偉華咨詢有限公司
VAL Consulting Limited

Valuation of Intangible Assets and Goodwill

Impairment Testing

Accounting Standards Compliance

HKFRS 36 requires:

I. the recoverable amount of an intangible asset (IA) with an indefinite useful life acquired in a business combination to be measured at least annually

II. the goodwill acquired in a business combination to be tested for impairment at least annually

IAs or goodwill is required to be impaired when its:

Recoverable Amount < **Carrying Amount**

The assets carrying amount should be reduced to its recoverable amount which is the higher of its *Fair Value Less Cost to Sell (FVLCS) and* its *Value in Use (VIU)*.

FVLCS is the amount obtainable from the sale of an asset or Cash Generating Unit (CGU) in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal; VIU is the present value of the future cash flows expected to be derived from an asset or CGU. The Standards set out rules and guidance specifying in detail how to determine the asset recoverable amount.

Relevance of Impairment Testing

The recent devastated financial crisis and economic turmoil in the developed markets have increased scrutiny on asset impairment among the regulators, auditors, banks and investors. Economic and business conditions are expected to be more volatile. Accordingly, businesses are more likely to experience temporary downturn as the economic conditions fluctuate. This creates a challenge for corporate management in deciding whether an impairment of acquired assets and goodwill is appropriate especially with the Standards prohibiting any reversal impairment loss for goodwill.

As a result, impairment testing is no longer just an accounting standard compliance matter but also a management focus. Failure to manage and communicate properly the decision to impair (and the impairment amount) or not to impair the acquired IAs and goodwill is more likely to cause greater reaction (such as from shareholders and debt holders) nowadays than the pre-crisis time. This is especially relevant for companies that hold significant amounts of goodwill and IAs of indefinite life such as brand and customer relationships as a result of acquisitions.

Indicators of Impairment

The Standard specifies that the recoverable amount shall be estimated for the individual (intangible) asset (and goodwill) and compared to its carrying value if there is an indication that an asset is impaired, or at least annually.

Some of the triggering events as stated below can be the potential indicators of impairment:

- A decline in market capitalisation to the extent that the company's book value is greater that its market capitalisation
- A significant deterioration in the debt/financing market condition leading to a hike in cost of capital
- A significant change in the technological, economic and regulatory environment
- Actual operating profits and free cash flows generated by the assets or company are significantly lower than originally forecasted
- Assets become idle, plans to discontinue or restructure the operation to which the asset belongs

How We Can Help

VAL Consulting has extensive knowledge and experience in providing impairment testing on IAs and goodwill for companies of various industries. We understand the requirements and issues from both a commercial perspective and from an auditor's perspective. We are confident that we can assist management to gain insights on the value of its acquired and recognised IAs and goodwill post acquisition and, to strike a balance between complying with the Standards and minimising the impairment impact on the business value.

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