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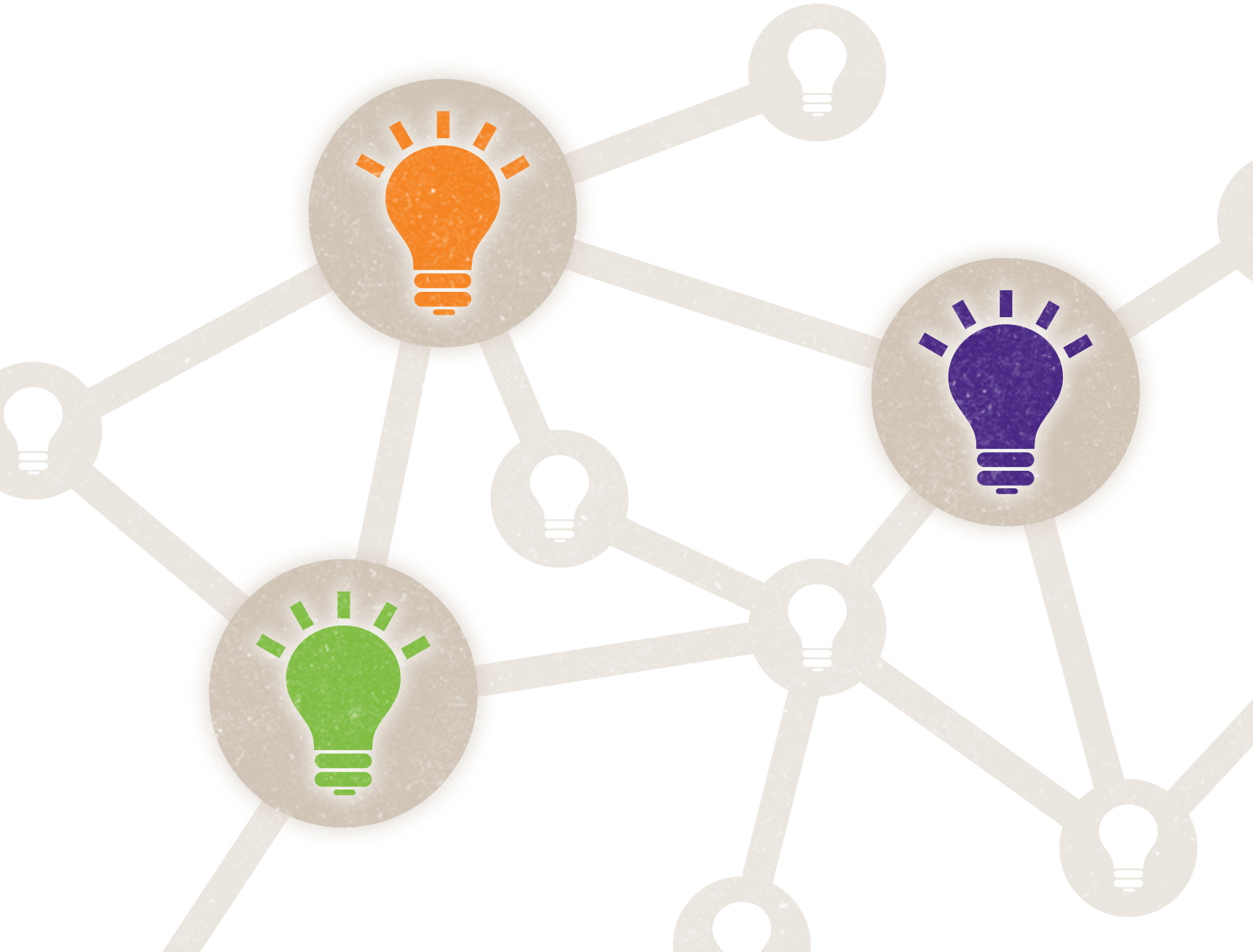
Impairment of Assets

A guide to applying IAS 36 in practice

March 2014



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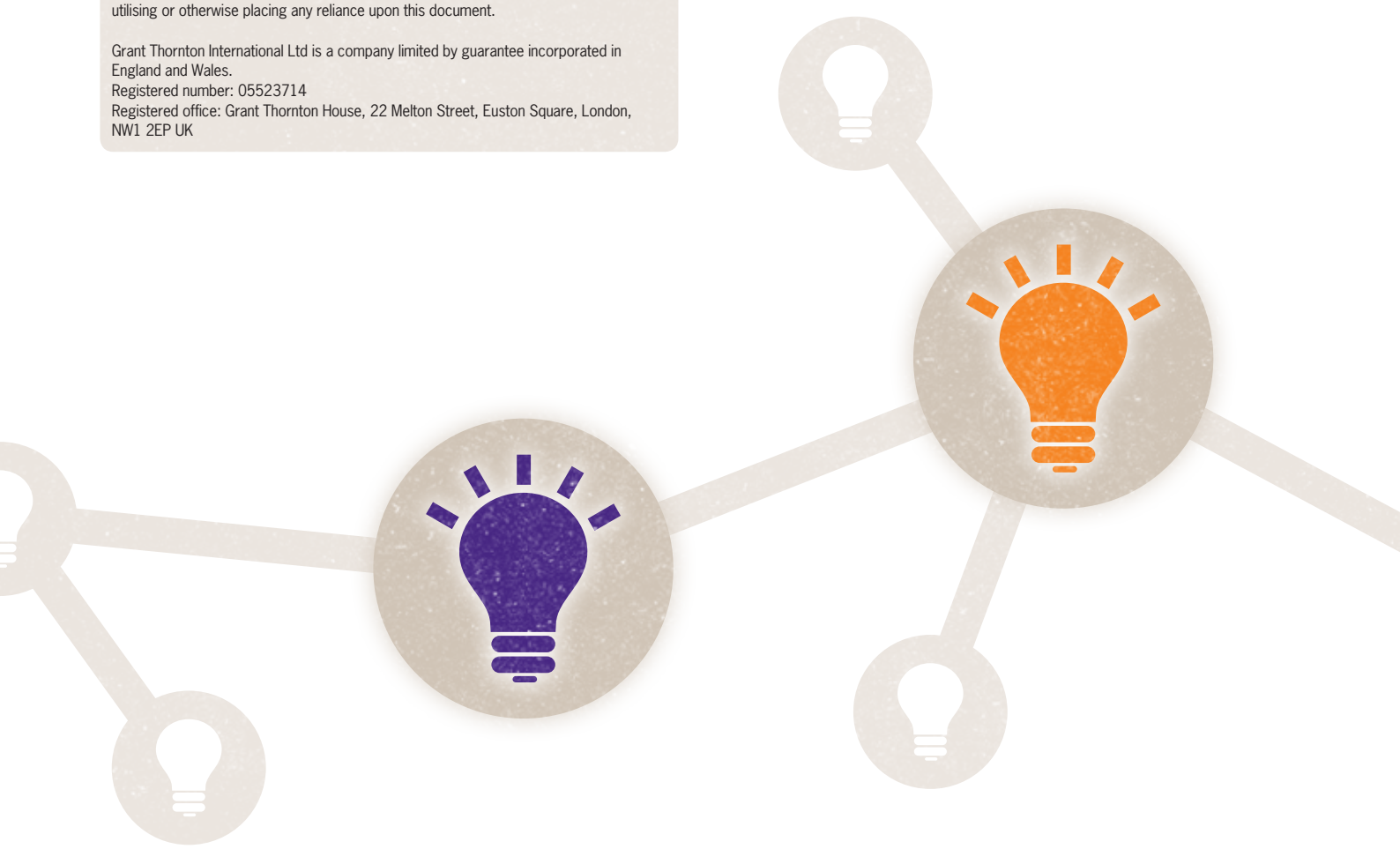


Introduction

Impairment of Assets

International Accounting Standard 36 'Impairment of Assets' (IAS 36, the Standard) is not new. In fact, the Standard was first issued in 1998 and later revised in 2004 and 2008 as part of the International Accounting Standards Board's (IASB's) work on the business combinations project. Since then only minor consequential amendments have been made.

However, although IAS 36's requirements are familiar, the impairment review remains challenging in practice. IAS 36's guidance is detailed, prescriptive and complex in some areas. Putting this guidance into practice involves making long-term estimates of uncertain future performance and the valuation of assets and operations for which observable prices are often not available. This also requires a significant degree of professional judgement. Against this background, financial statement users, regulators and accounting enforcement bodies continue to raise concerns about the rigour of entities' impairment assessments, the supportability of their underlying assumptions and the transparency of the related disclosures. In view of these challenges, a reminder of IAS 36's requirements and key application issues is time well spent.

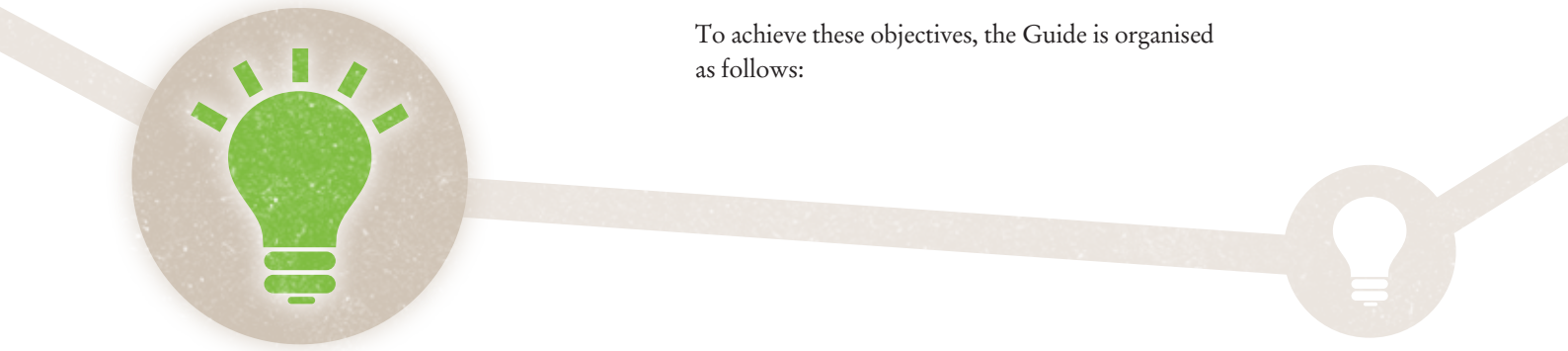
Fortunately, Grant Thornton – one of the world's leading organisations of independent assurance, tax and advisory firms with more than 35,000 Grant Thornton people across over 100 countries – has gained extensive insights into the application of IAS 36. Grant Thornton International Ltd (GTIL), through its IFRS team, develops general guidance that supports the Grant Thornton member firms' commitment to high quality, consistent application of IFRS. We are pleased to share these insights by publishing 'Impairment of Assets: A guide to applying IAS 36 in practice' (the Guide).

Using the Guide

The Guide has been written to assist management in understanding the requirements of IAS 36 while highlighting some common areas of confusion seen in practice. More specifically it:

- summarises the overall objective and basic requirements of IAS 36
- provides a step-by-step guide to performing an impairment assessment, and when required, testing for and/or recording or reversing impairment in accordance with IAS 36
- highlights interpretative and practical application issues that arise when performing these steps (see top 10 issues list on the following page)
- offers insights on best practices to address these issues.

To achieve these objectives, the Guide is organised as follows:



Overview of the Guide

Section A: IAS 36 at a glance

This Section provides an 'at a glance' overview of IAS 36's main requirements and outlines the major steps in applying those requirements. These steps are organised broadly into the following:

- What? (Determining the scope and structure of the impairment review)
- If and when? (Determining if and when a quantitative impairment test is necessary)
- How? (Understanding the mechanics of the impairment test and how to recognise or reverse any impairment loss, if necessary).

Section B: What?

This Section looks at the scope of the impairment review (ie the types of assets that are included) and how it is structured (ie the level at which assets are reviewed). Assets must be reviewed for impairment at the lowest level possible – sometimes this is the individual asset but more often assets must be allocated to a cash generating unit (CGU) for impairment review purposes. Further, goodwill and corporate assets will need to be allocated to a CGU or groups of CGUs. This Section covers the following two Steps of the impairment review:

- Step 1: Identify assets within the scope of IAS 36
- Step 2: Determine the structure of the impairment review.

Section C: If and when?

This Section explains if and when a detailed impairment test is required. The guidance prescribes different requirements for goodwill and indefinite life intangible assets (including those not ready for use) when compared to all other assets. As such, this Section will cover the following Step in the impairment review:

- Step 3: Determine if and when to test for impairment.

Section D: How?

This Section explains the process for the quantitative impairment test – in other words estimating the recoverable amount of the asset or group of assets and comparing this to the carrying value. The impairment test determines if an entity needs to record an impairment loss or reverse a previous loss. This Section covers the following Steps:

- Step 4: Estimate the recoverable amount
- Step 5: Compare recoverable amount with carrying amount
- Step 6: Recognise or reverse any impairment loss.

Section E: Other impairment issues

This Section discusses other common application issues encountered when applying IAS 36, including those related to:

- the 'deferred tax and goodwill problem'
- non-controlling interests
- equity accounting
- the interaction between IAS 36 and other IFRSs.

Section F: Disclosures

This Section provides a summary of the IAS 36 disclosure requirements and highlights particular areas of focus for regulators, including select illustrative examples for these areas of focus.

Top 10 pitfalls in applying IAS 36

In our experience, certain aspects of IAS 36 prove consistently challenging and problems in these areas are frequently identified by regulators. For ease of reference, the table below summarises ten of the most common pitfalls with references to the relevant section of the Guide.

Issue	Guide reference
Identifying CGUs at too high a level	Section B.2.1
Dealing with corporate assets in the impairment review	Section B.2.2.2 and D.2.2
Considering the market capitalisation indicator	Example C.1
Failing to assess impairment indicators, and test if necessary, at interim periods	Section C.1 and E.4.1
Estimating value in use: ensuring assumptions are reasonable and supportable	Section D.1.3.1
Estimating value in use: what to include and exclude in the cash flow estimates	Section D.1.3.1
Estimating value in use: using a pre-tax discount rate that reflects the specific risks of each asset or CGU	Section D.1.3.2
Failing to make a 'like-for-like' comparison of carrying value and recoverable amount	Section D.2.1
Grossing-up goodwill for non-controlling interests	Section E.2
Missing, inadequate or 'boilerplate' disclosures	Section F

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A. IAS 36 at a glance

Section A:
IAS 36 at a glance

This Section provides an 'at a glance' overview of IAS 36's main requirements and outlines the major steps in applying those requirements. These steps are organised broadly into the following:

- What? (Determining the scope and structure of the impairment review)
- If & when? (Determining if and when a quantitative impairment test is necessary)
- How? (Understanding the mechanics of the impairment test and how to recognise or reverse any impairment loss, if necessary).

The objective of IAS 36 is to outline the procedures that an entity applies to ensure that its assets' carrying values are not stated above their recoverable amounts (the amounts to be recovered through use or sale of the assets). To accomplish this objective, IAS 36 provides guidance on:

- the level at which to review for impairment (eg individual asset level, CGU level or groups of CGUs)
- if and when a quantitative impairment test is required, including the indicator-based approach for an individual asset that is not goodwill, an indefinite life intangible asset or intangible asset not yet ready for use
- how to perform the quantitative impairment test by estimating the asset's (or CGU's) recoverable amount
- how to recognise an impairment loss
- when and under what circumstances an entity must reverse an impairment loss and finally
- disclosure requirements (IAS 36.1).

The Standard defines key terms that are essential to understanding its guidance. The most significant definitions are highlighted in Figure A.1 below and others will be introduced in the relevant sections of the Guide:

Figure A.1 – Select key terms in IAS 36 (IAS 36.6)

Term	Definition
Carrying amount	The amount at which an asset is recognised after deducting any accumulated depreciation (amortisation) and accumulated impairment losses thereon
Impairment loss	The amount by which the carrying amount of an asset or a CGU exceeds its recoverable amount
Recoverable amount	The higher of an asset or CGU's fair value less costs of disposal (FVLCOD) and its value in use
Value in use (VIU)	The present value of the future cash flows expected to be derived from an asset or CGU

1 Summary of IAS 36's main requirements

Figure A.2 summarises IAS 36's main requirements.

Figure A.2 – Summary of IAS 36's main requirements

IAS 36 (or related IFRS) reference	Requirements
Objective (IAS 36.1)	IAS 36 prescribes the procedures to ensure that assets are carried at no more than their recoverable amount. To meet this objective, IAS 36 provides guidance on: • the level at which to assess and test for impairment (individual asset level, CGU level, etc.) • if and when a quantitative impairment test is required for particular assets • how to perform the impairment test (ie to determine if the recoverable amount exceeds the carrying value for an asset or group of assets) • how to record and reverse impairment losses • the detailed disclosure requirements (both in the case of impairment and also in the absence of impairment)
Principle	The guiding principle in IAS 36 is that assets should not be carried above their recoverable amount
Scope (IAS 36.2-5)	IAS 36 applies to all assets other than those for which the measurement requirements of other IFRSs are such that an IAS 36-based impairment review is irrelevant or unnecessary. Assets outside IAS 36's scope include: • inventories, financial assets, assets arising from construction contracts, deferred tax assets, assets arising from employee benefits, assets classified as held for sale, assets arising from an insurer's contractual rights under insurance contracts, investment property measured using the fair value model or biological assets IAS 36 does apply to: • financial assets classified as subsidiaries, associates and joint ventures (unless measured at fair value) • property, plant and equipment and intangible assets carried at a revalued amount in accordance with other IFRSs
Key definitions (IAS 36.6)	IAS 36 defines key terms that are essential to understanding its guidance including, but not limited to: • CGU • corporate assets • costs of disposal • impairment loss • recoverable amount • VIU • FVLCOD
Identifying an asset that may be impaired (IAS 36.7-14) (IAS 36.15-16)	IAS 36 prescribes the timing requirements for performing quantitative impairment testing as well as potential 'indicators' of impairment that may trigger impairment testing for some assets or groups of assets. Specifically, IAS 36 requires that: • goodwill, indefinite life intangibles and intangible assets not yet available for use are tested for impairment at least annually, in addition to when there is any indication of impairment • all other assets are tested for impairment when there is any indication that the asset may be impaired IAS 36 also outlines limited exceptions to the requirements noted above
Level of review (individual asset or group of assets) (IAS 36.22) (IAS 36.65-79) (IAS 36.80-99) (IAS 36.100-103)	IAS 36 prescribes the level of review for impairment: • where possible, an entity will estimate the recoverable amount of an individual asset • when this is not possible, an entity will determine the recoverable amount of the CGU to which an asset belongs For the purposes of impairment testing, IAS 36 prescribes how to allocate the following to CGUs: • goodwill • corporate assets

IAS 36 (or related IFRS) reference	Requirements
Measuring recoverable amount (IAS 36.18-24)	When an entity needs to test an asset or CGU for impairment, it must determine its recoverable amount. IAS 36 defines the recoverable amount as the higher of the asset's or CGU's FVLCOD and VIU
FVLCOD (IAS 36.28-29, 78)	IAS 36 provides guidance to determine FVLCOD including: • providing examples of 'costs of disposal' and items that do not meet that definition • outlining situations where it may be necessary to consider some recognised liabilities to determine the recoverable amount
VIU (IAS 36.30-57, Appendix A)	IAS 36 prescribes the elements that should be reflected in the calculation of an asset's or CGU's VIU including: • an estimate of the future cash flows the entity expects to derive from the asset • expectations about possible variations in the amount or timing of those future cash flows • the time value of money • the price for bearing the uncertainty inherent in the asset • other factors such as illiquidity that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset The guidance provides additional considerations in determining an appropriate estimate/rate for each of the above elements
Recognising an impairment loss (IAS 36.58-64) (IAS 36.104-108, Appendix C)	IAS 36 requires an entity to recognise an impairment loss when the carrying amount of an asset or CGU exceeds its recoverable amount, and provides guidance on how to recognise that loss, by: • outlining the requirements for recognising and measuring impairment losses for an individual asset • outlining the requirements for allocating losses when such losses are calculated for a CGU • providing additional considerations for allocating an impairment loss when there is a non-controlling interest
Reversing an impairment loss (IAS 36.109-125)	IAS 36 sets out the requirements for reversing an impairment loss recognised for an asset or CGU in prior periods by: • prescribing timing for assessment • providing indicators that an impairment loss recognised in prior periods for an asset (other than goodwill) or CGU may no longer exist or may have decreased • prescribing the accounting for reversing a prior impairment loss, including limitations on the amount that can be reversed
Disclosures (IAS 36.126-137)	IAS 36 sets out the disclosure requirements related to impairment. Some disclosures apply in the event an entity records an impairment loss while others are required irrespective of any impairment loss

2 IAS 36's impairment approach – step by step

IAS 36 prescribes the procedures that an entity applies to ensure that assets are carried at no more than their recoverable amounts (the impairment review). Very broadly, the impairment review comprises:

- an assessment phase and
- a testing phase, if required.

Assessment phase	
What?	Identifying assets within the scope of IAS 36 and determining the structure of the impairment review (**scope** and **structure**)
If and when?	Determining **if** an impairment test is required and if so, **when**

Testing phase	
How?	If required, understanding **how** to estimate the recoverable amount, **compare** the recoverable amount to the carrying amount, and **recognise or reverse** any impairment loss

This Guide uses the phrase 'impairment review' to encompass both the assessment and testing phase.

In the assessment phase management:

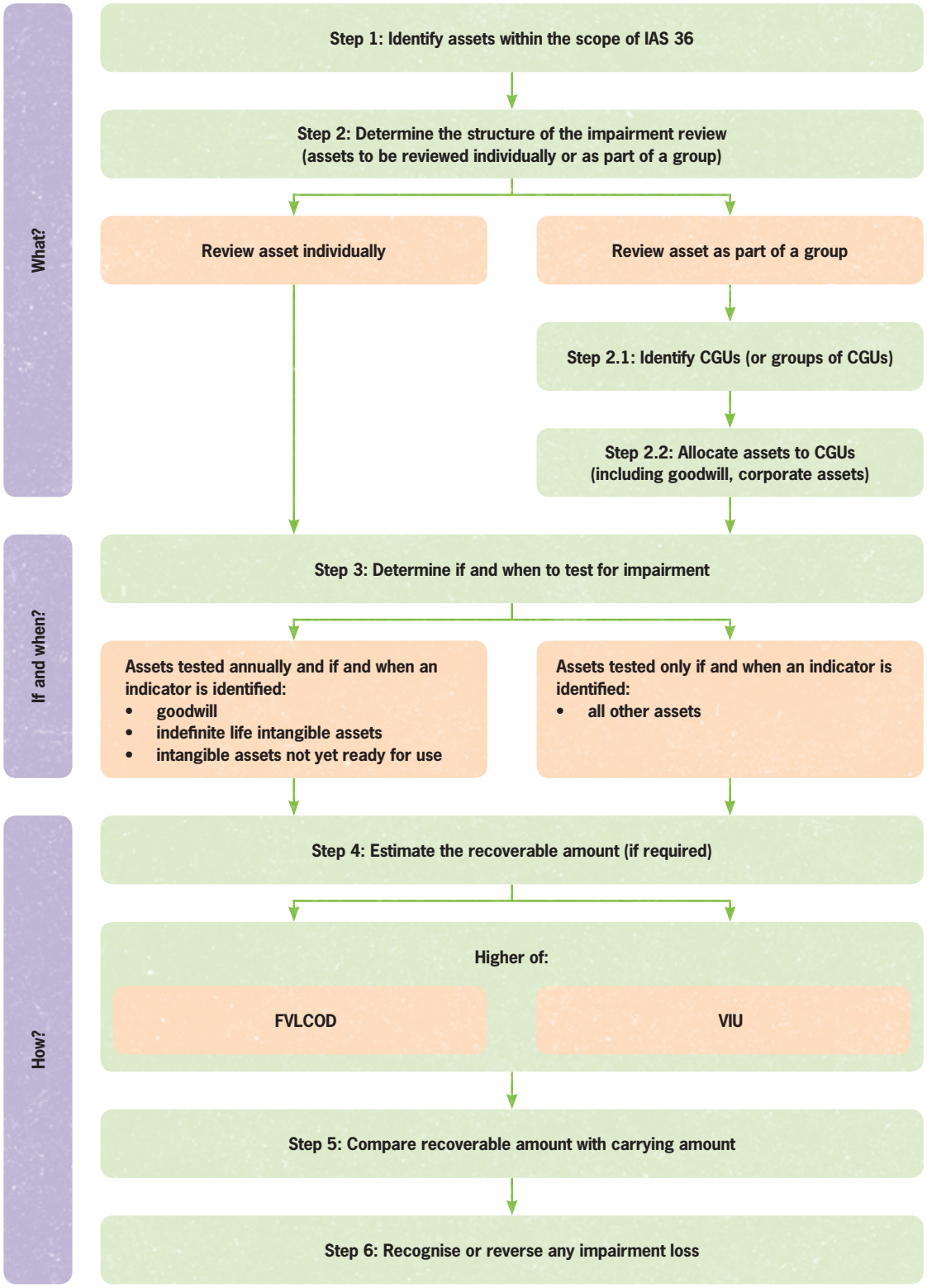
- identifies the assets within the scope of IAS 36
- identifies the assets for which a quantified impairment test is required. Goodwill, indefinite life intangibles and those not available for use are tested at least annually, even if there is no indication they might be impaired. Other assets are assessed and are tested only if one or more indicators are identified
- determines which assets will be tested individually and which as part of a CGU or group of CGUs, and identifies the CGUs to which assets belong (we refer to this as the 'structure' of the impairment review). IAS 36 requires that an entity tests individual assets wherever possible; however, it is usually not possible to determine the recoverable amount for an individual asset. As a result, more times than not, management must identify the CGU (or groups of CGUs) to which the individual asset relates. Additionally, management must allocate goodwill and corporate assets to a CGU (or groups of CGUs) for the purpose of applying IAS 36.

