Hong Kong Institute of Certified Public Accountants 香港會計師公會

MEMBERS' HANDBOOK

Update No. 149

(Issued 24 June 2014)

Handbook Improvements only

Document Reference and Title	***Instructions***	***Explanations***

VOLUME II

Contents of Volume II	Insert the revised pages i - ii. Discard the replaced pages i - ii.	Revised contents pages

Amendments to the following Standards, Basis for Conclusions and Implementation Guidance were previously set out in the Appendix to the Standards as they were not yet effective. The Institute has taken this opportunity to incorporate the amendments applicable on 1 January 2013 in the relevant affected Standards, Basis for Conclusions and Implementation Guidance, for greater clarity.

HONG KONG ACCOUNTING STANDARDS (HKAS)

HKAS 36 *Impairment of Assets* (Standard and Basis for Conclusions) HKAS 36 *Impairment of Assets* (Illustrative Examples)	Replace the Standard and Basis for Conclusions with revised Standard and Basis for Conclusions. Replace the cover page, pages 2, 7, 12, 16, 24 and 27 with revised cover page, pages 2, 7, 12, 16, 24 and 27.	Amendments due to - HKAS 19 *Employee Benefits* (2011) - HKFRS 10 *Consolidated Financial Statements* - HKFRS 11 *Joint Arrangements* - HKFRS 13 *Fair Value Measurement*
HKAS 40 *Investment Property*	Replace the cover page, pages 2-20, 25, 30, 32-35 and 37 with revised cover page, pages 2-20, 25, 30, 32-35 and 37. Discard page 38.	Amendments due to - HKAS 19 *Employee Benefits* (2011) - HKFRS 13 *Fair Value Measurement*

HKAS 41 *Agriculture* (Standard)	Replace the cover page and pages 2-18 with revised cover page and pages 2-18.	Amendments due to - HKFRS 13 *Fair Value Measurement*
HKAS 41 *Agriculture* (Basis for Conclusions)	Replace the cover page, pages 2-4, 8-10 and 13 with revised cover page, pages 2-4, 8-10 and 13. Discard page 20.	

HONG KONG FINANCIAL REPORTING STANDARDS (HKFRS)

HKFRS 2 *Share-based Payment* (Standard)	Replace the cover page, pages 2-4, 9, 23 and 26 with revised cover page, pages 2-4, 9, 23 and 26.	Amendments due to - HKAS 19 *Employee Benefits* (2011) - HKFRS 10 *Consolidated Financial Statements* - HKFRS 11 *Joint Arrangements* - HKFRS 13 *Fair Value Measurement*
HKFRS 2 *Share-based Payment* (Basis for Conclusions)	Replace the cover page, pages 2-4, 11, 14, 16, 18, 53 and 65 with revised cover page, pages 2-4, 11, 14, 16, 18, 53 and 65.	
HKFRS 4 *Insurance Contracts* (Standard)	Replace the cover page, pages 2-4, 18 and 20 with revised cover page, pages 2-4, 18 and 20.	Amendments due to - HKFRS 10 *Consolidated Financial Statements* - HKFRS 13 *Fair Value Measurement*
HKFRS 4 *Insurance Contracts* (Basis for Conclusions)	Replace the cover page, pages 2-4, 6-7, 33, 39, 41, 49 and 58 with revised cover page, pages 2-4, 6-7, 33, 39, 41, 49 and 58.	
HKFRS 4 *Insurance Contracts* (Implementation Guidance)	Replace the cover page, pages 2-3, 10 and 19 with revised cover page, pages 2-3, 10 and 19.	
HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* (Standard)	Replace the cover page, pages 2-4, 12-13, 16 and 18 with revised cover page, pages 2-4, 12-13, 16 and 18.	Amendments due to - *Presentation of Items of Other Comprehensive Income* (Amendment to HKAS 1) - HKFRS 10 *Consolidated Financial Statements* - HKFRS 11 *Joint Arrangements* - HKFRS 13 *Fair Value Measurement*
HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* (Basis for Conclusions)	Replace the cover page, pages 2, 5, 8, 14 and 17-18 with revised cover page, pages 2, 5, 8, 14 and 17-18. Insert page 17A after page 17.	
HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* (Implementation Guidance)	Replace the cover page, pages 2, 4, 6 and 11 with revised cover page, pages 2, 4, 6 and 11.	

