companies find the same areas as the most difficult?

The impairment area usually are not that comprehensive in annual reports. Do you think this is due to for example that the application of IAS 36 may be complicated or that companies try to avoid reporting impairments, since it might be seen as something negative?

Do you think that companies generally neglect to conduct impairment tests or recognise impairment losses, especially during a recession?

What routines do the companies have for impairment tests?

Do you have any criticism to the current standard?

Indications

Are you especially careful to ensure that companies take all of the indications into consideration during a recession?

Do you feel that companies consider the same indications year after year, or does it significantly vary from year to year? (Greater importance on internal or external indications?)

Are only the indications specified in IAS 36 considered, or is it common that also company-specific indications are considered?

Value in use and discount rate

How do companies assess the credibility of their forecasts of future cash flows?

What is most common as base for estimation of discount rate?

Do you believe that companies take adequate account of the market situation and possible risks when calculating the discount rate?

Cash Generating Units

In general, how is the CGUs estimated? Do you think that the companies usually define their CGUs at as low level as possible?

Appendix 2: Questionnaire – Volvo

The purpose of the thesis is to investigate what companies find difficult when applying IAS 36. Main focus is fixed assets, hence, goodwill issues will not be deeply investigated. We want to explore if there is a gap between the Standard and practice.

Worth mentioning, is that the questions below only shall be seen as suggested discussion areas and that we gladly discuss other areas that you find interest in regarding IAS 36.

General questions

What areas do you find most difficult while applying IAS 36?

Are impairment tests made continuously or at the end of the reporting period? Is it a part of everyone's routine or made centrally? At what level in the company, are decisions regarding impairments made?

Do you have any criticism to the current standard?

Indications

Are internal or external indications of greater importance?

Are the company especially careful to take all of the indications into consideration during a recession?

Are the same indications considered year after year, or does it significantly vary from year to year?

Are only the indications specified in IAS 36 considered, or are also any company-specific indications considered?

Recoverable amount

In the annual report from 2012 we noticed that “value in use” is most common when calculating recoverable amount. What may this depend on?

Is the value in use, calculated based on sales forecasts? How is the credibility of the forecasts of future cash flows assessed?

Discount rate

How is the discount rate calculated?

Does the discount rate usually follow the economic cycles?

How do the company ensure that the discount rate reflects current market conditions and risks?

Is the same discount rate used within different segments or geographical markets?

Cash Generating Units

In general, how is the CGUs estimated?

Can separate fixed assets be identified or do more or less all fixed assets belong to a CGU?