These steps determine the scope of the quantified impairment testing (the testing phase). In the testing phase management:

- estimates the recoverable amount for the assets and CGUs as required
- compares the recoverable amount to the carrying amount
- records (or reverses, if applicable) any impairment loss, to the individual assets, or allocated among the assets in impaired CGUs in accordance with IAS 36's guidance.

With this background in mind, this Guide is structured in the following step-by-step format, with Sections B to D discussing each step in detail:

Figure A.3 – Applying IAS 36 Step-by-step



B. IAS 36's impairment review – What?

Section B: What?

This Section looks at the scope of the impairment review (ie the types of assets that are included) and how it is structured (ie the level at which assets are reviewed). Assets must be reviewed for impairment at the lowest level possible – sometimes this is the individual asset but more often assets must be allocated to a cash generating unit (CGU) for impairment review purposes. Further, goodwill and corporate assets will need to be allocated to a CGU or groups of CGUs. This Section covers the following two Steps of the impairment review:

- Step 1: Identify assets within the scope of IAS 36
- Step 2: Determine the structure of the impairment review.

1 Step 1: Identify assets within the scope of IAS 36

IAS 36 must be applied in accounting for the impairment of all assets, unless they are specifically excluded from its scope (IAS 36.2). The scope exceptions cover assets for which the requirements of other IFRSs render an IAS 36-based impairment review irrelevant or unnecessary (eg – IAS 2 'Inventories' requires that inventory be written down to its net realisable value if lower than cost, so inventory is explicitly excluded from the scope of IAS 36). Figure B.1 summarises IAS 36's scope.

Figure B.1 – Scope of IAS 36

Asset	In scope	Out of scope	If out of scope, the applicable IFRS
Inventories		✓	IAS 2
Assets arising from construction contracts		✓	IAS 11
Assets not ready for use	✓		
Deferred tax assets		✓	IAS 12
Assets arising from employee benefits		✓	IAS 19
Financial assets within the scope of IAS 39/IFRS 9		✓	IAS 39/IFRS 9
Financial assets classified as subsidiaries (as defined in IFRS 10), associates (as defined in IAS 28), and joint ventures (as defined in IFRS 11) accounted for under the cost method for purposes of preparing the parent's separate financial statements	✓		
Investment property (measured using the fair value model)		✓	IAS 40
Investment property (measured at cost)	✓		
Biological assets (measured at fair value less costs of disposal)		✓	IAS 41

Asset	In scope	Out of scope	If out of scope, the applicable IFRS
Deferred acquisition costs and intangible assets arising from an insurer's contractual rights under insurance contracts		✓	IFRS 4
Non-current assets (or disposal groups) classified as held for sale		✓	IFRS 5
Plant, property and equipment, including revalued assets	✓		
Intangible assets, including goodwill and revalued assets	✓		

Other assets not specifically excluded in Figure B.1 are within the scope of IAS 36.

Practical insight – Scope of IAS 36 and operating lease prepayments

Questions sometimes arise with respect to operating lease prepayments and if such payments are within the scope of IAS 36. A lessee often makes an upfront payment to the lessor on entering into a lease (sometimes referred to as a lease premium). Any upfront lease payment is recorded in the statement of financial position as a prepayment asset if the lease is classified as an operating lease in accordance with IAS 17 'Leases'.

IAS 36 applies to all assets except those scoped out by IAS 36.2-5. IAS 36.2(e) scopes out financial assets that are within the scope of IAS 39 'Financial Instruments: Recognition and Measurement'/IFRS 9 'Financial Instruments', but it is not clear if a lease prepayment or premium is a financial asset (whereby the entity would apply the impairment guidance in IAS 39). In our view, an entity should apply the guidance in IAS 36 and assess at each reporting date whether there is any indication that the lease prepayment is impaired (IAS 36.8). If there is an indication of impairment, the entity determines the recoverable amount of the asset and records an impairment loss if the recoverable amount is less than its carrying amount (IAS 36.59). As a prepayment does not usually generate cash flows independently of other assets, it will need to be assigned to a CGU for impairment review purposes.

2 Step 2: Determine the structure of the impairment review

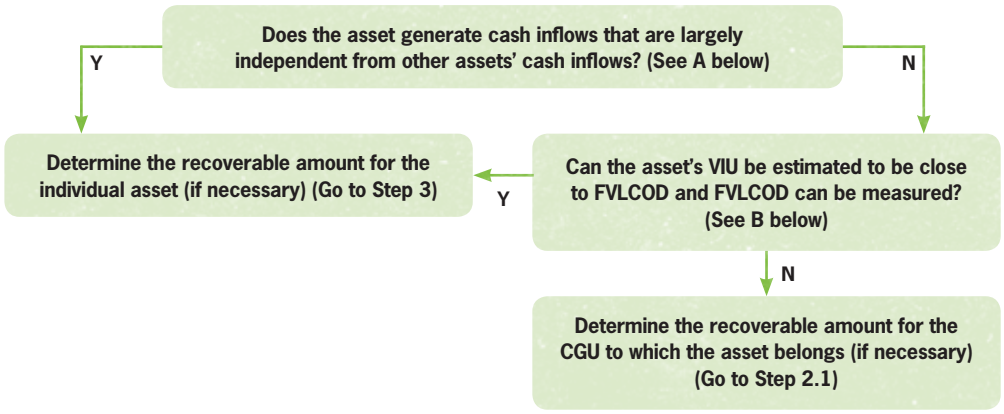
Once the entity has confirmed that the asset in question is within the scope of IAS 36, the next step is to determine whether the asset will be reviewed for impairment individually or as part of a larger group of assets (in other words, the structure of the impairment review for purposes of applying IAS 36).

When possible, IAS 36 should be applied at the individual asset level. This will be possible only when:

- the asset generates cash inflows that are largely independent of those from other assets or groups of assets) (IAS 36.22) or
- the asset's VIU can be estimated to be close to FVLCOD and FVLCOD can be measured (IAS 36.22).

Figure B.2 describes the assessment to determine the structure of the impairment review:

Figure B.2 – Determining the structure of the impairment review



The below paragraphs expand on the concepts of 'cash inflows that are largely independent' and where 'VIU can be estimated to be close to FVLCOD and FVLCOD can be measured' for the purpose of identifying whether assets are reviewed for impairment individually or as a part of a larger group.

A. Cash inflows that are largely independent

When determining if an asset generates cash inflows that are largely independent of the cash inflows from other assets (or groups of assets), an entity considers various factors including:

- how management monitors the entity's operation (such as by product lines, businesses, individual locations, districts or regional areas) or
- how management makes decisions about continuing or disposing of the entity's assets and operations (IAS 36.69).

The following example shows how this guidance may be applied in practice.

Example B.1 – Understanding when cash inflows are 'largely independent'

Background

A television network owns 50 TV programmes of which 20 were purchased and 30 were self-created. The network recognises each purchased programme as an intangible asset at the price paid while it expenses the cost of developing new and maintaining old programmes as incurred. Cash inflows are generated from licensing of broadcasting rights to other networks and advertising sales and are identifiable for each programme. The network manages programmes by customer segments. Programmes within the same customer segment affect to some extent the level of advertising income generated by other programmes in the segment. Management often abandons older programmes before the end of their economic lives to replace them with newer programmes targeted to the same customer segment.

Analysis

In this case, the cash inflows from each TV programme are largely independent. Even though the level of licensing and advertising income for a programme is influenced by the other programmes in the customer segment, cash inflows are identifiable for each individual programme. In addition, although programmes are managed by customer segments, decisions to abandon programmes are made on an individual basis.

Practical insight – Cash inflows versus net cash flows

IAS 36's guidance on whether recoverable amount can be determined for an individual asset specifically refers to cash inflows, not net cash flows or cash outflows. Accordingly, if an asset's cash inflows are largely independent but some of the related costs are interdependent with other assets, recoverable amount must still be determined at the individual asset level (if necessary). This view is explained further in 'Practical insight – Corporate assets and shared corporate costs in the regulatory spotlight' in Section B.2.2.2.

B. VIU can be estimated to be close to FVLCOD and FVLCOD can be measured

As depicted in Figure B.2, if the entity determines that the asset in question does not generate cash inflows that are largely independent of those from other assets, it should assess if the asset's VIU can be estimated to be close to FVLCOD and FVLCOD can be measured. The VIU of an asset may be assessed as close to or less than FVLCOD when the asset is no longer in use, or soon to be replaced or abandoned, such that the estimated future cash flows from continuing use of the asset are negligible (eg, where an entity holds a brand solely for defensive purposes). Further, VIU may be assessed to be close to FVLCOD in the limited circumstances when the entity's estimated cash flows from using the asset are consistent with the cash flows market participants would expect to generate, and costs of disposal are not material (ie when there are no entity-specific advantages or disadvantages, including tax-related factors).

When VIU can be estimated to be close to FVLCOD, the entity will determine the recoverable amount for the individual asset (the asset will not be included in a CGU for impairment assessment purposes) and any impairment is recognised immediately at the individual asset level.

Finally, when there is no reason to believe that VIU materially exceeds FVLCOD, IAS 36 allows an entity to estimate FVLCOD only for purposes of determining the recoverable amount (IAS 36.21).

The following example based on IAS 36.67 illustrates one application of this guidance.

Example B.2 – Where VIU cannot be estimated to be close to FVLCOD

Background

A mining entity owns a private railway to support its mining activities. The private railway does not generate cash inflows that are largely independent of the cash inflows from other assets of the mine. The costs of disposal of the private railway are expected to be high.

Analysis

It is not possible to estimate the recoverable amount of the private railway on a standalone basis because its VIU cannot be determined standalone and is probably different from the amount it would receive on disposal (in part due to the high costs associated with disposal). Therefore, the entity estimates the recoverable amount of the CGU to which the private railway belongs, which could be the mine as a whole.

Practical insight – Structure of the impairment review

Most assets generate cash inflows only in combination with other assets as part of a larger CGU. It is not possible to calculate a recoverable amount for most individual assets that are held for continuing use. Management must then identify the CGU to which an asset belongs to determine if quantitative impairment testing is required. The relevant guidance and application issues associated with this process are discussed in Step 2.1: Identify CGUs (or groups of CGUs).

2.1 Step 2.1: Identify cash generating units (or groups of CGUs)

Identifying CGUs is a critical step in the impairment review and can have a significant impact on its results. That said, the identification of CGUs requires judgement. The identified CGUs may also change due to changes in an entity's operations and the way it conducts them.

A CGU is defined as follows:

Defining a CGU

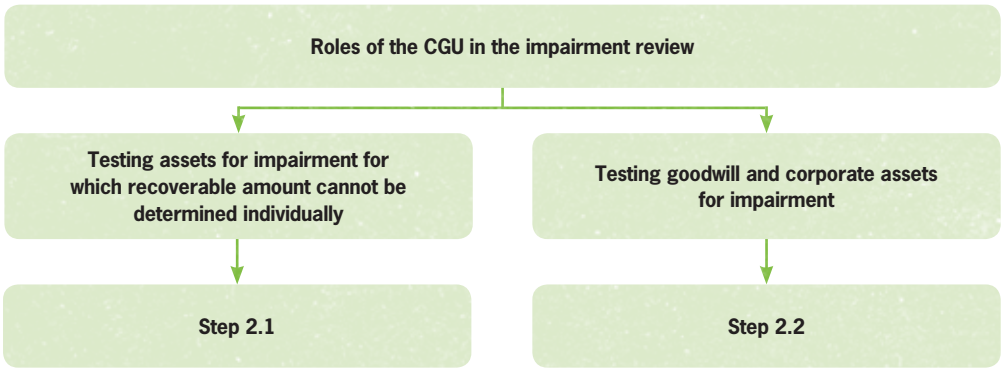
The smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets (IAS 36.6).

2.1.1 Roles of the cash generating unit in the impairment review

A CGU serves two primary roles in the impairment review. It facilitates the testing of:

- assets for which the recoverable amount cannot be determined individually; and
- goodwill and corporate assets for impairment.

Figure B.3 – The roles of the CGU in the impairment review



Goodwill and corporate assets by definition do not generate cash inflows on their own and therefore, must be allocated to a CGU or groups of CGUs for impairment testing purposes. The allocation of goodwill and corporate assets is discussed in Section B.2.2.

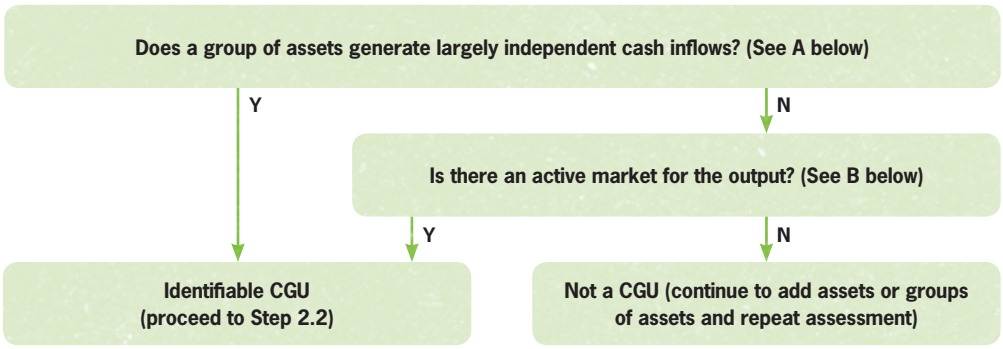
2.1.2 Identifying cash generating units

The objective of identifying CGUs is to identify the smallest identifiable group of assets that generates largely independent cash inflows. CGUs are identified at the lowest level to minimise the possibility that impairments of one asset or group will be masked by a high-performing asset.

To identify a CGU, an entity asks two questions:

1. Does a group of assets generate largely independent cash inflows?
2. Is there an active market for the output?

Figure B.4 – Identifying CGUs



A. Does a group of assets generate independent cash inflows?

Put simply, identifying CGUs involves dividing the entity into components. Because the CGU definition is based on cash inflows, the division process should focus on an entity's sources of revenue and how assets are utilised in generating those revenues. Management will consider various factors including how it monitors the entity's operations (such as by product lines, businesses, individual locations, districts or regional areas) or how management makes decisions about continuing or disposing of the entity's assets and operations (IAS 36.69).

Practical insight – Operational structure over legal structure

It may be the case that the design and management of an entity's operations does not reflect the legal structure of the group. Depending on the circumstances, a CGU might correspond with a legal entity, a division, product line, geographic region, physical location (such as a hotel or retail store) or collection of assets.

The following example illustrates the identification of the lowest aggregation of assets that generate largely independent cash inflows when the recoverable amount cannot be determined for an individual asset.

Example B.3 – Identifying the CGU: lowest level of largely independent cash inflows (IAS 36.68)

Background

A bus company provides services under contract with a municipality that requires minimum service on each of five separate routes. Assets devoted to each route and the cash flows from each route can be identified separately. One of the routes operates at a significant loss.

Analysis

Because the entity does not have the option to curtail any one bus route, the lowest level of identifiable cash inflows that are largely independent of the cash inflows from other assets or groups of assets is the cash inflows generated by the five routes together. The CGU is the bus company as a whole.

Example B.4 – Identifying the CGU: supermarket chain[1]

Background

Entity A owns and operates 10 supermarkets in a major city (City B), each store residing in a different neighbourhood throughout City B. Each supermarket in City B purchases its inventory through A's purchasing centre. Pricing, marketing, advertising and human resources policies (except for the hiring of each supermarket's local staff) are decided by A. Entity A also operates 50 other supermarkets in other major cities across the country.

Analysis

The supermarkets in City B probably have different customer bases as they reside in different neighbourhoods. Accordingly, although operations are managed at a corporate level by A, each supermarket generates cash inflows that are largely independent of those of other supermarkets. Therefore, it is likely that each supermarket in City B is a separate CGU.

In making its judgement about whether each supermarket is a separate CGU, Entity A might also consider if:

- management reporting monitors revenues on a supermarket-by-supermarket basis in City B; and
- how management makes decisions about continuing or closing its supermarkets (eg on a store-by-store or on a region/city basis).

B. Is there an active market for the output?

When management has identified a group of assets that generate an output, but those assets do not generate largely independent cash inflows, it needs to consider if there is an active market for the output.

For the purposes of applying IAS 36, even if part or all of the output produced by an asset (or a group of assets) is used by other units of the entity (ie, products at an intermediate stage of a production process), this asset (or group of assets) represents a CGU if the entity could sell the output on an active market. This is because the asset (or group of assets) could generate cash inflows that would be largely independent of the cash inflows from other assets (or groups of assets) (IAS 36.71).

Practical insight – Vertically integrated businesses and an active market for output

This is a common issue for vertically integrated businesses whereby some groups of assets do not generate independent cash inflows, only because each operation's output is used internally, rather than being sold externally. IAS 36 addresses this issue by clarifying that even if part or all of the output produced by an asset (or a group of assets) is used by other units of the entity, this asset (or group of assets) forms a separate CGU if the entity could sell the output on an active market. An active market is defined in IFRS 13 'Fair Value Measurement' as 'a market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis'. This may be the case for certain commodities such as oil or gold.

1 The IFRIC was asked to develop an Interpretation on whether a CGU could combine more than one individual store location. The submitter developed possible considerations including shared infrastructures, marketing and pricing policies, and human resources. The IFRIC noted that IAS 36.6 (and supporting guidance in IAS 36.68) requires identification of CGUs on the basis of independent cash inflows rather than independent net cash flows and so outflows such as shared infrastructure and marketing costs are not considered. In its March 2007 agenda decision, the IFRIC took the view that developing guidance beyond that already given in IAS 36 on whether cash inflows are largely independent would be more in the nature of application guidance and therefore decided not to take this item on to its agenda.

Example B.5 – Identifying the CGU: active market for the output

Background

Entity X produces a single product (widgets) and owns production plants 1, 2 and 3. Each plant is located in a different region of the world. Plant 1 produces a component of the widgets that is assembled in either plant 2 or plant 3 and sold worldwide from either plant 2 or plant 3. Neither plant 2 nor plant 3 is operating at full capacity. The utilisation levels depend on the allocation of order fulfillment between the two locations.

Scenario 1: There is an active market for plant 1's component.
Scenario 2: There is no active market for plant 1's component.

Scenario 1: It is likely that plant 1 is a separate CGU because there is an active market for its output. As cash inflows for plants 2 and 3 depend on the allocation of production across the two locations, it is unlikely that the future cash inflows for plants 2 and 3 can be determined individually so they would probably be combined into a single CGU.

Scenario 2: It is likely that the three plants (1, 2 and 3) are a single CGU because:

- there is no active market for plant 1's output and its cash inflows depend on sales of the final product by plants 2 and 3
- cash inflows for plants 2 and 3 depend on the allocation of production across the two locations. It is unlikely that the future cash inflows for plants 2 and 3 can be determined individually.

Where the cash inflows generated by an asset or CGU are affected by internal transfer pricing, an entity uses management's best estimate of future prices that could be achieved in an arm's length transaction in estimating:

- the future cash inflows used to determine the asset's or CGU's VIU; and
- the future cash outflows used to determine the VIU of any other assets or CGUs that are affected by the internal transfer pricing (IAS 36.70).

Example B.5 continued – Identifying the CGU: active market for the output

In Scenario 1, in determining the VIU of plants 1, 2 and 3, Entity X will adjust its financial budgets/forecasts to reflect its best estimate of future prices that could be achieved in arm's length transactions for plant 1's output while also incorporating future cash outflows used to determine the VIU of other assets impacted by the internal transfer pricing.

When the group of assets does not generate cash inflows that are largely independent and there is no active market for its output (even if used internally), the group is not a CGU. Management then combines these assets with others that contribute to the same revenue stream until a CGU is identified.

2.1.3 Changes in identified cash generating units

Unless a change is justified, CGUs are identified consistently from period to period for the same asset or types of assets (IAS 36.72). If a change in CGUs is justified (eg an asset belongs to a different CGU than in previous periods or previously recognised CGUs are combined or subdivided), and an impairment loss is recognised or reversed for the CGU, the entity must disclose additional information in accordance with IAS 36.130 (IAS 36.73).

Practical insight – Triggers for a change in CGU structure

IAS 36 does not provide examples of events or circumstances that would justify a change in CGUs. Such a change would generally be appropriate only if there has been a change in the entity's operations – ie different revenue-generating activities or different utilisation of assets in undertaking those activities. Typical triggers for a change might include:

- business combinations or divestments
- restructurings
- introduction or withdrawal of products or services
- entry to or exit from new markets or regions.

Practical insight – A change in CGU structure over time

The factors that justify a change in CGU structure sometimes develop over time rather than being driven by a specific event. For example, an entity might gradually change the way it allocates order intake across its production facilities or how it utilises assets to generate a revenue stream. In our view, the change in CGU structure is justified if an asset's cash inflows become, or cease to be, independent even if this cannot be attributed to a specific event. One practical suggestion for determining the effective date of the change is to consider when management began reviewing or assessing the CGUs differently (eg when management reporting changed).

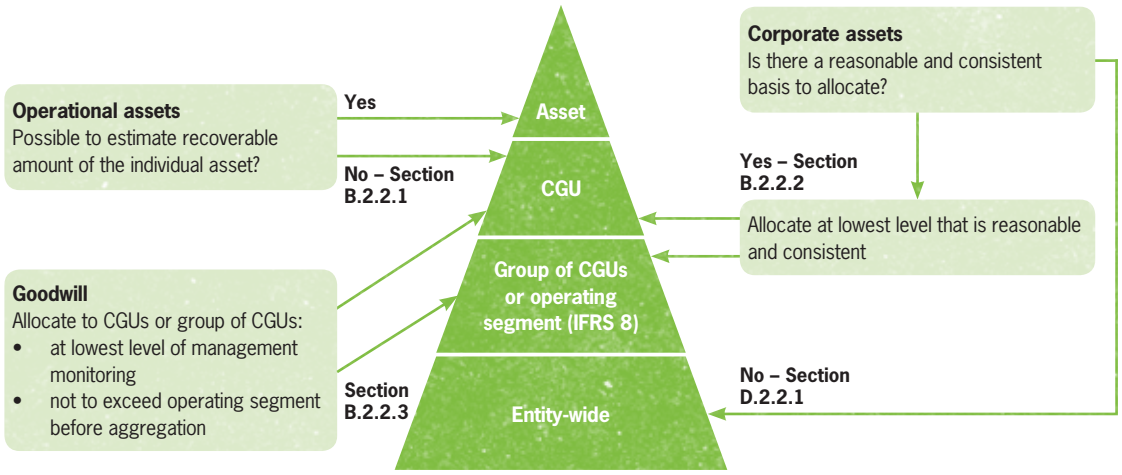
2.2 Step 2.2: Allocate assets to the cash generating units

After the entity identifies its CGUs it must determine which assets belong to which CGUs, or groups of CGUs. The basis of allocation differs for:

- operational assets
- corporate assets
- goodwill.

Figure B.5 summarises the different allocation bases. Each is discussed in turn below.

Figure B.5 – Allocation of assets overview



2.2.1 Operational assets

As discussed in Section B.2 (Step 2), recoverable amount is determined (if required) at the level of individual assets when possible. Where it is not possible to estimate the recoverable amount of the individual operational asset it is allocated to the CGU to which it belongs.

Assets that contribute to the cash flows of a CGU also need to be allocated to that CGU even if it is possible to determine recoverable amount individually (because, for example, an asset's VIU can be estimated as similar to its FVLCOD). This is to ensure a like-for-like comparison when the CGU is tested and its recoverable amount is compared to its carrying value.

The discussion in Step 2.1 'Identify CGUs (or groups of CGUs)' provides guidance on identifying the CGU to which an asset belongs.

2.2.2 Corporate assets

In some cases, management may identify certain assets that contribute to the estimated future cash flows of more than one CGU. It would be inappropriate to allocate these assets entirely to a single CGU. Such assets are referred to as 'corporate assets' or 'shared assets' and may include (for example):

- a headquarters building
- IT equipment
- research centre
- corporate or global brands.

Defining corporate assets (IAS 36.6)

Corporate assets are assets other than goodwill that contribute to the future cash flows of both the CGU under review and other CGUs.

Distinctive characteristics of corporate assets are that they do not generate cash inflows independently of other assets or groups of assets and their carrying amount cannot be fully attributed to the CGU under review (IAS 36.100).

If there is an indication of impairment for the corporate asset itself, recoverable amount cannot be determined at the individual asset level, unless management has decided to dispose of it (because corporate assets do not generate separate cash inflows) (IAS 36.101).

Corporate assets therefore need to be incorporated into the impairment review at the CGU level – not only to test the asset in question (when necessary), but also to test the CGUs that benefit from those assets. To do so, the entity must:

- identify corporate assets that relate to the CGU under review
- allocate the carrying amount of the corporate assets on a reasonable and consistent basis to the CGU under review (if a reasonable and consistent basis can be identified) (IAS 36.102(a)).

Where a portion of the carrying amount of a corporate asset cannot be allocated on a reasonable and consistent basis, the assets are incorporated into the impairment review at a higher level and the analysis becomes more complicated. This is addressed in Section D.2.2.1.

Example B.6 – Identification and allocation of corporate assets to CGUs

Background

Entity E has four CGUs: A, B, C and D. The carrying amounts of those units do not include goodwill. During the period, significant adverse changes in the legal environment in which Entity E operates take place. Entity E conducts impairment tests of each of its CGUs in accordance with IAS 36.12(b). At the end of the period, the carrying amounts of CGUs A, B, C and D are CU100, CU200, CU300 and CU250, respectively.

The four CGUs all utilise a central office and a shared global brand (carrying amounts of CU100 and CU75, respectively).

Management of E has determined that the relative carrying amounts of the CGUs are a reasonable approximation of the proportion of the central office building devoted to each CGU, but that the carrying amount of the global brand cannot be allocated on a reasonable and consistent basis to the individual CGUs.

The remaining estimated useful life of CGUs A, B, C and D are 10, 15, 15 and 20 years respectively. The central office has a remaining useful life of 20 years and is depreciated on a straight-line basis.

Analysis (ignoring tax effects)

Entity E identifies all corporate assets that relate to the individual CGUs under review (the central office and shared global brand) (IAS 36.102).

Entity E concludes that the carrying amount of the central office can be allocated on a reasonable and consistent basis to the CGUs under review while the carrying amount of the global brand cannot.

Although not the only way to do so, Entity E allocates the carrying amount of the central office to the carrying amount of each individual CGU using a weighted allocation basis because the estimated remaining useful life of A's CGU is 10 years, whereas the estimated remaining useful lives of B and C's CGUs are 15 years and D's CGU is 20 years.

	CGU A	CGU B	CGU C	CGU D	Total
Carrying amount	100	200	300	250	850
Useful life	10	15	15	20	
Weighting	1	1.5	1.5	2	
Carrying amount after weighting	100	300	450	500	1,350
Pro-rata allocation of the central office	7.4%	22.2%	33.3%	37.1%	100.0%
Allocation of the carrying amount of the central office (based on pro-rata above)	7.4	22.2	33.3	37.1	100
Carrying amount (after allocation of the central office)	107.4	222.2	333.3	287.1	950

See D.2.2.1 for discussion of how to account for the shared global brand (and other corporate assets) that cannot be allocated on a reasonable and consistent basis.

Practical insight – Allocating corporate assets

IAS 36 provides only limited guidance as to what is meant by 'allocated on a reasonable and consistent basis' for allocation of corporate assets to CGUs or groups of CGUs. Judgement is therefore required. This judgement will depend on the nature of the asset and should aim to reflect the extent to which each CGU benefits from the corporate asset. In our view, however, a reasonable and consistent basis of allocation should normally be possible in most circumstances by taking a pragmatic approach, even if the benefits obtained by the CGU are less clear-cut or observable. Example B.6 above shows one such pragmatic approach (allocating corporate assets using CGUs' carrying amounts, weighted by their useful lives) but several other methods could also be supportable (for example, headcount, revenue, floor space or utilisation metrics depending on the circumstances).

Practical insight – Corporate assets and shared corporate costs in the regulatory spotlight

In estimating VIU (see Step 4) for a CGU that benefits from a corporate asset, an entity must ensure that it also allocates shared corporate costs that relate to that corporate asset. A recent regulatory decision published in the 3 April 2013 European Securities and Markets Authority (ESMA) Report (ESMA/2013/444) highlights this point whereby an issuer did not allocate the costs of corporate officers to the individual CGUs on the basis that the cash flows benefited the company as a whole rather than the individual CGUs (highlighting the criterion of independency of cash flows when determining the cash inflows and outflows of a CGU). In the regulator's view, the corporate costs were cash outflows that were necessarily incurred to generate the cash inflows from continuing use of the assets and could be allocated on a reasonable and consistent basis to the asset. The regulator concluded that excluding certain corporate costs from the costs allocated to CGUs did not comply with the requirements of IAS 36 and that all cash outflows had to be included in the cash flow forecasts. The corporate costs were cash outflows that, according to IAS 36.39(b), were necessarily incurred to generate the cash inflows from continuing use of the CGU's assets and could be allocated on a reasonable and consistent basis to the CGU.

2.2.3 Goodwill

It is not possible to determine the recoverable amount of goodwill independently from other assets because goodwill does not generate cash flows of its own; rather it contributes to the cash flows of individual CGUs or multiple CGUs (IAS 36.81).

As such, goodwill must be allocated to individual CGUs (or groups of CGUs) for the purpose of impairment testing. The guidance in IAS 36.80 requires that goodwill acquired in a business combination is allocated to each of the acquirer's CGUs or groups of CGUs that are expected to benefit from the synergies of the combination. Further, the level to which the goodwill is allocated must:

- represent the lowest level within the entity at which the goodwill is monitored for internal management purposes (IAS 36.80(a)); and
- not be larger than an operating segment before aggregation as defined by IFRS 8 'Operating Segments' (IAS 36.80(b)).

Defining an operating segment (IFRS 8.5)

An operating segment is a component of an entity:

a. that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity),
b. whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and reassess its performance, and
c. for which discrete financial information is available.

An operating segment may engage in business activities for which it has yet to earn revenues, for example, start-up operations may be operating segments before earning revenues.

Example B.7 – Allocating goodwill acquired in a business combination

Background

Entity A acquires competitor E for CU1M and determines that this new acquiree is a single CGU (E). Entity A performs an analysis of its existing business and determines that CGUs B, C and D will all benefit from the acquisition of E and expect to realise potential synergies from the transaction. The identifiable net assets of E total CU750,000. Total goodwill from the acquisition equals CU250,000 (CU1M – CU750,000).

Analysis

Because some of Entity A's existing CGUs are expected to benefit from the synergies of the combination, a portion of the goodwill of CU250,000 should be allocated to these CGUs. IAS 36 provides little guidance on how to do this. However, if Entity A is able to estimate how much of the purchase price (and goodwill) relates to expected synergy benefits for its existing business, this can provide an initial basis for allocation. For example, if the estimated fair value of E is CU800,000 (ie excluding acquirer synergies), Entity A may allocate CU50,000 of goodwill to E (CU800,000-CU750,000) and allocate the remaining goodwill of CU200,000 between CGUs B, C and D, representing the expected synergies between E, B, C and D.

Allocating goodwill to groups of CGUs

IAS 36 acknowledges that sometimes goodwill cannot be allocated to individual CGUs on a non-arbitrary basis. It therefore allows or requires allocation to groups or clusters of CGUs, subject to the limits noted above.

If management has a monitoring process for goodwill, IAS 36 seems to require that goodwill is allocated to the lowest level at which it is monitored but limits this to the size of the operating segment before aggregation. Allocation at such a level means that goodwill can be monitored using existing reporting systems consistent with the way that management monitors its operations (IAS 36.81-82).

If there is no separate monitoring process for goodwill, IAS 36 seems to allow a choice of allocation to:

- individual CGUs
- groups of CGUs that form part of an operating segment before aggregation
- groups of CGUs that form an entire operating segment before aggregation.

Practical insight – Allocating goodwill acquired in a business combination

IAS 36 sets out requirements on both (a) the level of allocation and (b) the basis of allocation of goodwill to CGUs or groups of CGUs.

a. IAS 36 offers some flexibility on the level to which goodwill is allocated. The allocation can be to CGUs, or to groups of CGUs, provided the level of allocation
   - represents the lowest level within the entity at which the goodwill is monitored
   - is not larger than an operating segment.

   In our experience, the first condition rarely has a practical effect because few entities separately monitor goodwill outside the impairment review and external financial reporting process. The impact of the second condition is more varied. In some entities, an operating segment may comprise many CGUs while in others, the CGUs and operating segments might be similar or even identical. IAS 36 seems not to envisage that an operating segment could be smaller than a CGU – in our view, this is possible in theory but rare in practice.

b. The basis of allocation (the expected synergies from the combination) requires considerable judgement in practice. One approach is to perform a 'pre-combination' and 'post-combination' valuation and use this analysis as a basis to allocate the goodwill. Such an analysis may identify the factors that contribute to the synergies expected to arise from the acquisition (eg cost savings from economies of scale and reduced overheads or increased revenues from cross-selling opportunities to new markets). Others may use the relative carrying values of the CGUs to allocate the goodwill to impacted CGUs.

   In our view, the entity should take a practical approach while aiming to arrive at the most representative allocation of goodwill to those CGUs that are expected to benefit from the combination. If the requirements in IAS 36.80 are overlooked, and goodwill is allocated entirely to the acquired business, this can lead to unnecessary future impairment losses and complications (eg when the CGUs are subsequently reorganised or disposed of, as discussed in B.2.2.3B below).

Example B.8 – Limit on the level at which goodwill can be allocated

Background

Entity A manufactures and sells widgets. In year 20X1, it purchases Entity B, Entity C, and Entity D which also produce widgets, each in a different part of the world. Entity A recognised goodwill of CU1M with respect to the acquisition of Entity B, CU2M with respect to the acquisition of Entity C and CU4M with respect to Entity D, all attributable to the cost-savings opportunities from using Entity A's established centralised functions (purchasing, marketing, human resources).

Management has identified several CGUs, each of which is a component of one of entities A, B, C and D. The operating segments before aggregation for the purposes of IFRS 8 are Entities A, B, C and D as management reporting and resource allocation decisions are based on the corporate structure. Goodwill is not separately monitored.

Analysis

Management can choose whether to allocate goodwill among individual CGUs that are expected to benefit from the synergies of each combination, or at the level of its four operating segments. If management determines that it cannot allocate goodwill among its individual CGUs except on an arbitrary basis it will allocate at the operating segment level.

Changes in the allocation of goodwill

For various reasons, the initial allocation of goodwill to CGUs or groups of CGUs may change. The below Sections discuss these circumstances and outline the appropriate accounting for each in accordance with IAS 36:

Provisional allocation of goodwill	A
Reallocation of goodwill	B
• disposal of an operation within a CGU	B1
• reorganisation of the reporting structure	B2

A. Provisional allocation of goodwill

The initial allocation of goodwill acquired in a business combination should be completed before the end of the annual period in which the business combination takes place, if possible.

IFRS 3 'Business Combinations' (IFRS 3) sets out guidance on provisional accounting for a business combination, including a requirement to finalise the IFRS 3 accounting within the so-called measurement period (not to exceed twelve months from the acquisition date). In our view, if goodwill has been determined only provisionally in accordance with IFRS 3, then that provisional amount should be allocated to CGUs or groups of CGUs if possible (and then adjusted as necessary when the IFRS 3 accounting is complete). However, IAS 36 acknowledges that an initial allocation may not be possible, in which case the initial allocation should be completed before the end of the first annual period following the combination (IAS 36.84).

Practical insight – IFRS 3 resource reminder

For more on IFRS 3 accounting and the provisional accounting for goodwill, see the GTIL IFRS Guide: 'Navigating the accounting for business combinations – Applying IFRS 3 in practice' (December 2011).

In the event the entity is unable to allocate even the provisional amount of goodwill before the end of the period in which the combination takes place, it should disclose:

- the amount of unallocated goodwill and
- the reason(s) why it remains unallocated (IAS 36.133).

Example B.9 – Compliance with IAS 36 when an initial allocation of goodwill is not possible

Background

Entity P has acquired a subsidiary (Entity T) on 30 June 20X0 which will be accounted for in accordance with IFRS 3. At the reporting date of 31 December 20X0, Entity P has not completed its determination of the acquisition date fair values and therefore it cannot finalise its measurement of goodwill (ie the IFRS 3 measurement period remains open and the amounts reflected in the consolidated financial statements are stated as provisional). Entity P also concludes that it cannot complete the initial allocation of the provisional goodwill by 31 December 20X0.

Question

Does Entity P have to carry out an impairment test on the goodwill prior to 31 December 20X0 in accordance with IAS 36.96?

Analysis

When the initial allocation of goodwill has not been made in accordance with IAS 36.85 but facts and circumstances indicate that the goodwill may be impaired (eg, an overpayment for the acquisition), Entity P should use reasonable endeavours to ensure that the goodwill is not carried at an amount above its recoverable amount to comply with the overall principles of IAS 36 which require some form of recoverability test in such case. The fact that the allocation process remains incomplete does not exempt the entity from performing an impairment assessment using the best information available at the time. Depending upon the particular facts and circumstances, the form of this test may vary (for example, the entity may need to estimate the recoverable amount on an entity-wide basis).

B. Reallocation of goodwill

Various circumstances may necessitate a reallocation of goodwill among CGUs (or groups of CGUs) including:

- the disposal of an operation to which goodwill has been allocated
- the reorganisation of an entity's reporting structure.

B.1 Disposal of an operation within a CGU to which goodwill has been allocated

When goodwill has been allocated to a CGU and the entity disposes of an operation within that unit, the goodwill associated with the disposed operation must be:

- included in the carrying amount of the operation when determining the gain or loss on disposal (IAS 36.86(a)) and
- measured on the basis of the relative values of the operation disposed of and the portion of the CGU retained (unless another method better reflects the goodwill associated with the disposed operation (IAS 36.86(b))).

Example B.10 – Disposal of an operation to which goodwill has been allocated (IAS 36.86)

Background

An entity sells for CU100 an operation that was part of a CGU to which goodwill has been allocated. The goodwill allocated to the CGU cannot be identified or associated with an asset group at a level lower than that CGU, except arbitrarily. The recoverable amount of the portion of the CGU retained is CU300.

Analysis

Because the goodwill allocated to the CGU cannot be non-arbitrarily identified or associated with an asset group at a level lower than that CGU, the goodwill associated with the operation disposed of is measured on the basis of the relative values of the operation disposed of and the portion of the unit retained. Therefore, 25 per cent of the goodwill allocated to the CGU is included in the carrying amount of the operation that is sold.

B.2 Reorganisation of the reporting structure

When an entity reorganises its reporting structure in a way that changes the composition of one or more CGUs to which goodwill has been allocated, the goodwill must be:

- reallocated to the units affected and
- measured using a relative value approach (again, unless another method better reflects the goodwill associated with the reorganised units (IAS 36.87)).

Example B.11 – Reorganisation of the reporting structure (IAS 36.87)

Background

Goodwill had previously been allocated to CGU A. The goodwill allocated to CGU A cannot be identified or associated with a lower level asset group, except arbitrarily. CGU A is to be divided and integrated into three other CGUs: B, C and D.

Analysis

Because the goodwill allocated to CGU A cannot be non-arbitrarily identified or associated with an asset group at a lower level, it is reallocated to CGUs B, C and D on the basis of the relative values of the three portions of CGU A before those portions are integrated into CGUs B, C and D.

Practical insight – Other methods that better reflect the goodwill associated with the operation disposed of or reorganised

When an entity disposes of part of a CGU to which goodwill has been allocated, IAS 36 sets out a benchmark 'relative value' approach for re-apportioning the goodwill within that unit, while also permitting some flexibility.

Similar guidance applies when an entity reorganises its reporting structure – if the reorganisation changes the composition of one or more CGUs to which goodwill has been allocated, the goodwill needs to be reallocated to the affected units.

In our view, an alternative method of reallocation would be appropriate when the relative value approach does not take into account relevant differences between reorganised units (because the relative value approach assumes that each CGU has the same proportion of goodwill).

For example, assume an entity reorganises from three to two CGUs and the assets and activities of the third CGU (CGU C) are integrated with the remaining two (CGUs A and B). CGU C includes allocated goodwill of CU300 which must now be reallocated to CGUs A and B. Under the benchmark approach the reallocation would be based on the relative values of the portions of CGU C that are integrated into CGUs A and B. However, assume also that the portion of CGU C integrated with CGU A is a manufacturing operation and the portion integrated with CGU B is a service-based operation. Using the figures in the table below, the relative value basis would result in the allocation of CU150 to CGU A and CU150 to CGU B. The entity may deem it more appropriate in this case (given the different nature of the activities integrated into CGUs A and B) to allocate goodwill based on the notional goodwill of each portion resulting in an allocation of CU60 to CGU A (100/500*300) and CU240 to CGU B (400/500*300).

On date of reorganisation	Portion of C integrated with CGU A	Portion of C integrated with CGU B	Total
Fair value of assets	500	200	700
Fair value of portion	600	600	1,200
Notional goodwill	100	400	500

C. IAS 36's impairment review – If & when?

Section C: If and when?

This Section explains if and when a detailed impairment test is required. The guidance prescribes different requirements for goodwill and indefinite life intangible assets (including those not ready for use) when compared to all other assets. As such, this Section will cover the following Step in the impairment review:

- Step 3: Determine if and when to test for impairment.

1 Step 3: Determine if and when to test for impairment

IAS 36 requires an entity to a perform a quantified impairment test (ie to estimate the recoverable amount):

- if at the end of each reporting period, there is any indication of impairment for the individual asset or CGU (IAS 36.9) (indicator-based impairment) and
- annually for the following types of assets, irrespective of whether there is an indication of impairment:
  - intangible assets with an indefinite useful life
  - intangible assets not yet available for use
  - goodwill acquired in a business combination (IAS 36.10).

These requirements are summarised in Figure C.1 below.

Figure C.1 – Timing requirements for impairment testing by asset type

Asset	Test if indicator of impairment present at the end of the reporting period	Test at least annually	Section covered within this Guide
• **Goodwill** • **Indefinite life intangible asset** • **Intangible asset not yet available for use**	Yes	Yes	Section C.1.2
All other assets within the scope of IAS 36, but not included above	Yes and review the remaining useful life, depreciation/amortisation or residual value for asset	No	Section C.1.1

1.1 Indicator-based impairment testing

IAS 36 requires an entity to assess at the end of each reporting period whether there is any indication that an asset or CGU may be impaired. This requirement also applies to goodwill, indefinite life intangible assets, and intangible assets not yet ready for use (although, in practice, an indicator review is necessary only at period ends that do not coincide with the annual test). If any such indication exists, the entity should estimate the recoverable amount of the asset or CGU (IAS 36.9). The process to estimate the recoverable amount is discussed in Section D – Step 4.

Indicators

IAS 36.12 provides a non-exhaustive list of external, internal and other indicators that an entity should consider, summarised in Figure C.2 below:

Figure C.2 – Non-exhaustive list of impairment indicators from IAS 36

External sources of information (IAS 36.12 (a) – (d))

- Observable indications of a significant and unexpected decline in market value
- Significant negative changes (have occurred or are expected) in the technological, market, economic or legal environment
- Market interest rates or other market rates of return on investments have increased (which will increase the discount rate used in calculating an asset's VIU)
- Carrying amount of the net assets of the entity is more than its market capitalisation

Internal sources of information (IAS 36.12 (e) – (g))

- Evidence is available of obsolescence or physical damage of an asset
- Significant negative changes (have occurred or are expected) in the extent to which an asset is (or is expected to be used) (eg such as the asset becoming idle, plans to discontinue or dispose of the asset before the previously expected date, and reassessing the useful life of an asset as finite rather than indefinite)
- Evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected

Other indicators (IAS 36.12(h), IAS 38.83)

- For an investment in a subsidiary, joint venture or associate, the investor recognises a dividend from the investment and evidence is available that:
  - the carrying amount of the investment in the separate financial statements exceeds the carrying amounts in the consolidated financial statements of the investee's net assets, including associated goodwill; or
  - the dividend exceeds the total comprehensive income of the subsidiary, joint venture or associate in the period the dividend is declared
- The fact that an active market no longer exists for a revalued intangible asset

Generally, internal indicators would provide reasonably direct evidence that a specific asset or CGU may be impaired. For example, internal reports might show:

- cash flows for acquiring the asset or CGU, or subsequent cash needs for operating or maintaining it, are significantly higher than those originally budgeted;
- actual net cash flows or operating profit or loss flowing from the asset or CGU are significantly worse than those budgeted;
- a significant decline in budgeted net cash flows or operating profit, or a significant increase in budgeted loss, flowing from the asset or CGU; or
- operating losses or net cash outflows for the asset or CGU, when current period amounts are aggregated with budgeted amounts for the future (IAS 36.14).

However, external sources of information will more typically be broader and less clearly linked to a specific asset or CGU (for example, a decline in market capitalisation to less than the carrying value of the entity's net assets). This then may require the use of judgement to determine which assets or CGUs should be tested in response to an external source of information. Example C.1 illustrates this point.

Example C.1 – Bridging the gap from external indicators of impairment to testing specific assets

Background

BioTech Research Company (BTRC) develops and sells a range of diagnostic products. It operates from three manufacturing and distribution centres. Each centre is considered to be a separate CGU. BTRC is preparing its financial statements for its year-ended 31 December 20X1. Summary financial information for each CGU is as follows:

CU000	CGU 1	CGU 2	CGU 3	Total
Goodwill	1,900	–	–	1,900
Other intangible assets (amortising)	1,100	500	1,000	2,600
PPE	500	1,500	700	2,700
Subtotal	**3,500**	**2,000**	**1,700**	**7,200**
Corporate HQ				1,800
Net debt				(3,500)
Other assets and liabilities (net)				(500)
Net book value				5,000

The market capitalisation of BTRC as at 31 December 20X1 is CU3,000.

Analysis

As part of its indicator assessment, management should compare market capitalisation (CU3,000) with net book value (CU5,000). Given the seemingly material 'market to book' shortfall of CU2,000, a detailed impairment test is probably required. However, BTRC should consider all facts and circumstances, including:

- whether some or all of the shortfall is attributable to assets and liabilities outside IAS 36's scope (eg if the fair value of the entity's net debt is significantly different to its carrying value of CU3,500)
- whether any implied control premium included in the market capitalisation is reasonable in all the circumstances (eg is it 'standard' for this industry?)
- whether the market capitalisation reflects a discount for lack of liquidity
- share price volatility
- length of time over which a shortfall is observed
- other possible impairment indicators.

If, after considering these factors management concludes that detailed impairment testing is required, the question arises as to which CGUs and assets should be tested. CGU 1 needs to be tested for impairment in any event because goodwill has been allocated to it; however determining the relevance of the market to book shortfall for CGU 2 and 3 will require BTRC to make a judgement after considering all facts and circumstances including:

- whether there is a reasonable basis to conclude that the market capitalisation to book value shortfall relates to a specific CGU or CGUs
- the existence or otherwise of other impairment indicators for each CGU or
- the results of impairment testing for CGU 1 (if CGU 1 is impaired, the market capitalisation to book value shortfall may be reduced or eliminated).

If BTRC is unable to link the shortfall to particular CGUs it may conclude that all CGUS should be tested.

Practical insight – Indicators that develop over time

In practice, an adverse trend might develop over a series of reporting periods (eg a decline in market demand). While an entity may not be able to pinpoint a specific event or moment when an adverse trend becomes an impairment indicator, adverse trends such as this clearly cannot be ignored. Management will need to factor these types of trends into its impairment review and use judgement based on the specific facts and circumstances to decide whether the adverse trend constitutes an impairment indicator.

Review useful life, depreciation/amortisation method, residual value

The existence of an impairment indicator may also suggest that the remaining useful life, depreciation (amortisation) method or the residual value for the asset needs to be adjusted. When an entity identifies an indicator of impairment, the remaining useful life, the depreciation (amortisation) method or the residual value of the asset should be reviewed (and adjusted if necessary) even if no impairment loss is recognised (IAS 36.17).

1.2 Annual impairment testing

As depicted in Figure C.1, the Standard requires an intangible asset with an indefinite useful life, an intangible asset not yet available for use and goodwill to be tested for impairment both:

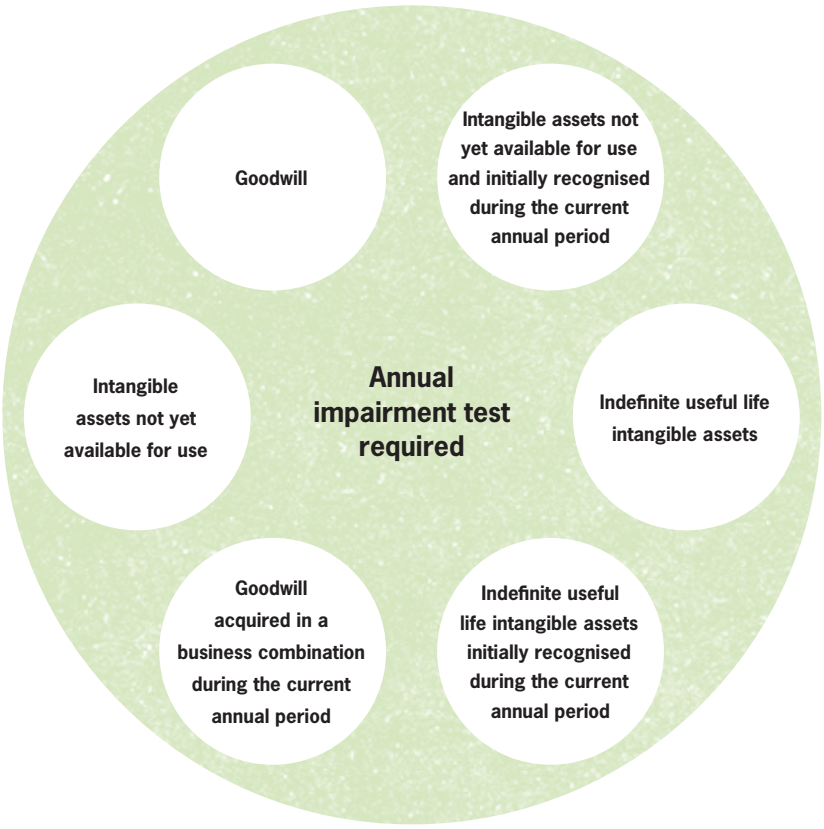
- when an indication of impairment exists (see Section C.1.1) (IAS 36.9) and
- at least annually, irrespective of indicators (IAS 36.10(a-b)).

Further, the intangible asset and/or goodwill should be tested for impairment before the end of the current annual period if:

- the asset was initially recognised during the current annual period (IAS 36.10(a)) or
- some or all of the goodwill allocated to the CGU under review was acquired in a business combination during the current annual period (IAS 36.96).

See Section B.2.2.3A for related discussion on the provisional allocation of goodwill.

Figure C.3 – Annual impairment test required



1.2.1 Timing of the annual impairment test

The annual impairment test for an asset may be performed anytime during the annual period provided the test is performed at the same time every year (IAS 36.10(a), IAS 36.96). Assets that are subject to annual testing may be tested at different dates provided the date is consistent for each. This provides some flexibility to spread the workload while providing a safeguard against manipulation.

Practical insight – Changing the annual impairment testing date

An entity may wish to change its annual impairment testing date, perhaps to align with the budget cycle or to reduce the testing burden in another period. IAS 36 is silent on this. In our view, a change of date is acceptable in reasonable circumstances subject to the entity demonstrating that this has not resulted in avoiding an impairment loss. For example, an entity with a 31 December year-end might wish to change its testing date from 30 June to 31 December. In the current annual period it could conduct tests at both dates, then test only at 31 December in the following annual period (assuming no indicators are identified at other period ends). In our view, IAS 36.96 serves as an anti-abuse provision which will not be breached if this approach is taken and the entity consistently tests at the new date on a go-forward basis. We do not regard moving to a new testing date to be a change in accounting policy. However, entities should consider disclosing the change and the reasons for it.

D. IAS 36's impairment test – How?

Section D: How?

This Section explains the process for the quantitative impairment test – in other words estimating the recoverable amount of the asset or group of assets and comparing this to the carrying value. The impairment test determines if an entity needs to record an impairment loss or reverse a previous loss. This Section covers the following Steps:

- Step 4: Estimate the recoverable amount
- Step 5: Compare recoverable amount with carrying amount
- Step 6: Recognise or reverse any impairment loss.

This Section of the Guide explains what are no doubt the most challenging Steps in applying IAS 36 which encompass the quantified impairment test (when required). Broadly, this involves estimating recoverable amount, comparing recoverable amount with carrying amount and recognising or reversing any impairment loss.

1 Step 4: Estimate the recoverable amount

In this Step, the Guide discusses:

D.1.1	The basis for estimating the recoverable amount (higher of FVLCOD (D1.2) and VIU (D1.3))
D.1.2	The premise for estimating FVLCOD
D.1.3	The mechanics of estimating the VIU (including what is and what is not included in the calculation)
D.1.4	Exceptions to the requirement to estimate the recoverable amount (eg when prior impairment tests may be relied upon, when either FVLCOD or VIU should be estimated and not both, etc.)

1.1 Recoverable amount

IAS 36 defines the 'recoverable amount' and related terms as follows:

Figure D.1 – Defining recoverable amount and related terms (IAS 36.6)

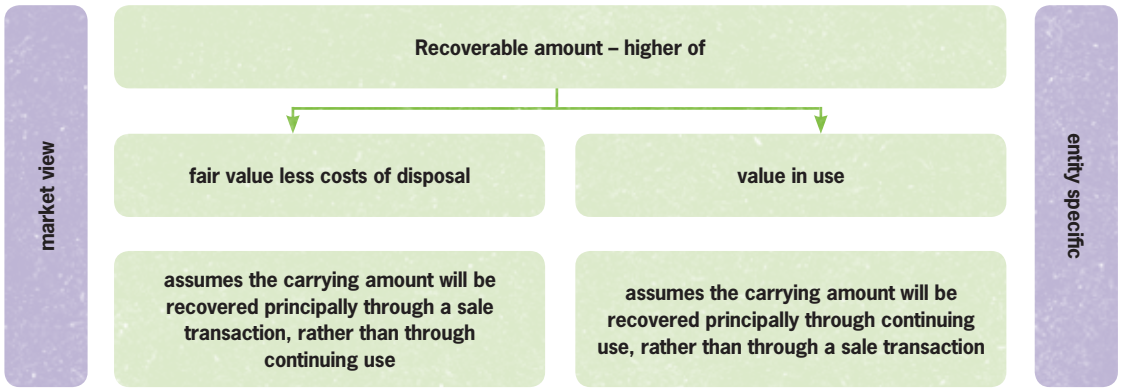
The **recoverable amount** of an asset or a CGU is the higher of its **fair value less costs of disposal (FVLCOD)** and its **value in use (VIU)**.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Costs of disposal are incremental costs directly attributable to the disposal of an asset or CGU, excluding finance costs and income tax expense.

Value in use is the present value of the future cash flows expected to be derived from an asset or CGU.

Figure D.2 – Recoverable amount



Therefore, an impairment test involves estimating both FVLCOD and VIU and comparing the higher amount to the asset's carrying amount. Section D.1.4 discusses the circumstances in which it is unnecessary to estimate both FVLCOD and VIU.

1.2 Fair value less costs of disposal

The 'fair value' and 'costs of disposal' elements of FVLCOD are discussed in turn below.

Fair value

The FVLCOD component of recoverable amount applies whether or not management currently intends to sell the asset. While IAS 36 previously included its own hierarchy of guidance to determine fair value, this has now been superceded by IFRS 13 'Fair Value Measurement' (issued May 2011).

Practical insight – IFRS 13

IFRS 13 was issued in May 2011 (effective for annual periods beginning on or after January 2013) and describes fair value as a market-based measurement (not an entity-specific measurement). A fair value estimate therefore incorporates the assumptions that market participants would use when pricing the asset, including assumptions about risk. The objective of a fair value measurement is to estimate the price at which an orderly transaction to sell the asset or transfer the liability would take place between market participants at the measurement date under current market conditions. When an observable price for an identical asset is not available (as will very often be the case for individual assets and almost always be the case for CGUs), fair value is estimated using another valuation technique that maximises the use of observable inputs.

For more information on IFRS 13, see the GTIL Publication: 'IFRS News Special Edition: Fair Value'.

Example D.1 – Estimating fair value

Background

An entity operates in the hotels sector. Management is testing a hotel for impairment for which the internal budget and cash flow forecasts include outflows and inflows relating to a significant enhancement planned to start in two years' time. This will involve temporary closure and undertaking a major upgrade from four to five star status. Management has determined that fair value and FVLCOD should be estimated using an income approach (ie a discounted cash flow approach).

Management is aware of IAS 36.44's requirement that, for VIU purposes, an asset's future cash flows should be estimated based on the asset's current condition. Management is considering whether, for the purposes of estimating FVLCOD using an income approach, adjustments are also required to exclude cash flows from the planned upgrade.

Analysis

A fair value estimate takes into account characteristics of an asset that market participants would take into account in pricing the item. Put another way, when estimating fair value and FVLCOD (in the absence of a quoted price), management should aim to use inputs and assumptions consistent with those that prospective buyers would use. Accordingly, although FVLCOD should be based on the hotel's current condition, IAS 36.44's requirement to exclude cash flows relating to enhancements when estimating VIU does not apply in the same way when estimating FVLCOD. Cash flows relating to the upgrade would therefore be included if market participants would consider these in their pricing decisions. This does not mean that management's budget and cash flow forecasts can simply be used without adjustment: various adjustments may be required to ensure that the estimates are unbiased and consistent with the assumptions that market participants would make.

Costs of disposal

Costs of disposal are incremental costs directly attributable to the disposal of an asset or CGU, excluding finance costs and income tax expense (and any other costs that have already been recognised as liabilities in the statement of financial position). Potential examples of costs of disposal that should be deducted to derive the FVLCOD include:

- legal costs
- stamp duty and similar transaction taxes
- costs of removing the asset
- direct incremental costs to bring an asset into condition for its sale (IAS 36.28).

1.3 Value in use

VIU in effect assumes that the asset will be recovered principally through its continuing use and ultimate disposal. VIU is therefore 'entity-specific' in that it reflects the entity's intentions as to how an asset will be used. VIU therefore differs from fair value because fair value reflects the assumptions that market participants would use when pricing the asset. Fair value does not reflect any of the following factors to the extent they would not be generally available to market participants:

- additional value derived from grouping assets
- synergies between the asset being measured and other assets
- legal rights or legal restrictions that are specific only to the current owner of the asset
- tax benefits or tax burdens that are specific to the current owner of the asset (IAS 36.53A(a) – (d)).

Estimating VIU involves the following:

- estimating the future cash inflows and outflows to be derived from continuing to use the asset and from its ultimate disposal (IAS 36.31(a))
- applying the appropriate discount rate to those future cash flows (IAS 36.31(b)).

Section D.1.3.1: estimating the **future cash inflows and outflows**

Section D.1.3.2: applying the appropriate **discount rate**

The VIU estimate incorporates the following risk factors, either as adjustments to the cash flows or as adjustments to the discount rate, but not both:

- expectations about possible variations in the amount or timing of those future cash flows (IAS 36.30(b))
- the price for bearing the uncertainty inherent in the asset (IAS 36.30(d))
- other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows that the entity expects to derive from the asset (IAS 36.30(e)).

Approaches to incorporating risk in present value

Appendix A to IAS 36 discusses two broad approaches to incorporating risk in the present value estimate:

- the traditional approach
- the expected cash flow approach.

The ultimate objective is to reflect the expected present value of the future cash flows, while incorporating possible variations in the amount or timing of future cash flows (IAS 36.32). Figure D.3 briefly describes each approach at a high level.

Figure D.3 – Traditional approach versus expected cash flow approach

Traditional approach	The traditional approach uses the single most likely cash flow projection and assumes that a single discount rate can incorporate all the expectations about the future cash flows and the appropriate risk premium. Therefore, the traditional approach places the most emphasis on the selection of a discount rate (IAS 36.A.4).
Expected cash flow approach	The expected cash flow approach uses all expectations about possible cash flows (instead of a single most likely cash flow) and applies probabilities to the estimated cash flows. As some risk assessment is incorporated into the cash flows using the expected cash flow approach, generally, a lower discount is applied when compared to the traditional approach.

The rest of this Section breaks down these elements (estimating future cash flows and determining the appropriate discount rate) in estimating VIU.

1.3.1 Estimating the future cash inflows and outflows

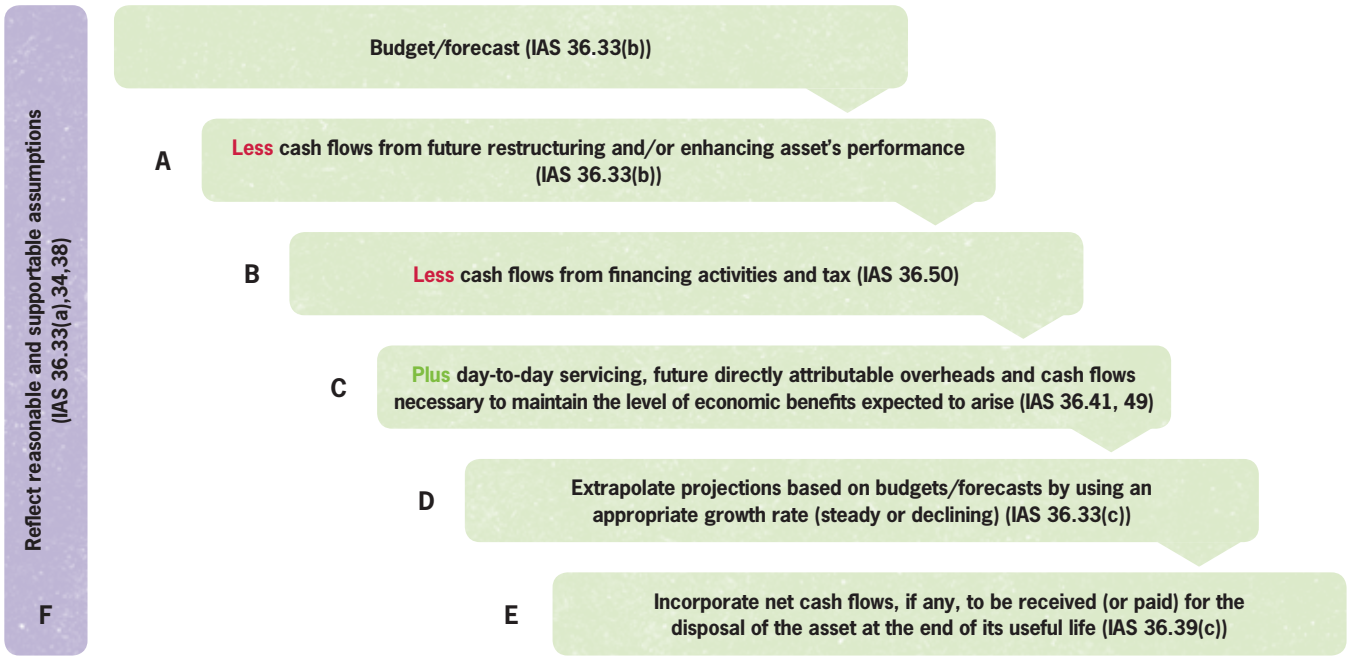
The starting point for estimating future cash flows is the most recent financial budget or forecast approved by management. From this starting point, the budget or forecast typically needs to be both adjusted and extrapolated. IAS 36 specifically requires that these budgets/forecasts are adjusted to:

- exclude any estimated future cash inflows/outflows expected to arise from future restructuring or improving or enhancing the asset's performance (IAS 36.33(b))
- exclude cash inflows or outflows from financing activities or income tax receipts/payments (IAS 36.50)
- include costs for day-to-day servicing, future directly attributable overheads (IAS 36.41) and cash flows necessary to maintain the level of economic benefits expected to arise from the asset in its current condition (IAS 36.49)
- cover a maximum period of five years (unless a longer period can be justified) (IAS 36.33(b)). Cash flow projections needed beyond the period covered must be estimated by extrapolating the budget/forecast projections using a steady or declining growth rate for subsequent years (unless an increasing rate can be justified) (IAS 36.33(c))
- incorporate net cash flows, if any, to be received (or paid) for the disposal of the asset at the end of its useful life (IAS 36.39(c)).

This list of adjustments is not exhaustive. The specific adjustments required in each case will naturally vary depending upon the basis of the budgets or projections used as a starting point and the nature of expected cash flows. As an overarching principle, it is also essential to ensure that the estimates and projections are based on reasonable and supportable assumptions (IAS 36.33(a), 34, 38).

Figure D.4 summarises how to estimate future cash flows. Each consideration is discussed in further detail below.

Figure D.4 – Estimating future cash flows



A. Exclude restructuring and anticipated cash flows from improving or enhancing asset performance

Cash flows should be estimated for an asset based on the asset's current condition. Therefore, the estimated future cash flows should not incorporate:

- cash flows related to future restructuring to which an entity is not yet committed (eg cost savings for reductions in staff costs) or
- cash flows related to improving or enhancing the asset's performance (IAS 36.44).

Restructuring

Estimates of future cash inflows and outflows should include any projected cost savings and other benefits of a future restructuring only when the entity becomes committed to the restructuring (IAS 36.47(a)).

Once the entity is committed to the restructuring, it will meet the requirements in IAS 37 'Provisions, Contingent Liabilities and Contingent Assets' (IAS 37) to recognise a provision (see Section E.4.4 for discussion of the interaction between IAS 36 and IAS 37). The estimates of future cash outflows for restructuring will, at that time, be included in the restructuring provision in accordance with IAS 37 (IAS 36.47(b)).

Guidance note: Effects of future restructuring when estimating VIU

Example 5 in the Illustrative Examples accompanying IAS 36 explains how a restructuring affects the VIU calculation for a CGU. It shows the effects of the restructuring (costs and benefits) being excluded from the cash flow estimates prior to the entity being committed to it. Once the entity is committed, which is itself a potential indicator of impairment reversal, the benefits expected from the restructuring are considered in forecasting the future cash flows. A provision is also recognised for the restructuring.

Improving or enhancing an asset's performance

Until an entity actually incurs cash outflows that improve or enhance the asset's performance, estimates of future cash flows do not include the estimated future cash inflows that are expected to arise from the enhancement (IAS 36.48).

Example D.2 – Improving or enhancing an asset's performance

Background

At the reporting period-end date (31 December 20X0), there is an indication that asset A may be impaired. Management estimates asset A's recoverable amount on the basis of a VIU calculation. Management's approved budgets reflect:

a. estimated cash flows necessary to maintain the level of economic benefit expected to arise from asset A in its current condition and
b. that in 20X2, management plans to incur CU50,000 to enhance asset A's performance.

Should Management include both (a) and (b) in its estimation of VIU in 20X0?

Analysis

No. At 31 December 20X0, the future cash flows used to determine VIU should include estimated costs necessary to maintain the level of economic benefit expected to arise from asset A in its current condition but exclude any estimated costs to enhance asset A's performance and the estimated benefits anticipated from enhancing its performance.

B. Exclude financing activities or income tax receipts/payments

Because the time value of money is considered by discounting the estimated future cash flows, the cash flows used to estimate VIU exclude cash inflows and outflows from financing activities. Similarly, because the VIU and discount rate are determined on a pre-tax basis, future cash flows are estimated on a pre-tax basis (IAS 36.51). See Section D.1.3.2.2 for more discussion on pre-tax vs. post-tax cash flows and discount rates.

C. Include day-to-day servicing and cash flows to maintain the level of economic benefit from the asset in its current condition

The premise underlying VIU is that the carrying value of the asset will be recovered through its continued use and ultimate disposal. Therefore, all cash outflows that are necessary to maintain the level of economic benefits expected to arise from the asset in its current condition should be included. These future cash outflows include day-to-day servicing of the asset, as well as overheads that can be directly attributed, or allocated on a reasonable and consistent basis, to the asset.

When a CGU consists of assets with different estimated useful lives (all of which are essential to the ongoing operation of the unit), the replacement of assets with shorter lives and the replacement of a component of a single asset are considered to be part of the day-to-day servicing of the unit/asset when estimating the future cash flows associated with the unit/asset (IAS 36.41, 49).

Example D.3 – Day-to-day servicing and the consideration of the 'core' asset

IAS 36 requires that the replacement of component parts necessary to maintain the cash inflows from the continued use of an asset are treated as cash outflows when estimating VIU. These components could include items that might be treated as separate depreciable components in accordance with IAS 16 'Property, Plant and Equipment' (IAS 16) (eg the lining of a furnace, the seating of an aircraft, the roof of a building). When estimating the VIU of a single asset, identifying the 'core' asset is straightforward (eg the furnace, aircraft or entire building). For example, when estimating the VIU of an airplane with an estimated useful life of 30 years, the entity would include the cash outflows for the day-to-day servicing and replacement of the components of the aircraft that have shorter useful lives such as the seating and engines.

The application of IAS 36.41 and 49 requires more judgement when estimating VIU for a CGU, or group of CGUs, if goodwill is being tested. If goodwill is treated as the core asset, the CGU's future life might be considered indefinite and the cash flows would include the replacement of the other assets within the CGU (in order to maintain the goodwill). If a particular identifiable asset is considered the core asset then the cash flows and useful life would be based on the useful life of that asset.

In our view, the appropriate approach will depend on the entity's business model and the particular facts and circumstances of the impairment test in question. For example, when assessing a hotel for impairment as part of a CGU with goodwill, the entity may deem the hotel to be the core asset as the cash flows from the hotel presumably support the life of the goodwill (there would not be goodwill without the core asset of the hotel).

In practice, when calculating the VIU of a CGU that includes goodwill, it is common to include a terminal value at the end of the specific projection period. This terminal value should be based on the 'normalised' forecast cash flows in the final period of the detailed budget or projection period, extrapolated using the long-term steady or declining growth rate and discounted to present value. The terminal value therefore takes account of a normalised level of cash flows for day-to-day servicing including replacement parts.

Practical insight – Including directly attributable (or reasonably allocated) future overheads

IAS 36.41 requires that projections of cash outflows include those for '…future overheads that can be attributed directly, or allocated on a reasonable and consistent basis, to the use of the asset'. The Standard does not expand on what such 'future overheads' may be included.

In our view, the key objective should be to ensure that the projections include all estimated outflows necessary to generate the estimated inflows. For example, a magazine company may identify two CGUs for impairment testing purposes (an online segment and a print segment). It is likely to be appropriate to allocate central marketing costs to the relevant CGUs where such costs are directly attributable or reasonably allocated. Also, as noted in Section B2.2.2, when a portion of a corporate asset is allocated to a CGU then this typically indicates that a portion of the cash outflows associated with the corporate asset should also be allocated.

However, applying this guidance requires judgement and will depend on the facts and circumstances.

Cash outflows incurred before the asset is ready for use or sale

IAS 36 requires an entity to include an estimate of any further cash outflow that is expected to be incurred before the asset is ready for use or sale when the carrying amount of the asset does not yet include all the cash outflows to be incurred before it is ready for use or sale (eg building under construction or development project that is not yet completed) (IAS 36.42).

Practical insight – Considerations for capitalised development projects

IAS 36 requires that intangible assets not yet ready for use are tested for impairment at least annually and at the end of the current annual period if initially recognised during the current annual period (IAS 36.10(a)). Capitalised development projects/assets require further development before they are ready for commercial use.

IAS 36.42 requires an entity to include an estimate of any further cash outflow that is expected to be incurred before the asset is ready for use (or sale) when the carrying amount of the asset does not yet include all the cash outflows to be incurred before it is ready for use (or sale) (eg a development project that is not yet completed). This is an exception to the general principle that an asset is tested for impairment in its current condition (IAS 36.44).

When estimating VIU, in our view, estimated future expenditure (including expenditure that does not yet meet the capitalisation criteria) and estimated cash inflows from potentially successful projects should be included in the cash flow estimates. When there is uncertainty about a project ultimately reaching commercialisation (as may be the case for acquired research and development costs, for example) this risk should be taken into account. As discussed in Section D.1.3, risk and uncertainty can be factored in either by adjusting the cash flows or by adjusting the discount rate.

In some cases the projections used for testing capitalised development project assets may (appropriately) extend beyond the normal five year period that IAS 36.35 sets as a benchmark for the availability of detailed, explicit and reliable financial budgets/forecasts.

(In estimating FVLCOD for a capitalised development project, the entity's objective should be to use assumptions consistent with a market participant perspective. These would normally include a market-based perspective on the probability of the project reaching commercialisation.)

D. Extrapolate projections based on budget/forecast information beyond the period covered

IAS 36 asserts that detailed and reliable budget/forecast information for periods longer than five years is not usually available. Estimates of future cash flows should therefore normally be based on the most recent budgets/forecasts covering no longer than this, and then extrapolated if necessary (see below). An exception to the five year limit applies if management can demonstrate its ability to forecast cash flows accurately over a longer period (IAS 36.33(b), 35).

Assets with useful lives longer than the budget/forecast cash flows should be extrapolated using a growth rate for subsequent years. This rate is steady or declining, unless an increase in the rate matches objective information about patterns over a product or industry lifecycle. A growth rate of zero, or a negative rate, might also be appropriate (IAS 36.36).

IAS 36 notes that entities will generally have difficulty exceeding the average historical growth rate over the long term (IAS 36.37).

Practical insight – Extrapolating future cash flows

IAS 36 implies, but does not state explicitly, that the final period covered by a detailed budget or forecast (normally up to five years in duration) should be used as the 'baseline' for extrapolating cash flows into the future. This approach is reasonable for projecting future cash flows for an established, 'going concern' CGU in a reasonably stable state. In other scenarios, such as start-ups or limited life projects or assets, other approaches may be more appropriate. It is also important to ensure that the baseline used for extrapolation is not affected by non-recurring factors (eg a planned shutdown that occurs less than annually). The approach taken will require judgement based on the particular circumstances.

E. Incorporate disposal proceeds

An estimate of the net cash flow to be received (or paid) for the disposal of an asset at the end of its useful life should be included in determining the estimated future cash flows (IAS 36.39(c)). This estimate is determined in a similar manner to determining FVLCOD, except that, in estimating those net cash flows, the entity:

- uses prices at the date of the estimate for similar assets that have reached the end of their useful life and operated under similar conditions (IAS 36.53(a))
- adjusts prices for general inflation and specific future price increases or decreases (IAS 36.53(b)) (although general inflation is not taken into account if the future cash flows from continuing use and discount rate exclude the effect of general inflation) (IAS 36.53(b)).

F. Reflect reasonable and supportable assumptions

It is an overarching principle of the VIU estimate that assumptions should be 'reasonable and supportable'. IAS 36 includes a requirement under which management should compare past projections with actual cash flows to ensure that the assumptions on which current projections are based are consistent with past actual outcomes (IAS 36.34).

IAS 36 requires consideration of whether the budget/forecast information used as the basis for the cash flow estimates reflects reasonable and supportable assumptions and management's best estimate of the set of economic conditions that will exist over the remaining useful life of the asset (IAS 36.38).

Practical insight – Reflecting reasonable and supportable assumptions

A budget is of course a management tool and not simply a prediction about the future. A budget may therefore incorporate stretch targets or similar aspirational features. In using such a budget for VIU purposes, management should carefully consider whether these types of assumptions are reasonable and supportable in the context of IAS 36.

Supporting the assumptions in a budget is more challenging in situations such as start-ups and development projects. Budgets may be less reliable and past projections can vary greatly compared to actual cash flows. Sometimes different budgets may be prepared (one being highly aggressive while another incorporates more realistic expectations and assumptions). In such cases the more realistic budget should be the basis used for future cash flow projections in accordance with IAS 36.

Finally, IAS 36.34 requires management to 'examine the causes of differences between past projections with actual cash flows' to ensure that the assumptions on which current projections are based are consistent with past actual outcomes. In our view, this examination is not limited to actual and projected outcomes for the past 12 months (ie the current period). Management should also consider the longer term track record of projecting cash flows over its specific forecasting period (as used for IAS 36 purposes – eg 5 years).

1.3.2 Applying the appropriate discount rate

The discount rate applied to the estimated cash flows should reflect the return that investors would require if they were to choose an investment that would generate cash flows of amounts, timing and risk profile equivalent to those that the entity expects to derive from the asset (IAS 36.56). In other words, the estimated cash flows in the VIU calculation are entity-specific, but the discount rate is not. IAS 36 prescribes that management apply a pre-tax discount rate(s) that reflects the current market assessment of both:

- the time value of money;
- the risks specific to the asset for which the future cash flow estimates have not been adjusted (IAS 36.55).

This rate may be estimated:

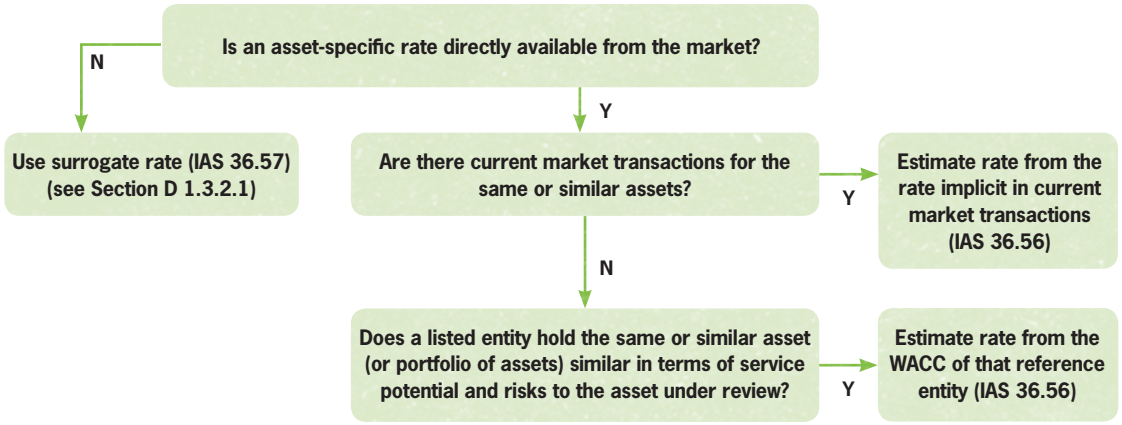
- from the rate in current market transactions for similar assets (IAS 36.56) or
- from the weighted average cost of capital (WACC) of a listed entity that has a single asset (or a portfolio of assets) similar in terms of service potential and risks to the asset under review (IAS 36.56).

In the event that neither of the above are available, the entity estimates the discount rate using surrogates (IAS 36.57).

The discount rate should reflect assumptions consistent with the estimated future cash flows. For example, a nominal discount rate should be used if the cash flows are estimated on a nominal rather than real terms basis. Both the cash flows and the discount rate should be prepared on a pre-tax basis (IAS 36.40, 51).

Figure D.5 illustrates IAS 36's guidance on determining an appropriate discount rate.

Figure D.5 – Determining an appropriate discount rate to apply



1.3.2.1 Using a surrogate

When an asset-specific rate is not directly available in the market (as is usually the case), the entity uses a surrogate to estimate the discount rate. The objective is to derive a market assessment of:

- the time value of money through the end of the asset's useful life (IAS 36.A16(c))
- expectations about possible variations in the amount or timing of those cash flows (IAS 36.A1(b))
- the price for bearing the uncertainty inherent in the asset (IAS 36.A1(d))
- other, sometimes unidentifiable, factors (such as illiquidity) that market participants would reflect in pricing the future cash flows from the asset (IAS 36.A1(e)).

One common approach is for the entity to determine a market-consistent discount rate for the entity as a whole, then adjust this rate to take into account factors specific to the asset or CGU being tested. For example:

- start with the entity's WACC, incremental borrowing rate, or other market borrowing rates (IAS 36.A17) and
- adjust these rates to reflect a market participant's view of the specific risks associated with the asset's estimated cash flows (considering country risk, currency risk and price risk) (IAS 36.A18).

Adjustments might also be necessary to exclude risks that are not relevant to the asset's estimated cash flows or for which the estimated cash flows have already been adjusted (IAS 36.A18).

Figure D.6 – Estimating the discount rate when no asset-specific market rate is available

Practical insight – Determining the discount rate in practice

In our experience, entities most often estimate a risk-adjusted discount rate starting with the entity's WACC. The WACC is a post-tax measure of the overall required return on the entity as a whole – essentially the rate that an entity is expected to pay on average to all its capital providers to finance its assets. This calculation proportionately weighs each category of an entity's capital (eg equity and long-term debt) to derive an entity-wide cost of capital. The proportionate weights are based on the fair value of debt and equity (not carrying amounts).

Keeping with the objective outlined for deriving an appropriate discount rate, an entity also needs to adjust the entity-wide WACC to achieve a discount rate for each asset or CGU, consistent with a market participant perspective.

If the entity is partially financed through long-term debt, the cost of debt in the WACC calculation will be based on long-term rates; therefore, an entity wishing to derive a discount rate for an asset with a short-term expected life will need to adjust appropriately.

The Capital Asset Pricing Model (CAPM) is a method of calculating anticipated investment risks and returns and is often used to determine the cost of equity component of an entity's WACC. The CAPM takes into account two factors: the return on an investment that is virtually risk-free (such as certain government bonds) and the market risk premium that would be required by an investor in the acquired business. The risk-free rate for the purposes of calculating the CAPM is generally obtained from yields on government bonds in the same currency and of the same or similar duration as the cash flows of the asset or CGU (eg 10- or 20-year government bonds). Adjustments may be required if government bond yields of the appropriate duration are not available. The market risk premium typically includes: an equity risk premium (the long-term rate of return for equities in excess of the risk-free rate), an adjustment for the specific industry or sector risk relative to the market as a whole (beta factor) and an additional asset- or CGU-specific risk premium (alpha factor).

Finally, given that the WACC is a post-tax rate, it needs to be adjusted to a pre-tax rate. See Section D1.3.2.2 for a discussion about making this adjustment.

1.3.2.2 Pre-tax and post-tax discount rates

IAS 36 requires the discount rate(s) used in estimating VIU to be a pre-tax rate(s) (IAS 36.55). If the rate is derived initially on a post-tax basis, it must be adjusted to reflect a pre-tax rate (IAS 36.A20). This is often necessary because many observable market rates and the entity's WACC are post-tax rates.

Using a post-tax discount rate to discount post-tax cash flows should lead to the same result as discounting pre-tax cash flows using a pre-tax discount rate if the pre-tax discount rate reflects an adjustment to take into account the specific amount and timing of the future tax cash flows (IAS 36.BCZ85). Calculating a pre-tax rate involves applying a post-tax rate to post-tax cash flows (tax cash flows being based on the allowances and charges available for the asset and related non-tax cash flows). The effective pre-tax rate is then calculated by removing the tax cash flows and using an iterative technique to calculate the rate that makes the present value of the adjusted cash flows equal the VIU calculated using post tax cash flows.

Paragraph BCZ85 of IAS 36's Basis for Conclusions provides an example of how to calculate a pre-tax discount rate from post-tax calculations using the iterative method.

Practical insight – Deriving pre-tax discount rates from post-tax rates

Despite IAS 36 calling for a pre-tax discount rate, we note that a post-tax analysis is sometimes undertaken in practice. This is because most rates that are observable in the market and the entity's WACC are post-tax. Computing a 'true' pre-tax discount rate starting from a post-tax rate can be complex, requiring information about the specific timing of tax-related cash flows for the asset or CGU and also iterative or goal-seek calculations.

IAS 36 highlights that the '…pre-tax discount rate is not always the same as the post-tax discount rate grossed up by the standard rate of tax' (IAS 36.BCZ85). This is because the tax cash flows do not normally occur proportionately with or at the same time as the pre-tax cash flows (eg due to temporary differences, tax loss carry-forwards and the timing of tax payments). However, in our view, a gross-up approach may provide a reasonable approximation in some circumstances (although consideration should be given to any facts and circumstances that would impact the relationship between the pre-tax and post-tax rate).

Moreover, if a simplified approach results in a VIU significantly above the carrying amount, management may reasonably conclude that it is unlikely that an impairment exists.

As outlined in Section F, IAS 36 requires disclosure of information about the discount rate.

1.3.3 Foreign currency issues

IAS 36 requires an entity to estimate future cash flows in the currency in which the cash flows will be generated and discount the cash flows to present value using a discount rate appropriate for that currency. The entity then determines the VIU in its functional currency by translating the present value using the spot exchange rate at the date of the VIU calculation (IAS 36.54).

Example D.4 – Estimating VIU for a foreign investment

Entity P's functional currency is the Euro. P has an equity-method investment (Investment I) in an investee located in the United States with USD functional currency. Entity P determines there is a need to estimate the recoverable amount of Investment I, having identified an impairment indicator at 31 December 20X0. Entity P calculates Investment I's VIU using cash flows based in USD and a discount rate that reflects USD. The present value so derived is translated to Euro using the spot exchange rate at 31 December 20X0.

See Section E.3 for more insights on IAS 36 and equity accounting.

Guidance note: Practical issues related to cash flows in a foreign currency

The use of the forward rate for converting foreign currency cash flows is prohibited. This is because the time value of money is taken into account by discounting the foreign currency cash flows at a rate appropriate for that currency (IAS 36.BCZ49). Converting expected foreign cash flows at estimated future spot exchange rates is also prohibited on the grounds of the unreliability of those future estimates (IAS 36.BCZ50).

1.4 Exceptions to calculating both fair value less costs of disposal and value in use

Although recoverable amount is defined as the higher of the FVLCOD and VIU, IAS 36 makes clear that it is not always necessary to determine both estimates. Figure D.7 outlines instances when an entity need only calculate either FVLCOD or VIU.

Figure D.7 – Instances when an entity need only calculate either FVLCOD or VIU

Situation	Calculate only	Reason	Reference
When either amount exceeds the asset's carrying amount	FVLCOD or VIU	The asset is not impaired and it is not necessary to calculate the other amount	IAS 36.19
It is not possible to measure FVLCOD because there is no basis for making a reliable estimate of the price in accordance with IFRS 13	VIU	It is usually possible to measure FVLCOD with sufficient reliability (even without a quoted price in an active market for an identical asset or frequent transactions in similar assets with observable prices). However, IAS 36 indicates (without elaborating) that sometimes it will not be possible to measure FVLCOD because there is no basis for making a reliable estimate	IAS 36.20
There is no reason to believe that VIU materially exceeds FVLCOD	FVLCOD	This will often be the case for an asset that is held for disposal as the future cash flows from continuing to use the asset until disposal are likely negligible and will consist mainly of net disposal proceeds	IAS 36.21

Short-cuts for estimating FVLCOD or VIU

IAS 36 also clarifies that it is sometimes not necessary to perform the detailed computations (as described in Step 4) for determining FVLCOD or VIU. Estimates, averages and/or computational short cuts may be used when they provide reasonable approximations of the detailed computations for determining FVLCOD or VIU (IAS 36.23).

IAS 36 also provides relief from calculating recoverable amount in some situations when an indicator has been identified or the annual impairment testing date has been reached. Figure D.8 summarises the relief provisions available in IAS 36 for intangible assets and goodwill. Broadly, the relief provisions note that the concept of materiality applies in identifying the need to estimate recoverable amount.

Figure D.8 – IAS 36 relief provisions from estimating the recoverable amount (despite an impairment indicator being present or reaching the annual impairment testing date)

Asset type	Relief reference	Description of relief
Intangible assets with an indefinite useful life (or not yet available for use) and goodwill	IAS 36.15	The concept of materiality applies. Examples include: • if previous calculations show that an asset's recoverable amount is significantly greater than its carrying amount, the entity need not re-estimate the asset's recoverable amount if no events have occurred that would eliminate that difference • if a previous analysis shows that an asset's recoverable amount is not sensitive to one (or more) of the indicators identified in Section C.1.1. (see example D.5 below)
Intangible assets with an indefinite useful life	IAS 36.24	The most recent detailed calculation of such an asset's recoverable amount made in a preceding period may be used in the impairment test for that asset in the current period, provided all of the following criteria are met: • where an intangible asset is tested for impairment as part of the CGU to which it belongs, the asset and liabilities making up that unit have not changed significantly since the most recent recoverable amount calculation; • the most recent recoverable amount calculation resulted in an amount that exceeded the asset's carrying amount by a substantial margin; and • based on an analysis of events that have occurred and circumstances that have changed since the most recent recoverable amount calculation, the likelihood that a current recoverable amount determination would be less than the asset's carrying amount is remote.
Goodwill	IAS 36.99	The most recent detailed calculation made in a preceding period of the recoverable amount of a CGU to which goodwill has been allocated may be used in the impairment test of that unit in the current period provided all of the following criteria are met: • the assets and liabilities making up the unit have not changed significantly since the most recent recoverable amount calculation; • the most recent recoverable amount calculation resulted in an amount that exceeded the carrying amount of the unit by a substantial margin; and • based on an analysis of events that have occurred and circumstances that have changed since the most recent recoverable amount calculation, the likelihood that a current recoverable amount determination would be less than the current carrying amount of the unit is remote.

Examples D.5 and D.6 illustrate the application of this guidance. In practice, this is of course an area that requires careful judgement based on the particular facts and circumstances.

Example D.5 – Considering materiality despite an indicator of impairment being present or reaching the annual impairment testing date (IAS 36.16)

Background

Market interest rates and returns on investments in general have increased during the period, indicating that Entity A's asset may be impaired (IAS 36.12(c)). Entity A's management is considering if it needs to estimate the recoverable amount of its asset.

Analysis

Entity A would not be required to estimate the recoverable amount of the asset if the discount rate used in calculating the asset's VIU is unlikely to be affected by the increase in these market rates (eg, increases in short-term interest rates may not have a material effect for an asset with a long remaining useful life). Further, even if the discount rate is likely to be affected by the increase in these market rates, Entity A would not be required to estimate the recoverable amount of the asset if a previous sensitivity analysis of recoverable amount shows that it is unlikely that there will be a material decrease in recoverable amount or the decrease in recoverable amount is unlikely to result in a material impairment loss.

Example D.6 – Using the most recent detailed calculation

Background

Entity P has a 31 December 20X0 reporting date. In June 20X0, Entity P acquires subsidiary S, which will be accounted for in accordance with IFRS 3. In November 20X0, Entity P completes the determination of the acquisition date fair values and allocates the resultant goodwill to the appropriate CGUs. At 31 December 20X0, the measurement period has closed (as Entity P has received the information it was requesting about subsidiary S) and the amounts are considered final (IFRS 3.45). Entity P carries out a detailed impairment test on the goodwill as at 31 December 20X0 in accordance with IAS 36.96. The test indicates that recoverable amount exceeds carrying value by a comfortable margin.

Entity P wishes to set its annual impairment testing date for the goodwill at 30 June. Should it carry out another detailed test at 30 June 20X1 in order to establish its annual testing date?

Analysis

In our view, Entity P need not carry out a full impairment test as at 30 June 20X1 if the conditions in IAS 36.99 apply. This paragraph provides relief from performing a detailed impairment test if various conditions are met, but is still regarded as an impairment test for the purposes of IAS 36.90. The assumptions used in the previous 'full' impairment test calculation remain valid until facts and circumstances change such that a new detailed calculation becomes necessary.

2 Step 5: Compare recoverable amount with carrying amount

After calculating the asset's recoverable amount (as discussed in Step 4), the next step is to compare this to the carrying amount. Where the carrying amount exceeds the recoverable amount, the entity will record an impairment loss (Step 6).

Although making this comparison may appear straightforward, practical issues arise in relation to:

- including the right assets (and, in limited circumstances, liabilities) to ensure a 'like for like' correspondence with the cash flows underpinning the recoverable amount
- the order of testing for purposes of comparing the carrying amount to the recoverable amount when allocated corporate assets or goodwill relate to more than one CGU.

2.1 Like-for-like comparison of recoverable amount and carrying amount of a cash generating unit

When assets are grouped for recoverability assessments, it is important to include in the CGU all assets that generate or are used to generate the relevant cash inflows. If assets are omitted inappropriately, the CGU may appear to be fully recoverable when an impairment loss has in fact occurred (IAS 36.77). The overarching objective is that the CGU's carrying amount is determined consistently with its recoverable amount (IAS 36.75).

The recoverable amount of a CGU (as discussed in Step 4) is determined excluding cash flows that relate to:

- assets whose cash flows are largely independent of the cash inflows from the asset under review (for example, financial assets such as receivables)
- liabilities that have already been recognised (IAS 36.43).

Certain exceptions to this general rule apply and are discussed in more detail below.

2.1.1 Exceptions to the rule – including other assets and liabilities

Liabilities that are inseparable from the CGU

It may be necessary to consider some recognised liabilities to determine the recoverable amount of a CGU. This may be the case when the disposal of the CGU would require the buyer to assume the liability. As such, the FVLCOD of the CGU might be estimated using pricing information that takes account of the liability that buyers would assume.

To perform a meaningful comparison between the carrying amount of the CGU and its recoverable amount, the liability is also deducted from the CGU's carrying amount and the cash flows from settling the liablity are included in the VIU calculation (IAS 36.78). Example D.7 illustrates this point.

Example D.7 – Including liabilities that relate to the CGU (IAS 36.78)

Background

A company operates a mine in a country where legislation requires that the owner must restore the site on completion of its mining operations. The cost of restoration includes the replacement of the overburden, which must be removed before mining operations commence. A provision for the costs to replace the overburden was recognised as soon as the overburden was removed. The amount provided was recognised as part of the cost of the mine and is being depreciated over the mine's useful life. The carrying amount of the provision for restoration costs is CU500, which is equal to the present value of the restoration costs. The entity is testing the mine for impairment. The CGU is the mine as a whole. The entity has received various offers to buy the mine at a price around CU800. The price reflects the fact that the buyer will assume the obligation to restore the overburden. Disposal costs for the mine are negligible. The VIU of the mine is approximately CU1,200, excluding restoration costs. The carrying amount of the mine is CU1,000.

Analysis

The CGU's FVLCOD is CU800. This amount considers the restoration costs that have been provided for. As a consequence, the VIU for the CGU is determined after consideration of the restoration costs and is estimated to be CU700 (CU1,200 less CU500). The carrying amount of the CGU is CU500, which is the carrying amount of the mine (CU1,000) less the carrying amount of the provision for restoration costs (CU500). Therefore, the recoverable amount of the CGU (CU800 being the higher of the FVLCOD and VIU) exceeds its carrying amount (CU500) and the CGU is not impaired.

It should also be noted that, in this example, it would not be necessary in practice to calculate both FVLCOD and VIU (as both amounts exceed carrying value).

Practical insight – Including liabilities that relate to the CGU

The key reason to include some liabilities in a CGU is that the market-based transaction price on which fair value is based necessarily includes the transfer of any liabilities that are inseparable from the asset. If the impairment test is based solely on VIU (eg because FVLCOD cannot be measured reliably) it may not be necessary to include inseparable liabilities and the related cash flows to achieve a meaningful and like-for-like comparison. In any case, including or excluding the liability (and related cash outflows) will often make little or no practical difference (eg if the liability is short-term or if it is discounted using a similar rate to that used for estimating VIU).

Other assets/liabilities

Sometimes, for practical reasons, the recoverable amount of a CGU is determined after consideration of assets that are not part of the CGU (for example, receivables or other financial assets) or liabilities that have been recognised (for example, payables, pensions and other provisions). In such cases the carrying amount of the CGU is:

- increased by the carrying amount of those assets and
- decreased by the carrying amount of those liabilities (IAS 36.79).

Practical insight – Other assets/liabilities

The carrying amount of a liability may not be the present value of its future cash outflows or may not be discounted using the same rate as for estimating VIU. One such example is a pension obligation which might be discounted using a high quality corporate bond rate. If an entity includes the pension contributions in its cash flows for VIU purposes, it will need to consider if some portion of those contributions relates to past services and is therefore a settlement of part of the pension liability. Achieving a like-for-like comparison is potentially a complex exercise. However, it is not possible to simply ignore the costs of providing pensions and other employee benefits when estimating VIU and a pragmatic approach (such as including future service costs rather than contributions, and excluding the liability) might need to be taken.

Practical insight – Rent-free periods

A situation frequently met in practice is the case of 'rent-free' periods whereby a lessee recognises a liability and expense during the period of time in which no cash payment is due to the lessor as a result of straight-lining the lease payments over the lease term. A question arises as to whether the lessee should include this liability as part of the carrying amount of the CGU being tested for impairment if the estimates of future cash flows include 100% of the future lease payments (therefore including those that effectively settle the liability).

As discussed in section D.1.3, in estimating VIU, an entity will incorporate the future cash inflows and outflows from continuing to use the group of assets and from its ultimate disposal; however, estimates of future cash flows would not include cash outflows for settling liabilities that have already been recognised unless the associated liability is included as part of the CGU being tested for impairment. In the case of a rent-free period, comparing like-for-like could be achieved either by:

- including all the future lease payments in the cash outflows when estimating VIU and deducting the rent-free period liability from the CGU's the carrying amount; or
- excluding both the liability and the portion of the future lease payments that effectively settle it. In many cases including the straight-lined based lease expense (instead of the full lease payment) should prove a sufficiently accurate approximation.

Practical insight – Working capital balances

In our view, cash flows from the settlement or realisation of working capital balances (that exist at the measurement date) may be included or excluded in the cash flow projections in estimating VIU, so long as a consistent approach is taken when deriving the carrying amount of the CGU. The net effect should be insignificant where the present value of cash flows from the settlement or realisation of working capital items would be similar to the balances themselves. However, in estimating future cash flows for VIU purposes, material changes in future working capital requirements associated with the asset or CGU under review need to be considered.

Careful consideration must be given to inventory. The basic approach would be to exclude inventory balances from the impairment review as it is excluded from the scope of IAS 36 (and addressed in IAS 2). Under this approach, the estimated future cash flows from future sales of the inventory held at the measurement date should be excluded when estimating VIU. Where management includes inventory in its VIU calculation for practical reasons, it will include the estimated future cash flows from future sales of the inventory. An adjustment may be necessary for gross margins, where deemed significant.

2.2 The order of impairment testing for corporate assets and goodwill

IAS 36 specifies the order of testing in three circumstances:

Circumstances requiring guidance on order of testing	Section
When a corporate asset cannot be allocated on a reasonable and consistent basis to the unit under review (IAS 36.102(b))	Section D.2.2.1
When assets within a CGU to which goodwill has been allocated are tested for impairment at the same time as the unit (IAS 36.97)	Section D.2.2.2
If a CGU making up a group of CGUs to which goodwill has been allocated is tested for impairment at the same time as the group of units (IAS 36.97)	Section D.2.2.2

We discuss each in turn below.

2.2.1 Order of testing for corporate assets that cannot be allocated

Section B.2.2 discusses the process of allocating corporate assets to a CGU. If a portion of the carrying amount of a corporate asset can be allocated on a reasonable and consistent basis, the carrying amount of the CGU, including the portion of the carrying amount of the corporate asset allocated, is compared with its recoverable amount (IAS 36.102(a)).

The assessment becomes more complex where a portion of the carrying amount of a corporate asset cannot be allocated on a reasonable and consistent basis to an individual CGU being tested. In this case, the entity will:

- first, compare the carrying amount of the unit, excluding the corporate asset, with its recoverable amount and recognise any impairment loss (IAS 36.102(b)(i)) [see Step 1 in Example D.8]
- next, compare the carrying amount of the smallest group of CGUs under review to which a portion of the carrying amount of the corporate asset can be allocated on a reasonable and consistent basis (IAS 36.102(b)(ii)) and compare that amount with the recoverable amount of the group of units and recognise any impairment loss (IAS 36.102(b)(iii)) [see Step 2 in Example D.8]. Any additional impairment loss calculated in this step should be recognised as follows:
  i. first, to reduce the carrying amount of any goodwill allocated to the CGU (or groups of CGUs) and
  ii. next, to the other assets of the CGU (or groups of CGUs) pro rata based on the carrying amount of each asset in the CGU (or groups of CGUs)
- when all or part of the corporate asset remains untested, the entity should test for impairment on an entity-wide basis and follow the same allocation process as outlined in bullet 2 above for any additional impairment calculated at this level.

Example D.8 depicts the order of testing where the corporate asset cannot be allocated on a reasonable and consistent basis, other than on an entity-wide level.

Example D.8 – Order of testing corporate assets that cannot be allocated on a reasonable and consistent basis

Background

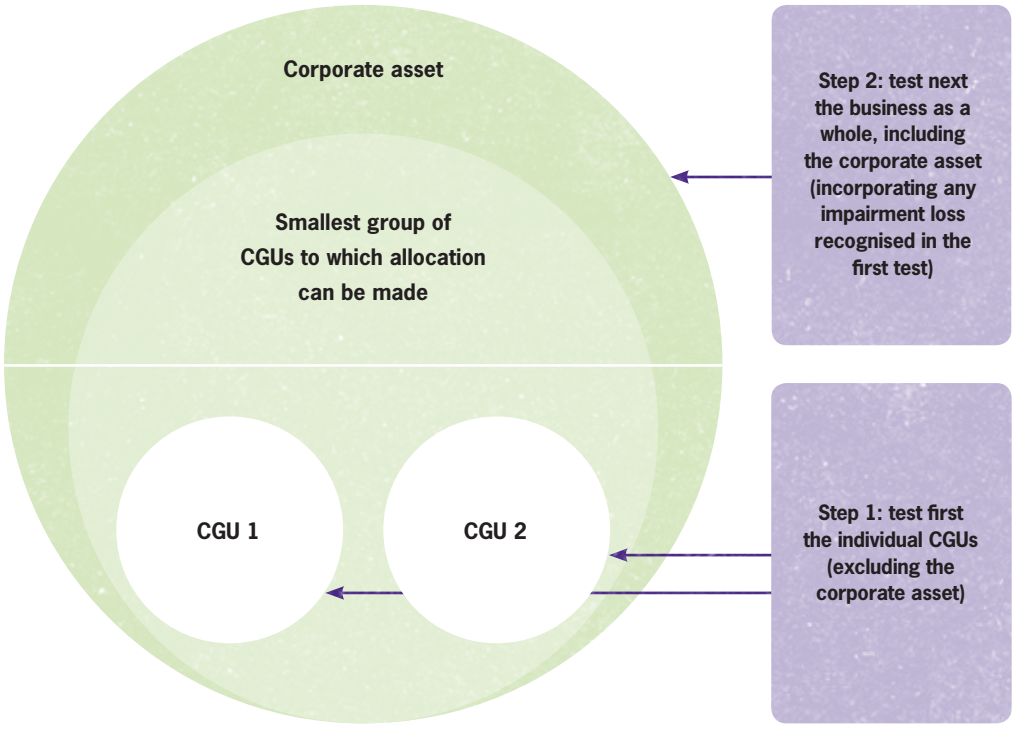
Entity A identifies two CGUs for impairment testing purposes. Entity A determines that it cannot allocate its 'brand' asset to a CGU or group of CGUs on a reasonable and consistent basis.

Analysis

Entity A will first test the individual CGUs (CGU 1 and CGU 2) for impairment, excluding any allocation of the brand asset which cannot be allocated on a reasonable and consistent basis, and record any impairment loss if necessary.

Next, Entity A will compare the carrying amount of the entity as a whole with the recoverable amount of the group of units (including the brand). Any additional impairment loss arising from this step should be allocated:

1. first, to reduce the carrying amount of any goodwill allocated to CGU 1, CGU 2 (or the group of CGUs) and
2. next, on a pro rata basis to the other assets of CGU 1, CGU 2, and the brand corporate asset. However, the impairment loss does not reduce the carrying amount of any asset below the highest of:
   a. its fair value less cost to sell
   b. its value in use and
   c. zero.



2.2.2 Order of testing for assets and cash generating units to which goodwill has been allocated

If certain assets forming part of a CGU to which goodwill has been allocated are tested for impairment at the same time as the CGU, these assets are tested before the CGU as a whole is tested (IAS 36.97). This enables the entity to isolate any impairment at an individual asset level (if applicable) before proceeding to test at the CGU level. This requirement would apply only when the entity:

- is required to test the individual asset (eg because an impairment indicator has been identified); and
- it is possible to determine the asset's recoverable amount even though it is part of a CGU (eg an asset that does not generate largely independent cash flows but whose recoverable amount is estimated based on FVLCOD).

Similarly, if a group of CGUs to which goodwill has been allocated is tested for impairment at the same time as the individual CGUs, the individual CGUs are tested for impairment before the group of CGUs (IAS 36.97).

Not adhering to the prescribed order of testing in these particular cases will usually result in a different allocation of any impairment loss among the individual assets or CGUs. Step 6 discusses the allocation of impairment losses in more detail.

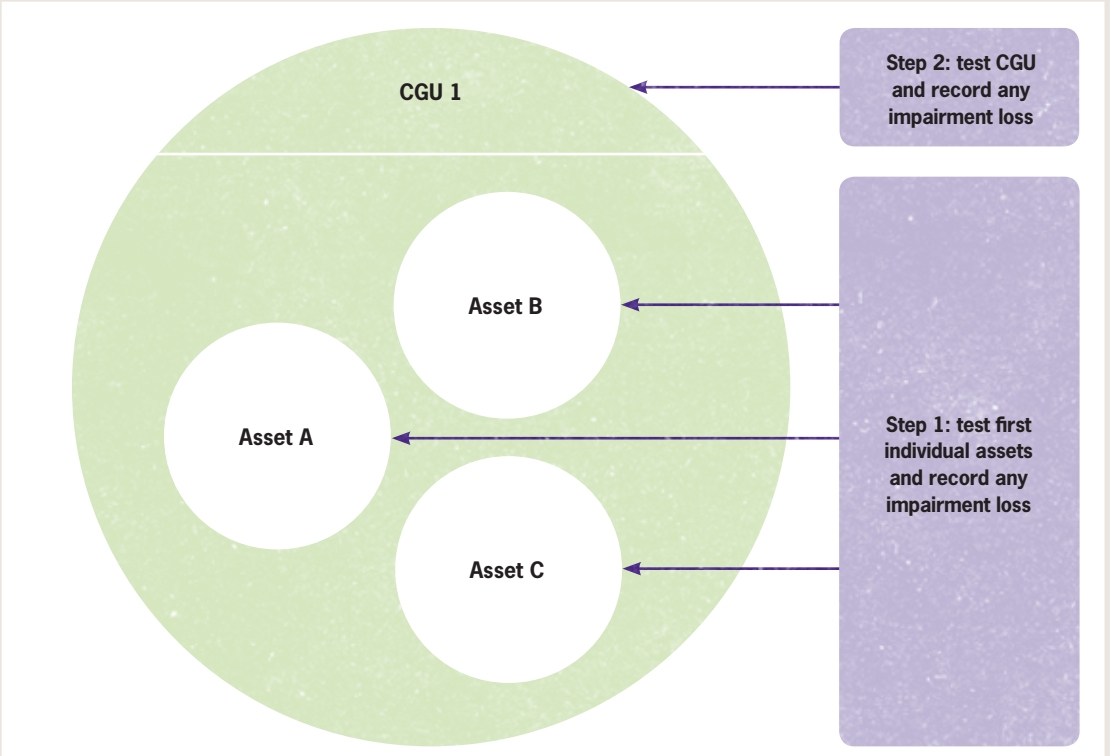
Example D.9 – Order of testing for assets and CGUs to which goodwill has been allocated

Background

Entity Z includes assets A, B, and C (among other assets) in CGU 1 for purposes of testing goodwill. Entity Z tests the goodwill for impairment annually at 30 June. At 30 June 20X0, management determines that an impairment indicator necessitates the impairment testing of assets A, B and C.

Analysis

Entity Z first tests the individual assets (assuming that their recoverable amount can be determined individually), recording any impairment loss(es) at the individual asset level. Next, Entity Z tests CGU 1 and records any remaining impairment loss (as outlined in Section D.3.2). If any additional loss arises in this second step, it is first allocated to goodwill. Assets A, B and C are not reduced to less than their individual recoverable amounts.



3 Step 6: Recognise or reverse any impairment loss

The requirements for recognising and measuring impairment losses differ based on the structure of the impairment testing as determined in Step 2. The requirements for recognising and measuring impairment losses for an individual asset (other than goodwill) are addressed in Section D.3.1 below; while the requirements for recognising and measuring impairment losses for CGUs and goodwill are addressed in Section D.3.2 below.

3.1 Recognising an impairment loss for an individual asset

When the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset needs to be reduced to its recoverable amount and that reduction is recognised as an impairment loss (IAS 36.59).

For assets accounted for using the revaluation model in IAS 16 or IAS 38 'Intangible Assets' (IAS 38), the impairment loss is treated in the same way as a downward revaluation in accordance with those standards (IAS 36.60-61). Accordingly any impairment is recognised in other comprehensive income to the extent that it does not exceed a previous revaluation surplus. Any excess is recognised in profit or loss (IAS 36.60-61).

To the extent the amount estimated for an impairment loss exceeds the carrying amount of the asset to which it relates, an entity shall recognise a liability if, and only if, required by another Standard (IAS 36.62).

Practical insight – Impairment loss exceeds the carrying amount of the asset to which it relates

An unallocated impairment loss for an individual asset (ie a loss exceeding the carrying amount of the asset in question) might arise if the asset is expected to generate negative net future cash flows – for example an asset that is nearing the end of its economic life and requires significant decommissioning or holding costs. In such cases the VIU estimate would be negative. In addition, the entity might need to pay potential buyers to acquire the asset in which case FVLCOD would also be negative. In these cases, the entity would not reduce the carrying value of the asset to less than zero. The entity would look to IAS 37 to determine whether a provision for decommissioning costs must be recognised.

Finally, when an entity recognises an impairment loss for an individual asset, it must:

- adjust the future depreciation (amortisation) charge for the asset to allocate the asset's revised carrying amount, less its residual value (if any) on a systematic basis over its remaining useful life (IAS 36.63) [see Example D.10] and
- determine any related deferred tax assets or liabilities in accordance with IAS 12 'Income Taxes' (IAS 12) by comparing the revised carrying amount of the asset with its tax base (IAS 36.64) [see Example D.11].

Example D.10 – Adjusting future depreciation of an asset after recognising an impairment

Background

A machine was purchased on 1 January 20X1 by Entity A for CU300,000 with an estimated useful life of 3 years and no residual value; therefore, CU100,000 of depreciation expense was recognised on a straight-line basis for both 2001 and 2002 (or CU8,333 per month). At 31 December 20X2, management determines an impairment indicator exists and estimates the recoverable amount of the machine to be CU80,000 (carrying amount at 31 December 20X2 is CU100,000).

Analysis

Entity A recognises an impairment loss for the difference (CU100,000-CU80,000 or CU20,000). In accordance with IAS 36.63, the entity also adjusts future depreciation of the machine after recording the impairment at 31 December 20X2 and will therefore recognise CU6,667 per month of depreciation from 1 January 20X3 – 31 December 20X3.

Example D.11 – Determining any related deferred tax assets/liabilities after recognising an impairment

Background

An entity owns a machine with a carrying amount of CU2,000. After finding evidence of an impairment indicator, management estimates the recoverable amount of the machine to be CU1,600. The entity records an impairment loss of CU400 (CU2,000 – CU1,600) for the machine. The tax rate is 35% and the tax base of the machine is CU1,800. Impairment losses are not deductible for tax purposes.

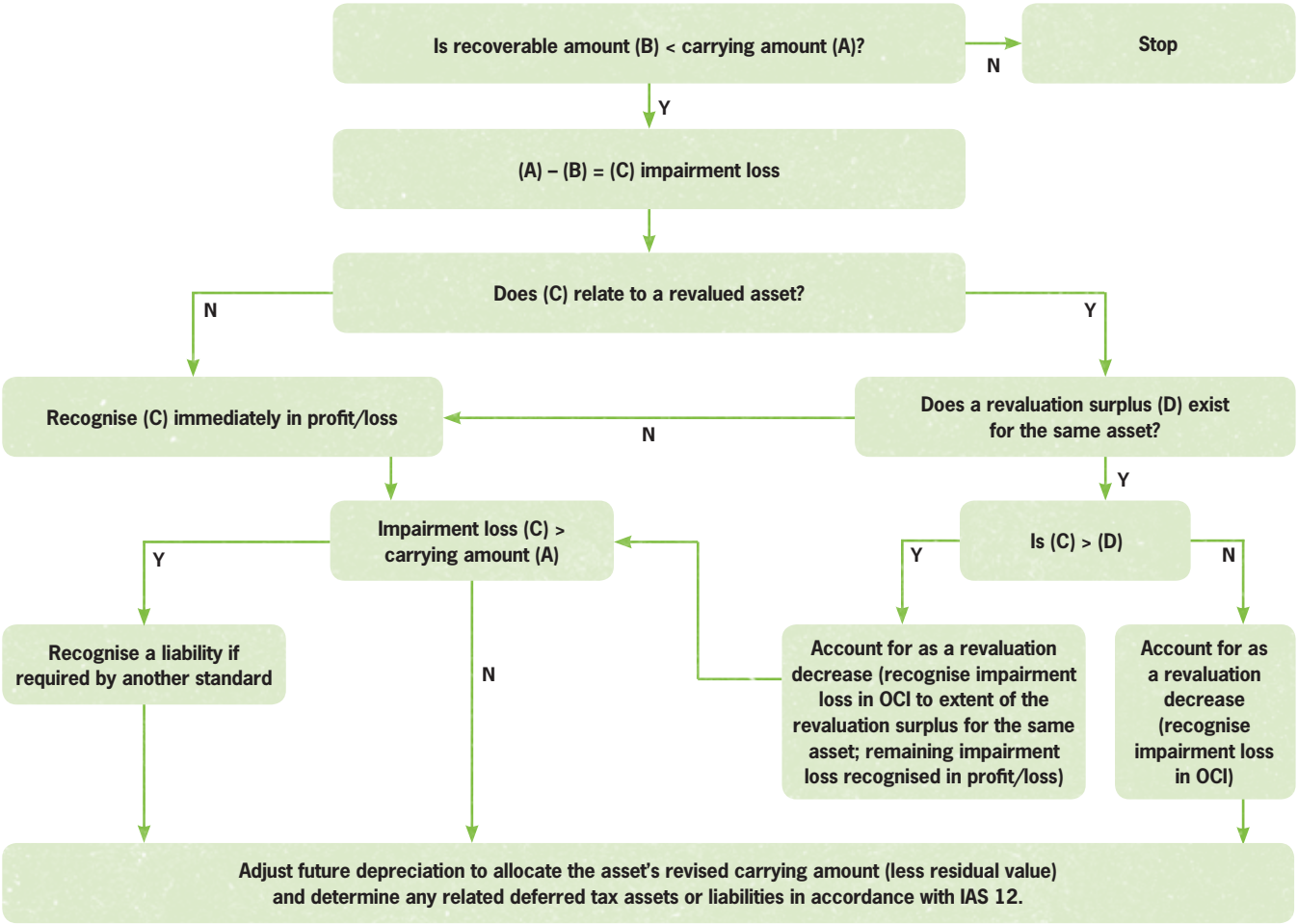
Analysis

The recognition of the impairment loss creates a deferred tax asset of CU70 as shown below, subject to meeting the criteria in IAS 12 for recognition of deferred tax assets.

	Before impairment	Effect of impairment	After impairment
Carrying amount	2,000	(400)	1,600
Tax base	1,800	–	1,800
Taxable (deductible) temporary difference	**200**	**(400)**	**(200)**
Deferred tax liability (asset) at 35%	**70**	**(140)**	**(70)**

Figure D.9 summarises IAS 36's requirements for recording an impairment for an individual asset.

Figure D.9 – Recording an impairment for an individual asset



3.2 Recognising an impairment loss for cash generating units

An impairment loss must be recognised for a CGU when the recoverable amount of the unit is less than its carrying amount. IAS 36 prescribes that the impairment loss be allocated:

- first, to reduce the carrying amount of any goodwill allocated to the CGU (IAS 36.104(a))
- then, to the other assets of the unit, pro rata on the basis of the carrying amount of each asset in the unit (IAS 36.104(b)).

However, in allocating the impairment loss, an entity cannot reduce the carrying amount of an individual asset below the highest of:

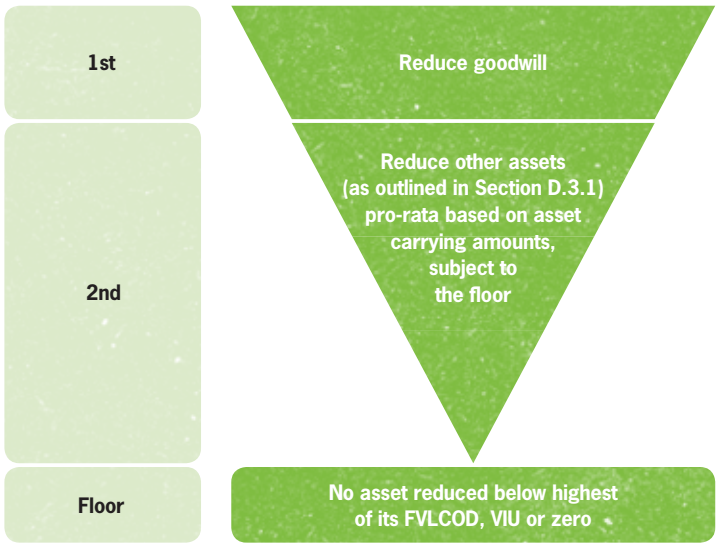
- its FVLCOD (if measurable);
- its VIU (if determinable); and
- zero (IAS 36.105).

These amounts serve as a 'floor' as outlined in the Figure D.10.

If, for an individual asset within an impaired CGU, it is possible to measure FVLCOD but not VIU (and therefore not possible to determine the individual asset's recoverable amount), then the floor is the higher of FVLCOD and zero. Under this scenario no impairment loss is recognised for the individual asset if the asset's CGU is not impaired, even if the asset's FVLCOD is less than its carrying amount (IAS 36.107(b)).

Should the 'floor' be applicable for an asset; any amount that would have been allocated to that individual asset must be allocated pro rata to the other assets of the unit (IAS 36.105). The reductions in carrying amounts from applying the above requirements are treated as impairment losses on the individual assets and recognised as outlined in Section D.3.1 (IAS 36.104).

Figure D.10 – Allocating an impairment loss to assets within a CGU



Example D.12 below illustrates the interaction of these requirements in allocating the impairment loss to individual assets comprising a CGU.

Example D.12 – Allocating an impairment loss to assets within a CGU

Background

Entity X carries out an impairment test of CGU 1 on 31 December 20X0. CGU 1 has a total carrying amount of CU800 and consists of two identifiable intangible assets (Asset A, CU400, and Asset B, CU300) in addition to allocated goodwill of CU100. Asset A was also tested for impairment at 31 December 20X0 and found not to be impaired because its FVLCOD (CU450) exceeds its carrying amount (CU400). Management has concluded that Asset B's VIU cannot be determined individually and its FVLCOD cannot be measured reliably. The results of the impairment test of CGU 1 show a recoverable amount of CU500; as such, an impairment loss of CU300 must be recognised.

CGU 1	Carrying amount	Recoverable amount (individual asset level)	Impairment loss allocation
Goodwill	100	N/A	100
Asset A	400	450	–
Asset B	300	N/A	200
Total	**800**		
Recoverable amount of CGU 1	**500**		
Impairment loss	**300**		**300**

Analysis

Entity X first allocates the impairment loss to goodwill (IAS 36.104(a)). Next, Entity X allocates the remaining impairment loss (in this case CU200) to the individual assets comprising the CGU, subject to the floor (IAS 36.104(b), 105). No impairment loss can be allocated to Asset A (due to the floor) as the asset cannot be reduced to less than its recoverable amount. Therefore, the remaining impairment loss of CU200 is allocated to Asset B.

Example D.13 – Understanding if the recoverable amount can be determined for individual assets and the effect on recognising an impairment (IAS 36.107)

Background

A machine has suffered physical damage but is still working, although not as well as before it was damaged. The machine's FVLCOD is less than its carrying amount. The machine does not generate independent cash inflows. The smallest identifiable group of assets that includes the machine and generates cash inflows that are largely independent of the cash inflows from other assets is the production line to which the machine belongs. The recoverable amount of the production line shows that the production line (taken as a whole) is not impaired.

Scenario 1: budgets/forecasts approved by management reflect no commitment of management to replace the machine.

Scenario 2: budgets/forecasts approved by management reflect a commitment to replace the machine and sell it in the near future. Cash flows from continuing to use the machine until its disposal are estimated to be negligible.

Scenario 1 Analysis

The recoverable amount of the machine alone cannot be estimated because the machine's VIU:

a. may differ from its FVLCOD; and
b. can be determined only for the CGU to which the machine belongs (the production line).

The production line is not impaired. Therefore, no impairment loss is recognised for the machine. Nevertheless, the entity may need to reassess the depreciation period or the depreciation method for the machine.

Scenario 2 Analysis

The machine's VIU can be estimated to be close to its FVLCOD. Therefore, the recoverable amount of the machine can be determined. Because the machine's FVLCOD is less than its carrying amount, an impairment loss is recognised for the machine.

Remaining (unallocated) amount of an impairment loss for a CGU

When the requirements above have been applied and result in a remaining unallocated amount of impairment loss for a CGU, such an amount is only recognised as a liability if required by another IFRS (IAS 36.108).

Practical insight – Any remaining (unallocated) amount of an impairment loss for a CGU

This situation might arise in relation to a loss-making CGU that is in need of restructuring (for example). As noted in Section D.1.3.1A, the effects of a future restructuring would be excluded from the VIU estimate before the entity has an obligation for the restructuring in accordance with IAS 37. Also, the need for future restructuring may result in FVLCOD being negative. In this situation the entity would limit any impairment loss to the carrying value of the CGU's assets and separately evaluate whether the criteria in IAS 37 to recognise a restructuring provision have been met.

3.3 Considerations for foreign operations

Any impairment loss is not a partial disposal for the purposes of IAS 21 'The Effects of Changes in Foreign Exchange Rates'. The foreign exchange gain or loss recognised in other comprehensive income on translating the foreign operation's financial statements is not therefore reclassified to profit or loss when recognising an impairment (IAS 21.49).

3.4 Reversing an impairment loss

3.4.1 Indicators for reversing an impairment loss

In addition to assessing evidence of possible impairment, entities must also assess whether there is any indication that a previously recognised impairment loss for an asset (other than goodwill) no longer exists or may have decreased. If an indication of possible reversal is identified, the entity must estimate the recoverable amount of that asset (IAS 36.110).

Guidance note: Goodwill impairments cannot be reversed

IAS 36 prohibits any reversal of impairment losses recognised on goodwill (IAS 36.124). The reason for this is because IAS 36 views any increase in the recoverable amount of goodwill after the recognition of an impairment loss to likely be an increase in the internally generated goodwill (not a reversal of the impairment loss recognised for the acquired goodwill). IAS 38 prohibits the recognition of internally generated goodwill.

Accordingly, the references to impairment reversals in this Section D.3.2 do not include goodwill.

Similar to the list provided in IAS 36 of indications of an impairment loss, IAS 36 provides a non-exhaustive list of indications that a previously recognised impairment loss may no longer exist. These are summarised in Figure D.11.

Figure D.11 – Non-exhaustive list of impairment reversal indicators from IAS 36 (IAS 36.111)

External sources of information (IAS 36.111(a) – (c))
• Observable indications that the asset's value has increased significantly during the period
• Significant favourable changes (have occurred or are expected) in the technological, market, economic or legal environment
• Market interest rates or other market rates of return on investments have decreased during the period (which will decrease the discount rate used in caluclating the asset's VIU)
Internal sources of information (IAS 36.111(d) – (e))
• Significant favourable changes (have occurred or are expected) in the extent to which an asset is used (or is expected to be used) (eg, costs incurred during the period to improve or enhance the asset's performance or restructure the operation to which the asset belongs)
• Evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, better than expected

The reversal of an impairment loss reflects an increase in the estimated service potential of an asset (either from use or from sale) since the date when an entity last recognised the impairment loss for the asset (IAS 36.115). A reversal of an impairment loss should therefore only be recognised if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. Said differently, an impairment loss is not reversed solely because of the passage of time or the unwinding of the discount, even if the recoverable amount of the asset becomes higher than its carrying amount (IAS 36.114, 116).

Guidance note: Disclosure required for an increase in the estimated service potential

IAS 36.130 requires that the entity identify and disclose the change in estimates that cause the increase in the estimated service potential. Examples include:

a. a change in the basis for measuring recoverable amount (ie whether recoverable amount is based on FVLCOD or VIU)
b. where the recoverable amount was based on VIU, a change in the amount or timing of estimated future cash flows or in the discount rate; or
c. where the recoverable amount was based on FVLCOD, a change in estimate of the components of FVLCOD (IAS 36.115).

Regardless of whether an impairment loss is reversed for an asset, if the entity identifies an indication that a previously recognised impairment loss may no longer exist, the entity may need to review and adjust the:

- the remaining useful life
- the depreciation (amortisation method) and/or
- the residual value of the asset (IAS 36.113).

Practical insight – Indicators for reversing a previously recognised impairment loss

Most of the 'reversal indicators' listed are the inverse of the loss indicators listed in IAS 36.12 (discussed in Section C.1.1); there are however some exceptions to this. In particular, an increase in market capitalisation above carrying value of an entity's net assets is not listed as a reversal indicator.

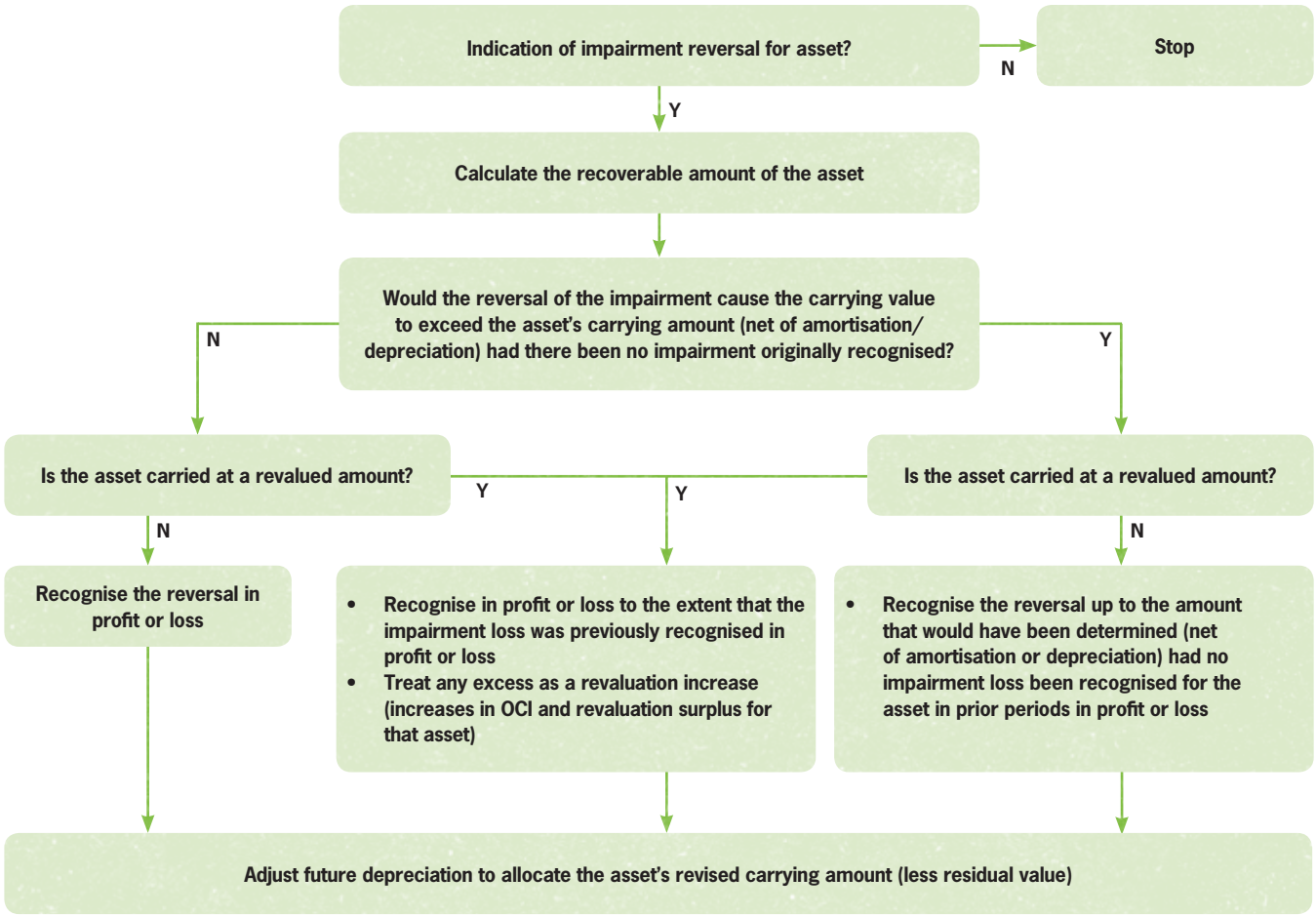
3.4.2 Reversing impairment losses for individual assets (other than goodwill)

When recoverable amount is recalculated and exceeds the asset's carrying value, the carrying amount is increased to the recoverable amount subject to a 'ceiling' (ie an upper limit). The increased carrying amount cannot exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years (IAS 36.117).

For assets accounted for using the revaluation model in IAS 16 or IAS 38, the reversal of the impairment loss is accounted for in the same way as a revaluation increase in accordance with those Standards.

Figure D.12 below depicts the requirements for reversals of impairment losses for individual assets and Example D.14 illustrates their practical application.

Figure D.12 – Reversing impairment losses for individual assets



Example D.14 – Reversing a previously recognised impairment loss for an individual asset

At 1 January 20X1, Entity T purchased an item of PP&E (a machine) for CU1,800 (T will depreciate the machine on a straight-line basis over its useful life of 15 years). In 20X1, T recognised an impairment loss of CU500 on this machine, having identified indicators showing a reduction in expected demand for the machine output due to the introduction of a superior product released by a competitor. T applies the cost model in accordance with IAS 16 and the impairment loss was recognised in profit or loss. The amounts before and after the recognition of the impairment loss were as follows with respect to the machine:

31 December 20X1	**Machine**
Historical cost	1,800
Accumulated depreciation (20X1)	(120)
Carrying amount	1,680
Impairment loss	(500)
Carrying amount after impairment loss	1,180

In 20X3, T determines that the competitor product is experiencing technical issues and that its effect on demand for T's output is less than expected. Sales have exceeded forecast and management estimates that production will increase by 25%. At 31 December 20X3, T estimates the recoverable amount of the machine in accordance with IAS 36.111(b). The recoverable amount of the machine is estimated to be CU1,300.

31 December 20X3	**Machine**
31 December 20X1 carrying amount after impairment loss	1,180
Accumulated depreciation (20X2 and 20X3)*	(168)
Carrying amount	1,012
Recoverable amount	1,300
Excess of recoverable amount over carrying amount	288

*T revised the depreciation charge (from CU120 per year to CU84 per year) for the machine based on the revised carrying amount and remaining useful life at 31 December 20X1 (CU1,180/14 years or CU84 depreciation expense per year). Depreciated historical cost of the machine at 31 December 20X3 is as follows:

31 December 20X3	**Machine**
Historical cost	1,800
Accumulated depreciation (CU120 X 3)*	(360)
Depreciated historical cost	1,440
Carrying amount	1,012
Difference	428

Analysis

T recognises a reversal of the impairment loss recognised in 20X1 in accordance with IAS 36.114. T increases the carrying amount of the machine by CU316 (to lower of recoverable amount (CU1,300) and the depreciated historical cost (CU1,440)) (IAS 36.117). The increase is recognised immediately in profit or loss (IAS 36.119) and T will again adjust future depreciation to allocate the asset's revised carrying amount (IAS 36.121).

3.4.3 Reversing impairment losses for cash generating units

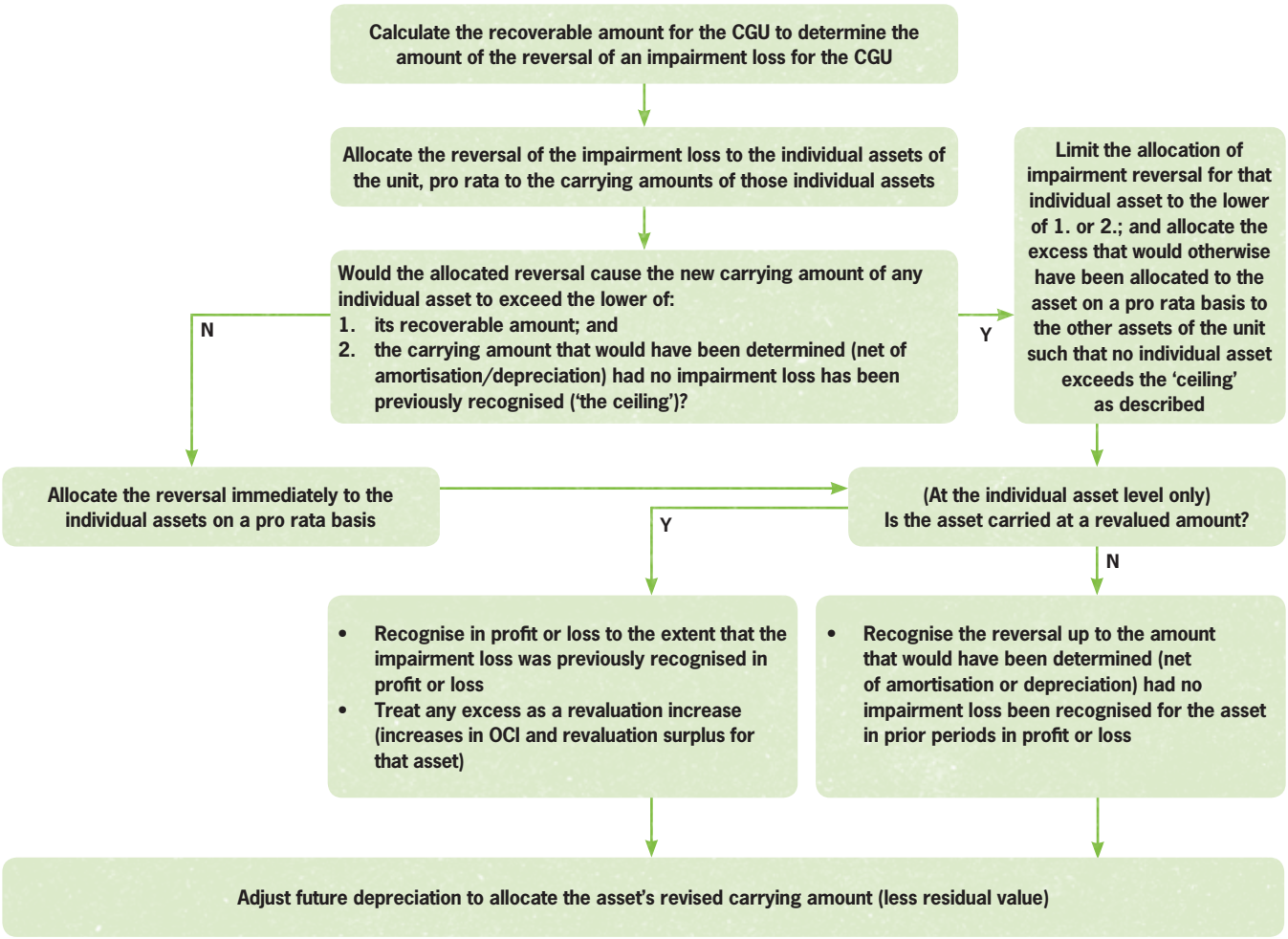
Any reversal of an impairment loss for a CGU must be allocated to the individual assets that make up that CGU (excluding goodwill). The entity allocates the reversal of an impairment loss to the CGU's assets pro rata to their carrying amounts. This is again however subject to a 'ceiling' whereby no individual asset's carrying amount is increased above the lower of:

- its recoverable amount (if determinable); and
- its carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior periods.

If this 'ceiling' takes effect for one or more of the CGU's assets, the reversal of the impairment loss that would otherwise have been allocated to those assets is allocated on a pro rata basis to the other assets, subject to the same ceiling (IAS 36.122-123).

Figure D.13 below depicts the allocation process.

Figure D.13 – Reversing impairment losses for CGUs



Example D.15 illustrates the practical application of these requirements.

Example D.15 – Reversing a previously recognised impairment loss for a CGU with allocated goodwill

Entity T is in the healthcare industry and has identified three CGUs for impairment review purposes (CGU 1, CGU 2 and CGU 3), each located in a different country. In 20X1, Entity T recognised an impairment loss of CU1,250 with respect to CGU 1, following the election of a new government in the country in which CGU 1 operates and anticipated changes in healthcare laws that would reduce demand for Entity T's products. The amounts before and after the recognition of the impairment loss were as follows with respect to CGU 1:

31 December 20X1	Goodwill	CGU 1 identifiable assets	Total
Historical cost	750	1,800	2,550
Accumulated depreciation (20X1)	–	(120)	(120)
Carrying amount	750	1,680	2,430
Impairment loss	(750)	(500)	(1,250)
Carrying amount after impairment loss	–	1,180	1,180

In 20X3 T determines that the impact of the new healthcare laws is less than expected. Sales have exceeded forecast and management estimates that production will increase by 25%. At 31 December 20X3, T estimates the recoverable amount of CGU 1 in accordance with IAS 36.111(b). The recoverable amount of CGU 1 is estimated to be CU1,500. It is not possible to determine recoverable amount for any of the individual assets in the CGU.

31 December 20X3	Goodwill	CGU 1 identifiable assets	Total
31 December 20X1	–	1,180	1,180
Accumulated depreciation (20X2 and 20X3)*	–	(168)	(168)
Carrying amount	–	1,012	1,012
Recoverable amount			1,500
Excess of recoverable amount over carrying amount			488

*T revised the depreciation charge (from CU120 per year to CU84 per year) for the identifiable assets of CGU 1 based on the revised carrying amount and remaining useful life at 31 December 20X1. Depreciated historical cost of CGU 1 at 31 December 20X3 is as follows:

31 December 20X3	CGU 1 identifiable assets
Historical cost	1,800
Accumulated depreciation (CU120 X 3)*	(360)
Depreciated historical cost	1,440
Carrying amount	1,012
Difference	428

Analysis

At 31 December 20X3, T recognises a reversal of the impairment loss (recognised at 31 December 20X1) in accordance with IAS 36.114. T will increase the carrying amount of CGU 1's identifiable assets by CU428 (to the lower of recoverable amount (CU1,500) and the depreciated historical cost of the non-goodwill assets (CU1,440) had no impairment loss been recognised in prior periods) (IAS 36.122-123). The increase is recognised immediately in profit or loss. The impairment loss recognised for goodwill in 20X1 is not reversed (IAS 36.124).

E. Other impairment issues

Section E:
Other impairment issues

This Section discusses other common application issues encountered when applying IAS 36, including those related to:

- the 'deferred tax and goodwill problem'
- non-controlling interests
- equity accounting
- the interaction between IAS 36 and other IFRSs.

This Section of the Guide highlights some other issues that can be problematic when entities apply IAS 36. Figure E.1 outlines the topics discussed in this Section.

Figure E.1 – Other application issues

Section reference	Other application issues
1.	**Deferred tax and goodwill problem**
2.	**Non-controlling interests**
3.	**IAS 36 and equity accounting**
4.	**Interaction between IAS 36 and other IFRS standards**

1 Deferred tax and goodwill problem

This refers to a well-known application issue that sometimes arises in testing goodwill for impairment. In some business combinations, goodwill arises mainly or solely as a consequence of deferred tax liabilities (DTLs). DTLs are recognised (and increase goodwill) when the acquisition date fair value of identifiable assets exceeds their tax base. The effect of deferred tax on goodwill is relevant to most business combinations but can be particularly significant for acquisitions involving:

- properties acquired in a corporate shell for which the tax base is driven by the historical amount paid by the shell entity
- intangible assets that are recorded at fair value by the acquirer but were not recognised by the acquired entity (and therefore have a tax base of zero).

Example E.1 illustrates how this interaction can affect the impairment review.

Example E.1 – Deferred tax and goodwill problem

Background

Entity A is a real estate investor and developer. The acquisition of an investment property is usually accomplished through buying a shell company which holds the property. The shell is used to minimise taxes payable when the property is sold on. The shell company allows the owner to postpone corporation tax on any increase in the value of the property.

During the period, Entity A acquires an investment property (a retail outlet) through buying Entity B, a shell or single asset entity company that holds the property. Entity A concludes the acquisition is a business combination because the retail outlet is a business as defined in IFRS 3.

The price paid by Entity A for 100% of Entity B is CU5,000, which is equal to fair value of Entity B and the fair value of the retail outlet is also CU5,000. The tax base of the retail outlet is CU3,000. The applicable tax rate is 35%. There are no other assets or liabilities in the shell company.

Entity A records the retail outlet at fair value in accordance with IFRS 3. The difference between the fair value of the investment property and its tax base (which in this case is the cost of the property in Entity B's individual financial statements) results in a DTL. This is measured on an undiscounted basis in accordance with IAS 12. Entity A's acquisition accounting is then summarised:

	CU
Fair value of the retail outlet	5,000
Deferred tax liability 35% * (5,000-3,000)	(700)
Net assets acquired in accordance with IFRS 3	4,300
Goodwill (balancing figure)	700
Consideration transferred	5,000

For this purpose, the retail outlet is considered a separate CGU.

Analysis

As required by IAS 36, Entity A tests its goodwill for impairment at least annually. The carrying value of the CGU determined excluding the DTL is CU5,700. However, if fair values remain the same as the acquisition date then the FVLCOD is CU5,000 less costs of disposal. Also, it is very likely that VIU would be similar to fair value in this fact pattern (unless Entity A can benefit from significant synergies or other entity-specific advantages not available to other market participants). If the VIU calculation also results in CU5,000, this suggests an apparent immediate impairment loss of CU700.

In our view, this deferred tax-related goodwill is an accounting phenomenon that does not represent real benefits that the acquirer has paid for and that may increase future cash flows. When this goodwill is tested for impairment (having been allocated to CGUs) using the normal IAS 36 approach, as illustrated in Example E.1 above, it may be immediately impaired (also referred to as a 'day 1' impairment).

IAS 36.75 requires the carrying value of a CGU to be calculated in a manner consistent with the determination of VIU. Hence, tax balances should generally be excluded from CGUs for impairment testing. However, recognizing a day 1 impairment loss is also counter-intuitive and is viewed by some as an unintended consequence of the various requirements in IFRS 3, IAS 12 and IAS 36.

For this reason, many commenters believe that it is appropriate to use a practical expedient to avoid a day 1 impairment when it is due solely to DTLs increasing goodwill in a business combination. However, views differ on how to achieve this.

Practical insight – The deferred tax and goodwill problem

In Example E.1, recoverable amount based on FVLCOD, assuming that the acquisition price was fair value (and that nothing else has changed and costs of disposal are immaterial), would be CU5,000. In our view, when comparing this to carrying value, it is appropriate to include the DTL. This is because FVLCOD takes account of the tax features of the asset and the DTL would transfer to a buyer of the CGU (assuming they buy the shell company). Accordingly, no impairment loss arises. However, this approach is not a complete solution. While it may justify the CGU's carrying value based on FVLCOD, in other circumstances recoverable amount is wholly or partly based on VIU (eg if FVLCOD cannot be reliably measured going forward – which is more likely the case for some intangible assets recognised in a business combination).

In our view, however, IAS 36.78 can also be interpreted to allow some flexibility when considering which assets and liabilities can be included in the carrying value of a CGU for the purpose of comparison to VIU. It can be argued that, in order to undertake a meaningful impairment calculation, it is necessary to include the DTL in the net assets of the CGU to which this goodwill relates. However, it would only be appropriate to include this specific DTL in the carrying amount of the CGU. It is also important to note that over time, it may be difficult to track the specific DTLs that have led to the goodwill gross-up, especially as the related asset's carrying value and tax base change over time.

For more on this topic and deferred taxes in general, see our GTI publication: Deferred tax – A Chief Financial Officer's guide to avoiding the pitfalls.

2 Non-controlling interests

Non-controlling interests (NCI) are equity instruments of the acquiree not held directly or indirectly by the acquirer and arise when a parent holds less than 100% of the equity of a subsidiary. IFRS 3 includes an accounting policy option to initially measure NCI at either:

- fair value or
- the proportionate interest in the acquiree's recognised identifiable net assets (IFRS 3.19).

When the fair value model is used, 100% of the goodwill in the acquiree is effectively recognised (both the acquirer's and the NCI's share) in the statement of financial position. This is sometimes described as the 'full goodwill' method. In this case, when the entity performs its impairment review, there is no 'mismatch'. This is because VIU and FVLCOD are estimated based on 100% of the asset or CGU under review and its related cash flows. Said differently, the entity will be comparing 'like with like'.

In practice however, acquirers more often measure NCI at the proportionate interest in the acquiree's recognised identifiable net assets. In this case, only the acquirer's interest in the goodwill is recognised ('partial goodwill' method). Therefore, without an adjustment, the carrying value of the CGU is understated because recoverable amount is based on 100% of the cash flows but the carrying value does not include all the goodwill that contributes to those cash flows). Said differently, the entity will not be comparing 'like with like'.

In this situation, an adjustment is required to address the mismatch. The carrying amount of goodwill allocated to the unit must be grossed-up to include the goodwill attributable to the NCI (IAS 36.C4). This involves:

- adding goodwill attributable to the NCI to the CGU
- comparing the adjusted carrying amount of the CGU to its recoverable amount.

If an impairment loss then arises, this must be allocated between the amount relating to the parent's recognised goodwill and the NCI share. Only the impairment loss relating to the goodwill that is allocated to the parent is recognised as a goodwill impairment loss (IAS 36.C8).

Example E.2 demonstrates how to adjust the impairment test when the proportionate interest method option is used to recognise and measure NCI in a business combination.

Example E.2 – Adjusting the impairment test when the partial goodwill method has been applied

Background

Assume Entity A acquired an 80% interest in Entity B during the year for consideration of CU1,750. At that time, Entity A calculated the fair value of the identifiable net assets to be CU1,350 resulting in goodwill of CU400. Assume for simplicity that Entity B is a separate CGU (CGU B), that all the goodwill is allocated to CGU B and that Entity B only includes assets which belong to this CGU.

At the end of the year, Entity A tests this goodwill for impairment. Management calculates CGU B's recoverable amount to be CU1,700. The carrying value of CGU B's identifiable assets remains CU1,350.

Analysis

Entity A performs the following calculations:

Carrying amounts of CGU B's assets		1,350
Allocated goodwill	80%	400
Notional NCI share of goodwill	20%	**100**
Notionally adjusted carrying amount of CGU B		1,850
Recoverable amount		1,700
Notional impairment loss		**150**

	CGU B (Entity A's interest)	**NCI**	**Total allocation**
Allocated goodwill	400	–	400
NCI	–	100	100
Notional impairment loss allocated as follows	**(120)**	**(30)***	**(150)**
	280	**70**	**350**
Remaining CGU B's assets	1,350	–	1,350
Revised carrying amount	**1,630**	**70**	**1,700**

* Entity A recognises CU120 impairment loss only (its share of the impairment), not the CU30 as that is the portion attributable to the NCI.

Practical insight – Tracking NCI share of goodwill

Example E.2 demonstrates the mechanics of considering NCI in the goodwill impairment test. If Entity A were to ignore this requirement, it would have calculated an impairment of CU50 (CU1,750 – CU1,700), rather than the CU120 recognised in accordance with IAS 36.

An entity must ensure that it tracks the NCI's share of goodwill on an acquisition-by-acquisition basis in order to apply this guidance. It is important to note that the 'gross-up' illustrated above is based on the NCI percentage when the acquisition occurred. If the NCI percentage later changes (due for example to partial disposals or NCI purchases with no change of control), this does not alter the amount of goodwill or the gross-up percentage. The tracking process also becomes more complex in various other circumstances, such as when:

- goodwill is allocated to more than one CGU
- goodwill from multiple acquisitions with different NCI percentages is allocated to the same CGU
- CGUs are reorganised
- components of a CGU with allocated goodwill are disposed of.

3 IAS 36 and equity accounting

As discussed in 'Step 1: Identify assets within the scope of IAS 36', the requirements of IAS 36 apply to subsidiaries, associates and joint ventures accounted for under the cost method in the parent's separate financial statements and to investments accounted for using the equity method in accordance with IAS 28 'Investments in Associates and Joint Ventures'. The impairment review for an investment in an associate or a joint venture involves two steps:

Step 1	Applying the equity method to recognise the investor's share of any impairment losses from the associate's or joint venture's identifiable assets
Step 2	Reviewing the investment in the associate or joint venture as a whole for impairment and recognising any impairment loss

Step 1: Applying the equity method

IAS 28 requires use of the equity method for investments in associates and joint ventures (with some very limited exceptions). In summary, the equity method involves:

- recording the investment at cost on acquisition
- subsequently adjusting the carrying value for the investor's share of profits or losses, less any distributions received (IAS 28.10).

In determining its share of share of profits or losses, the investor uses financial statements of the investee that comply with IFRSs and are prepared using uniform accounting policies. This includes the application of IAS 36 to account for impairment of the investee's identifiable assets. It should be noted that the investor should adjust the carrying amount of the investee's assets and liabilities to fair value at the date significant influence or joint control is obtained (in a similar manner to business combination accounting). This may in turn require subsequent adjustments to the investee's results – including its depreciation and impairment charges (see Example E.3).

Step 2: Reviewing the investment in the associate or joint venture as a whole for impairment

After applying the equity method, the investor should also consider whether there is objective evidence of impairment of its overall net investment (IAS 28.40). Any goodwill identified at acquisition is included in the overall net investment for this purpose. In evaluating the need for any additional impairment charge, the investor:

- applies the requirements of IAS 39.58-62 to determine whether or not there is objective evidence of impairment (IAS 28.40)
- if necessary, applies the requirements of IAS 36 to quantify any impairment loss (IAS 28.42) (See Example E.4).

Example E.3 – Step 1: Applying the equity method

Background

On 1 January 20X1, Investor A acquires a 40% interest in Entity B, for CU300. Investor A determines that Entity B meets the IAS 28 definition of an associate. Entity B reports in accordance with IFRS and applies accounting policies consistent with Investor A's. At 1 January 20X1, Entity B's net assets total CU540. Investor A applies the requirements of IFRS 3 to recognise and measure Entity B's identifiable assets, liabilities and contingent liabilities (mainly at their fair value). The book values and adjustments are summarised in the following table:

	Book value at 1 January 20X1	Fair value and other adjustments	Notes	Total
Property, plant & equipment (PP&E)	300	100	(a)	400
Goodwill	40	(40)	(b)	–
Other intangible assets	–	150	(c)	150
Other assets & liabilities	200	–		200
Contingent liability – litigation	–	(150)	(d)	(150)
Total	**540**	**60**		**600**
Investor A's 40% interest				**240**
Cost of 40% interest				**300**

a. Adjustment to revalue PP&E to fair value of CU400. The remaining useful life is assessed as 10 years, with zero residual value
b. Goodwill recognised by Entity B is not an identifiable asset so is excluded from the fair value statement of financial position
c. Adjustment to recognise two brands owned by Entity B: Brand X is valued at CU130. Brand Y is valued at CU20. The estimated useful life of both brands is 10 years
d. Adjustment to record at fair value a contingent liability in relation to a lawsuit filed against Entity B.

The accounting entry recorded on 1 January 20X1 is as follows:

1 January 20X1	Debit	Credit
Investment in associate	300	
Cash		300

During 20X1, Entity B records a net profit of CU200. This figure includes:

- an impairment charge of CU40 in relation to the goodwill recorded in Entity B's statement of financial position
- depreciation of CU30 in relation to PP&E
- a charge of CU200 reflecting a payment to settle the lawsuit referred to in (d) above.

Also, during 20X1 Entity B's management decides to discontinue Brand Y and focus on Brand X. Investor A determines that Brand Y is fully impaired. Entity B does not make any distributions in the year.

Based on these facts, Investor A makes the following adjustments to Entity B's net profit to determine the share of profit for equity accounting purposes:

	Notes	CU
Net profit as reported by Entity B		200
Adjustments:		
– additional depreciation	(a)	(10)
– reversal of B's goodwill impairment	(b)	40
– amortization of Brand X	(c)	(13)
– impairment of Brand Y	(d)	(20)
– litigation settlement	(e)	150
Net profit for equity accounting purposes		**347**
Investor A's 40% interest		**139**

a. Adjustment to record additional depreciation based on the fair value of Entity B's PP&E – CU100/10 years
b. Goodwill recognised by Entity B is excluded from the fair value statement of financial position, so the impairment charge needs to be reversed for equity accounting purposes
c. Amortisation of Brand X – CU130/10 years
d. Impairment charge of CU20 to write-off Brand Y
e. Entity B has recorded an expense of CU200 for the litigation settlement but the contingent liability was recorded at an amount of CU150 in the fair value statement of financial position. This contingent liability is reversed for equity accounting purposes.

Investor A records the following entry to recognise its share of Entity B's profits:

31 Dec 20X1	Debit	Credit
Investment in associate	139	
Income statement (share of profit of associate)		139

Consequently, the carrying value of the investment at 31 December 20X1 becomes CU439.

Example E.4 – Step 2: Reviewing the investment in the associate or joint venture as a whole for impairment

If there is any objective evidence of impairment of this net investment amount as at 31 December 20X1, its recoverable amount should be estimated. The goodwill identified at acquisition (CU60) is included in the overall net investment for this purpose.

The impairment assessment performed should be in accordance with the principles and procedures outlined in IAS 36 (therefore, the entity will compare the carrying amount of the investment to the higher of its FVLCOD and VIU). VIU is determined by estimating:

a. its share of the estimated future cash flows expected to be generated by the associate or joint venture (including proceeds from the ultimate disposal of the investment) or
b. estimated future cash flows expected to arise from dividends to be received from the investment and from its ultimate disposal.

Both should yield the same result (IAS 28.42).

4 Interaction between IAS 36 and other IFRS Standards

This Section highlights how IAS 36's requirements can interact with the requirements of certain other IFRSs (excluding interactions addressed elsewhere in the Guide).

4.1 IAS 36 and IAS 34 'Interim Financial Reporting'

IAS 36 calls for an assessment 'at the end of each reporting period' for any indication that an asset may be impaired (IAS 36.9). For entities that prepare half-yearly or quarterly financial statements in accordance with IAS 34, the assessment will be more frequent than for entities that prepare only annual financial statements, subject to the 'reliefs' highlighted in Section D.1.4 (Figure D.8).

IAS 34 requires an entity to apply the same accounting policies in its interim financial statements as are applied in its annual financial statements.

IAS 34 also states that the frequency of an entity's reporting (annual, half-yearly, or quarterly) should not affect the measurement of its annual results (IAS 34.28). However, the frequency of reporting can in fact affect annual results when an entity recognises an impairment loss on goodwill in an interim period. This loss cannot be reversed even if conditions change at the end of the annual period and indicate that the impairment loss would have been reduced or avoided (had the entity only reported annually). IFRIC 10 'Interim Financial Reporting and Impairment' effectively confirms that the prohibition on reversing goodwill impairment in IAS 36 overrides the statement in IAS 34.28.

Example E.5 – Interim financial reporting and impairment

Entity A prepares quarterly filings and therefore in accordance with IAS 36.9, Entity A assesses at the end of its first quarter (31 March 20X0) whether there is any indication that its assets are impaired. As an indicator is present, Entity A performs impairment testing for various assets and CGUs which include allocated goodwill. Ultimately, Entity A writes down certain assets and its goodwill balances as at 31 March 20X0.

By 31 December 20X0, conditions improve and indicate that the impairment loss recognised in the first quarter no longer exists, triggering Entity A to determine the recoverable amount for the same assets and CGUs.

Entity A reverses impairment losses recognised in prior periods for all assets (subject to the ceilings discussed in Section D.3.4), with the exception of goodwill as reversals of impairment losses for goodwill are prohibited (IAS 36.114, 124).

4.2 IAS 36 and IAS 10 'Events after the Reporting Period'

IAS 10 provides guidance on whether an entity should adjust its financial statements for events that occur after the reporting period and prescribes related disclosures. In summary, adjustments are made for events that provide evidence of conditions that existed at the end of the reporting period while no adjustments are made for events that are indicative of conditions that arose after the end of the reporting period (IAS 10.3). An event such as physical damage arising after the reporting period would clearly be non-adjusting.

The impact of evidence that becomes available after the reporting period about adverse changes in economic performance or the external environment may require more detailed evaluation. Judgement may be required to decide whether the underlying adverse condition existed at the period-end.
If an entity concludes that an event after period-end is indicative of conditions that arose after the reporting period (ie a non-adjusting event), disclosure in accordance with IAS 10 may still be necessary.

Practical insight – IAS 36 and IAS 10

Practical issues arise in this area where management receives information after the period-end that may be evidence of an impairment loss (or reversal) indicator as at the period-end (eg, after the period-end, a competitor launches a new, superior product that will significantly and negatively impact the business or new information becomes available related to a key input in the entity's VIU estimate, such as a change in commodity prices, which makes current assumptions unsupportable). Management must carefully consider all particular facts and circumstances when such instances arise. Generally, these practical issues arise only when an entity uses VIU to estimate the recoverable amount of an asset, CGU or groups of CGUs as fair value estimates are generally not updated for changes in fair value after the period-end (IAS 10.11 and IFRS 13).

4.3 IAS 36 and IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations'

Once an asset meets the criteria to be classified as held for sale (or is included in a disposal group that is classified as held for sale), it is excluded from the scope of IAS 36 and included within the scope of IFRS 5. However, immediately prior to reclassification to IFRS 5, any impairment is recognised in accordance with the provisions outlined in IAS 36.

Practical insight – IAS 36 and IFRS 5 as noted by regulators

Plans to dispose of assets may be an indicator that the asset(s) may be impaired and may accordingly trigger impairment testing procedures (IAS 36.12(f)). Any impairments (or reversals of previous impairments) are recognised before the entity classifies the asset(s) as held for sale (IFRS 5.18). Where the statement of comprehensive income shows a loss from discontinued operations (including asset disposals), but the entity did not recognise any impairment loss in prior periods, this has been identified as a red flag for regulators, and in some cases, regulators have investigated further.

For more information on IFRS 5, see GTIL IFRS Guide: 'Non-current Assets Held For Sale and Discontinued Operations – Challenges in applying IFRS 5'.

4.4 IAS 36 and IAS 37 'Provisions, Contingent Liabilities and Contingent Assets'

The interaction between IAS 36 and IAS 37 in relation to restructuring plans and VIU is explained in Section D.1.3.1.

Another interaction arises in relation to onerous contracts. IAS 37.69 requires that an entity recognises any impairment loss that has occurred on assets dedicated to a contract before recognising an onerous contract provision. For example, a lessee in an operating lease of property that might have become onerous would test any leasehold improvements for impairment before recognising and measuring a provision for the onerous lease.

F. Disclosures

Section F: Disclosures

This Section provides a summary of the IAS 36 disclosure requirements and highlights particular areas of focus for regulators, including select illustrative examples for these areas of focus.

1 Summary of IAS 36 disclosure requirements

IAS 36 prescribes the disclosure requirements when an entity recognises an impairment loss and/or reversal during the reporting period. IAS 36 also requires the disclosure of information used in estimating the recoverable amount where goodwill or indefinite-life intangible assets have been allocated to a CGU (or group of CGUs) for impairment review purposes (whether or not any impairment loss or reversal was recognised).

Figure F.1 summarises the 'categories' of disclosure requirements outlined in IAS 36 while Figure F.2 summaries the detailed disclosure requirements for each category. For the purposes of Figure F.2, 'key assumptions' are those to which the asset's (or CGU's) recoverable amount is the most sensitive.

Figure F.1 – IAS 36 disclosure categories

Section reference within Figure F.2	IAS 36 disclosure category
1.	**For each class of assets**
2.	**When a material impairment loss has been recognised or reversed during the period**
3.	**Where goodwill or indefinite-life intangible assets allocated to a CGU (or group of CGUs) is significant in comparison with the entity's total carrying amount of each**
4.	**Where goodwill or indefinite-life intangible assets is allocated across multiple CGUs (or groups of CGUs) and the amount allocated is not significant in comparison with the entity's total carrying amount of each**
5.	**Other**

Figure F.2 – Summary of disclosure requirements of IAS 36

Section 1: For each class of assets

IAS 36 disclosure area	Required disclosures
Impairment losses or reversals recognised in profit or loss during the period (IAS 36.126(a),(b))	• amount of impairment losses recognised in profit or loss during the period • line item(s) of the statement of comprehensive income within which the impairment loss was recognised • amount of reversals of impairment losses recognised in profit or loss during the period • line item(s) of the statement of comprehensive income within which the impairment loss was reversed
Impairment losses or reversals on revalued assets (IAS 36.126(c),(d))	• amount of impairment losses on revalued assets recognised in OCI during the period • amount of reversals of impairment losses on revalued assets recognised in OCI during the period
If segment information is disclosed (IAS 36.129(a),(b))	• amount of impairment losses and reversals of impairment losses recognised in profit or loss and OCI during the period for each reportable segment

Section 2: When a material impairment loss has been recognised or reversed during the period

IAS 36 disclosure area	Required disclosures
For each individual asset (including goodwill or a CGU) (IAS 36.130(a),(b),(e))	• events and circumstances that led to the recognition or reversal of the impairment loss • amount of the impairment loss recognised or reversed • recoverable amount of the asset or CGU* • whether the recoverable amount of the asset or CGU is FVLCOD or VIU
For individual assets (IAS 36.130(c)(i),(ii))	• nature of the asset • asset's reportable segment, if the entity reports segment information
For a CGU (IAS 36.130(d)(i)-(iii))	• description of the CGU • amount of the impairment loss recognised or reversed by class of assets and by reportable segment (if the entity reports segment information) • description of the current and former way of aggregating assets and the reasons for changing the way the CGU is identified, if changed since the previous estimate of the CGU's recoverable amount
If recoverable amount is FVLCOD* (IAS 36.130(f)(i)-(iii))	• level of the fair value hierarchy (see IFRS 13) within which the fair value of the asset or CGU is categorised in its entirety (without taking into account whether the 'costs of disposal' are observable) • for fair value measurements categorised within Level 2 and Level 3 of the fair value hierarchy: – a description of the valuation technique(s) used to measure FVLCOD – a change in valuation technique and the reason(s) for making such change, if applicable – each key assumption on which management has based its determination of FVLCOD – discount rate(s) used in the current and previous measurement if FVLCOD is measured using a present value technique
If recoverable amount is VIU (IAS 36.130(g))	• discount rate(s) used in the current and previous estimate (if any) of VIU
Where an entity does not disclose information above in accordance with paragraph IAS 36.130 (IAS 36.131(a)(b))	• for aggregate impairment losses and reversals recognised during the period: – main classes of assets affected by the impairment losses and reversals – main events and circumstances that led to the recognition of these impairment losses and reversals

*See guidance note below

Section 3: Where goodwill or indefinite-life intangible assets allocated to a CGU (or group of CGUs) is significant in comparison with the entity's total carrying amount of each

IAS 36 disclosure area	Required disclosures
General (IAS 36.134(a),(b),(c),(f))	• carrying amount of goodwill or indefinite-life intangible assets allocated to the CGU (or groups of CGUs) • basis on which recoverable amount was determined for the group (FVLCOD or VIU)* • if a reasonably possible change in a key assumption on which management has based its determination of the CGU (or group of CGUs') recoverable amount would cause the carrying amount to exceed its recoverable amount: – amount by which the CGU's (or group of CGUs') recoverable amount exceeds its carrying amount – value assigned to the key assumption – amount by which the value assigned to the key assumption must change in order for the CGU's (or group of CGUs') recoverable amount to be equal to its carrying amount (after incorporating any consequential effects of that change on the other variables used to measure recoverable amount)
Where recoverable amount is based on VIU (IAS 36.134(d)(i)-(v))	• each key assumption on which management has based its cash flow projections for the period covered by the most recent budgets/forecasts • a description of management's approach to determining the value(s) assigned to each key assumption • whether those value(s) reflect past experience or are consistent with external sources of information (if applicable) and, if not, how and why they differ from past experience or external sources of information • period over which management has projected cash flows based on financial budgets/forecasts approved by management • explanation of why a longer period is justified where a period greater than five years is used • growth rate used to extrapolate cash flows projections beyond the period covered by the most recent budgets/forecasts • where the growth rate used to extrapolate cash flow projections exceeds the long-term average growth rate for the products, industries, or country or countries in which the entity operates, or the market to which the CGU (or groups of CGUs) is dedicated, the justification for using such growth rate • discount rate(s) applied to the cash flow projections
Where recoverable amount is based on FVLCOD (IAS 36.134(e)(i)-(v))	• valuation technique(s) used to measure FVLCOD** • where FVLCOD is not measured using a quoted price for an identical unit (or group of units): – each key assumption on which management has based its determination of fair value less cost of disposal – description of management's approach to determining the value (or values) assigned to each key assumption – whether those value(s) reflect past experience or are consistent with external sources of information (if applicable) and, if not, how and why they differ from past experience or external sources of information – level of the fair value hierarchy (see IFRS 13) within which the fair value measurement is categorised in its entirety (without giving regard to the observability of 'costs of disposal') – where there has been a change in valuation technique, the reason(s) for the change • where FVLCOD is measured using discounted cash flow projections, an entity shall disclose the following information: – the period over which management has projected cash flows – the growth rate used to extrapolate cash flow projections – the discount rate(s) applied to the cash flow projections

**Entities follow disclosure requirements in IAS 36 instead of IFRS 13 when using FVLCOD (scope exception in IFRS 13)

Section 4: Where goodwill or indefinite-life intangible assets is allocated across multiple CGUs (or groups of CGUs) and the amount allocated is not significant in comparison with the entity's total carrying amount of each

IAS 36 disclosure area	Required disclosures
General (IAS 36.135)	• disclose that fact • aggregate carrying amount of the goodwill or indefinite life intangible assets allocated to those units
Where recoverable amounts of any of the CGUs are based on the same key assumption(s) and the aggregate carrying amount of goodwill or indefinite-life intangible assets allocated to them is significant in comparison with the entity's total carrying amount of each (IAS 36.135(a)-(e))	• disclose that fact • aggregate carrying amount of goodwill allocated to those CGUs (groups of CGUs) • aggregate carrying amount of indefinite-life intangible assets allocated to those CGUs (groups of CGUs) • description of management's approach to determining the value(s) assigned to each key assumption • whether those value(s) reflect past experience or are consistent with external sources of information (if applicable) and, if not, how and why they differ from past experience or external sources of information • if a reasonably possible change in key assumption(s) would cause the aggregate of the CGUs' (groups of CGUs') carrying amounts to exceed the aggregate of their recoverable amounts: – the amount by which the aggregate of the CGUs' (or group of CGUs') recoverable amount exceeds the aggregate of their carrying amounts – the value(s) assigned to the key assumption(s) • amount by which the value(s) assigned to the key assumption(s) must change in order for the aggregate of the CGUs' (or group of CGUs') recoverable amount to be equal to the aggregate of their carrying amounts (after incorporating any consequential effects of that change on the other variables used to measure recoverable amount)

Section 5: Other

IAS 36 disclosure area	Required (or encouraged where noted) disclosures
For all assets or CGUs where the entity has estimated recoverable amount (IAS 36.132)	• assumptions used to determine the recoverable amount of assets (and CGUs) during the period (encouraged, not required)***
Where any portion of goodwill acquired in a business combination during the period has not been allocated to a CGU at the end of the reporting period (IAS 36.133)	• amount of the unallocated goodwill, together with the reasons why that amount remains unallocated
Where the preceding period's recoverable amount calculation of a CGU (group of CGUs) is carried forward in accordance with IAS 36.24 or IAS 36.99 (IAS 36.136)	• information required by IAS 36.134 and IAS 36.135 using the information related to the carried forward calculation of the recoverable amount

***This disclosure is encouraged, not required, in the case outlined, but this disclosure is required where estimates to measure the recoverable amount of a CGU (or groups of CGUs) contain goodwill or indefinite-life intangible assets.

***Guidance note**

These disclosures are impacted by (and incorporate) the IASB's issuance of 'Recoverable Amount Disclosures for Non-Financial Assets: Amendments to IAS 36' (the Amendments) in May 2013. The Amendments accomplish three objectives:

- corrects an unintended disclosure requirement in IAS 36 (amended IAS 36.134(c),(e)). When the IASB issued IFRS 13, it intended to amend IAS 36 to require the disclosure of information about the recoverable amount of impaired assets if the amount was based on FVLCOD; however, the actual amendments made resulted in a requirement to disclose the recoverable amount for each CGU for which the carrying amount of goodwill or indefinite-life intangible assets is significant in comparison with the entity's total carrying amount of each
- amends IAS 36 to require additional information about the fair value measurement when the recoverable amount of impaired assets is based on FVLCOD (IAS 36.130(f)(i)-(iii))
- requires an entity to disclose the discount rates that have been used in the current and previous measurements if the recoverable amount of impaired assets based on FVLCOD was measured using a present value technique (thereby harmonising the disclosure requirements for FVLCOD and VIU when present value techniques are used to measure the recoverable amount of impaired assets (IAS 36.130(f)(iii)).

The Amendments must be applied retrospectively for annual periods beginning on or after 1 January 2014, while early application is permitted. An entity should not apply the Amendments in periods in which it does not apply IFRS 13.

Practical insight – if adopting IFRS 13, but not adopting the Amendments to IAS 36

A consequence of adopting IFRS 13, but not yet adopting (or not early adopting) the Amendments discussed above means the entity technically will need to comply with the unintended disclosure requirements discussed in the Guidance note above (disclosing the recoverable amount of CGUs or groups of CGUs where goodwill and/or indefinite-life intangible assets have been allocated and are significant when compared to the entity's total carrying amount of each, despite no impairment loss or reversal being recognised with respect to these CGUs or groups of CGUs).

2 Application issues (as noted by regulators)

In recent years, regulators around the world have focused on the IAS 36 disclosure requirements, noting areas where financial statements filed with the various regulators 'fall short' in their view. Figure F.3 highlights areas of consistent focus by regulators, including common criticism by area of focus, including the following:

Figure F.3 – Common IAS 36 disclosure criticisms as noted by regulators

IAS 36 disclosure requirement	Criticism by regulators	Illustrative example
Explanation of the events and circumstances that contributed to the impairment loss or reversal (IAS 36.130(a))	• disclosures were too broad and did not provide entity-specific factors of the main events and circumstances that resulted in the impairment	Example 1
Description of the entity's CGU when it recognises or reverses an impairment loss for the CGU during the period (IAS 36.130(d)(i))	• disclosures did not provide a description of the CGU or such description lacked substance and/or entity-specific information; therefore, financial statement users did not have sufficient context regarding the impact of the impairment on the overall activities and operations of the entity	Example 2
Explanation of the basis of key assumptions and the valuation approach used to determine the recoverable amount (IAS 36.132(encouraged), 134(d)(i)-(v), (e)(i)-(v), 135(d))	• disclosures did not always discuss key assumptions and for those that did, many did not contain sufficient detail that would provide meaningful information to investors • key assumptions incorporate more than the discount rate and growth rate, consistent with Illustrative Example 9 in IAS 36 (eg gross margin, government bond rates, exchange rate for the period, raw material price inflation, market share, etc.) • comparative information is required	Example 3
Where goodwill or indefinite life intangibles have been allocated to a CGU (or group of CGUs), but no impairment has been recognised, reasonably possible changes in assumptions if such changes would cause the unit's carrying amount to exceed its recoverable amount (IAS 36.134(f), IAS 36.135(e))	• disclosures did not always contain a sensitivity analysis and for those that did, there was a lack in consistency of the analyses provided • where equity book value exceeds market capitalisation, some regulators would expect to see a transparent sensitivity analysis • sensitivity analyses should incorporate all key assumptions (beyond discount rate and growth rate)	Example 4

Practical insight – Recent regulatory activity related to IAS 36 disclosure requirements

ESMA defined its European Common Enforcement Priorities (Priorities) for 2013 in a press release dated 11 November 2013 (ESMA/2013/1635). The Priorities are used by European Economic Area (EEA) national authorities in their assessment of listed companies' 2013 financial statements in order to promote the consistent application of IFRS across the EEA. One of the five Priorities was the application of IFRS in relation to 'Impairment of non-financial assets'. ESMA will collect data on how European listed entities have applied the Priorities and will publish its findings in 2014.

Similarly, the Office of the Chief Accountant of the Ontario Securities Commission (OSC) published a bulletin in September 2013 (OSC Staff Notice 52-721) highlighting observations about asset impairment disclosures with the objective of providing useful information to market participants that may assist in preparing future financial reports.

3 Select illustrative examples

This Section illustrates the areas of common criticism by regulators as highlighted in Figure F.3 above.

This Section is not intended to illustrate all of the required disclosures in all circumstances. The form and content of the disclosures will depend on the specific facts and circumstances surrounding each entity's impairment review. Accordingly, these illustrative disclosures should be amended, amplified or abbreviated to reflect such specific circumstances.

The illustrative disclosures presented below are excerpts from the 31 December 2013 consolidated financial statements of a fictional company: Illustrative Corporation and subsidiaries (the Group). The Group provides consulting on IT and telecommunications systems, in addition to online sales of hardware and software products of the Group's business partners. Select disclosures for the Group are as follows:

Example disclosure	Topic
1.	**Explanation of the events and circumstances that contributed to the impairment loss or reversal (IAS 36.130(a))**
2.	**Description of the entity's CGU when it recognises or reverses an impairment loss for the CGU during the period (IAS 36.130(d)(i))**
3.	**Explanation of the basis of key assumptions and the valuation approach used to determine the recoverable amount (IAS 36.132(encouraged), 134(d)(i)-(v), (e)(i)-(v), 135(d))**
4.	**Reasonably possible changes in assumptions (IAS 36.134(f), IAS 36.135(e))**

Example 1: Explanation of the events and circumstances that contributed to the impairment loss (IAS 36.130(a))

IAS 36.130(a)	The Group considers both qualitative and quantitative factors when determining whether an asset or CGU may be impaired. The Group noted the following indications of impairment for the consulting segment (considered a CGU for impairment testing purposes) and its internally developed software: *Consulting segment* The forecast was adjusted in 2012 for the decline in consulting services related to conventional telecommunication solutions. The market shifted considerably towards inter- and intranet based solutions during 2012 and continued in 2013. As a result, management expects lower growth and moderately declining profit margins for this segment. *Internally developed software* Alternative software products were developed by a competitor during 2013 that offer functionality that are not presently incorporated in the Group's products. Management's expectation is that the market will shift considerably towards other alternative software products and will significantly reduce future revenues and profits in the next two to three years.

Example 2: Description of the entity's CGU when it recognises or reverses an impairment loss for the CGU during the period (IAS 36.130(d)(i))

IAS 36.130(d)(i)	For the purposes of assessing impairment, the Group's assets are grouped and reviewed for impairment at the CGU level (determined by management as equivalent to its operating segments). The Group has identified two service lines as its operating segments: consulting and retail. Assets related to each segment and the cash inflows generated by each are separately identifiable and independent of other assets or groups of assets. Internal management reporting is organised to monitor revenues at an operating segment-level basis while management makes strategic decisions about continuing or exiting operations on the basis of operating segment results. An impairment loss was recognised for the consulting segment during the period.

Example 3: Explanation of the basis of key assumptions and the valuation approach used to determine the recoverable amount (IAS 36.132(encouraged), 134(d)(i)-(v), (e)(i)-(v), 135(d))

For the purpose of annual impairment testing, goodwill is allocated to the operating segments expected to benefit from the synergies of the business combinations in which the goodwill arises. The carrying amount of goodwill allocated to the retail and consulting segments was deemed to be significant in comparison with the total carrying amount of goodwill and was allocated as follows:

	2013 CU000	2012 CU000
Retail	4,796	2,493
Consulting	245	1,044
Goodwill at 31 December	**5,041**	**3,537**

Excerpt from the discussion of the Retail Segment

IAS 36.134(d)(i)
IAS 36.134(d)(ii)

The recoverable amount of the retail segment was determined based on value-in-use calculations. The following paragraphs describe the key assumptions on which management has based its cash flow projections for the period covered by the most recent budgets/forecasts and a description of management's approach to determining the value(s) assigned to each key assumption:

Key assumptions

Management's key assumptions include:

- stable profit margins, based on past experience in this market (consistent with 2012). The Group's management believes that this is the best available input for forecasting this mature market. Cash flow projections reflect stable profit margins achieved immediately before the budget period. No expected efficiency improvements have been taken into account and prices and wages reflect publicly available forecasts of inflation for the industry.
- forward exchange rates (USD/GBP) based on the average market forward exchange rate for the budget period (consistent with 2012). Management obtains quoted rates from external sources of information. The exchange rate is estimated to be consistent with the average market forward exchange rate over the budget period.
- budgeted market share based on the average market share for the previous two periods, increased by the historical growth rate. Management anticipates that market share will continue to grow by 2-3% per year for the next 5 years (2-3% estimated in 2012) due to its continued success in Europe.

IAS 36.134(d)(iii) **Cash flow projections**

Cash flow projections are based on management's approved three-year budgets, followed by an extrapolation of expected cash flows for the remaining useful lives using growth rates determined by management as outlined below:

IAS 36.134(d)(iv)
IAS 36.134(d)(v)

	Growth rates		Discount rates	
	2013	2012	2013	2012
Retail	3.0%	3.0%	9.3%	9.5%
Consulting	0.1%	0.5%	10.9%	10.1%

	Growth rates The growth rates reflect the long-term average growth rates for the product lines and industries of the segments (all publicly available). The growth rate for the retail segment exceeds the overall long-term average growth rates for Europe because this sector is expected to continue to grow at above-average rates for the foreseeable future. **Discount rates** The present value of the expected cash flows of each segment is determined by applying a suitable discount rate. The discount rate was derived based on WACC for comparable entities in the IT industry, based on market data. The discount rates reflect appropriate adjustments relating to market risk and specific risk factors of each segment (incorporating adjustments for geographic location and currency risk). Management considered cash flows for the consulting segment to be more volatile due to the number of new consulting entities emerging in this space. Further, management considered the maturity and stability of the retail segment when determining the appropriate adjustments to this rate.

Example 4: Reasonably possible change in assumptions (IAS 36.134(f), 135(e))

IAS 36.134(f)	After considering all key assumptions, management considers that a reasonably possible change in only the following assumptions would cause the Retail segment's carrying amount to exceed its recoverable amount: **Discount rate** If the discount rate currently used of 9.3% (9.5% 2012) decreased by 2.4% (after incorporating any consequential effects of the change on other inputs used in the recoverable amount estimate), the CGU's recoverable amount would be equal to its carrying amount. This analysis incorporated reasonable changes in other key inputs into the discount rate including foreign currency, market risk premium, and the cost of debt. **Stable profit margins** If the assumed profit margins deviate by more than 5% (after incorporating any consequential effects of the change on other inputs used in the recoverable amount estimate), the CGU's recoverable amount would be equal to its carrying amount.

Guidance note

See Illustrative Example 9 in IAS 36 which illustrates the disclosures required by IAS 36.134-135.

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