HKFRS 8 *Operating Segments* (Standard)	Replace the cover page, pages 2-4 and 12 with revised cover page, pages 2-4 and 12.	Amendments due to - HKAS 19 *Employee Benefits* (2011) - HKFRS 10 *Consolidated Financial Statements*
HKFRS 8 Operating Segments (Basis for Conclusions)	Replace the cover page, pages 2 and 7 with revised cover page, pages 2 and 7.	

Hong Kong Institute of Certified Public Accountants
香港會計師公會

MEMBERS' HANDBOOK
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(Updated to June 2014)

HKAS 36
Revised ~~June 2013~~June 2014

Hong Kong Accounting Standard 36

Impairment of Assets

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

CONTENTS

Hong Kong Accounting Standard 36 *Impairment of Assets* (HKAS 36) is set out in paragraphs 1-141 and Appendices A - D. All the paragraphs have equal authority. HKAS 36 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for ~~the Preparation and Presentation of~~ Financial ~~Statements~~Reporting*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

IN1 Hong Kong Accounting Standard 36 *Impairment of Assets* (HKAS 36) replaces SSAP 31 *Impairment of Assets* (issued in 2001), and should be applied:

(a) on acquisition to goodwill and intangible assets acquired in business combinations for which the agreement date is on or after 1 January 2005.

(b) to all other assets, for annual periods beginning on or after 1 January 2005.

Earlier application is encouraged.

Reasons for issuing HKAS 36

IN2 Pursuant with its convergence policy, the Hong Kong Institute of Certified Public Accountants ("HKICPA") issues HKAS 36 as part of its project on business combinations to converge with the International Accounting Standard Board ("the Board")'s project on business combinations. The project's objective was to improve the quality of the accounting for business combinations and the subsequent accounting for goodwill and intangible assets acquired in business combinations.

IN3 The project had two phases. The first phase resulted in the HKICPA issuing simultaneously in 2004 HKFRS 3 *Business Combinations* and HKAS 36 and HKAS 38 *Intangible Assets* to converge with IFRS 3 and revised versions of IAS 36 and IAS 38 issued by the Board. The first phase of the project focused primarily on the following issues:

(a) the method of accounting for business combinations;

(b) the initial measurement of the identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination;

(c) the recognition of provisions for terminating or reducing the activities of an acquiree;

(d) the treatment of any excess of the acquirer's interest in the fair values of identifiable net assets acquired in a business combination over the cost of the combination; and

(e) the accounting for goodwill and intangible assets acquired in a business combination.

IN4 The second phase of the project resulted in the HKICPA issuing simultaneously in 2008 a revised HKFRS 3 and amendments to HKAS 27 *Consolidated and Separate Financial Statements*[*] to converge with a revised IFRS 3 and amendments to IAS 27 issued by the Board. The HKICPA's intention while issuing HKAS 36 was to reflect only those changes resulting from the Business Combinations project, and *not* to reconsider all of the previous requirements in SSAP 31. The changes are primarily concerned with the impairment test for goodwill.

[*] The consolidation requirements in HKAS 27 were superseded by HKFRS 10 *Consolidated Financial Statements*, issued in June 2011.

Summary of main changes

Frequency of impairment testing

IN5 SSAP 31 required the recoverable amount of an asset to be measured whenever there is an indication that the asset may be impaired. This requirement is included in the Standard. However, the Standard also requires:

(a) the recoverable amount of an intangible asset with an indefinite useful life to be measured annually, irrespective of whether there is any indication that it may be impaired. The most recent detailed calculation of recoverable amount made in a preceding period may be used in the impairment test for that asset in the current period, provided specified criteria are met.

(b) the recoverable amount of an intangible asset not yet available for use to be measured annually, irrespective of whether there is any indication that it may be impaired.

(c) goodwill acquired in a business combination to be tested for impairment annually.

Measuring value in use

IN6 The Standard clarifies that the following elements should be reflected in the calculation of an asset's value in use:

(a) an estimate of the future cash flows the entity expects to derive from the asset;

(b) expectations about possible variations in the amount or timing of those future cash flows;

(c) the time value of money, represented by the current market risk-free rate of interest;

(d) the price for bearing the uncertainty inherent in the asset; and

(e) 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 Standard also clarifies that the second, fourth and fifth of these elements can be reflected either as adjustments to the future cash flows or adjustments to the discount rate.

IN7 The Standard carries forward from SSAP 31 the requirement for the cash flow projections used to measure value in use to be based on reasonable and supportable assumptions that represent management's best estimate of the economic conditions that will exist over the remaining useful life of the asset. However, the Standard clarifies that management:

(a) should assess the reasonableness of the assumptions on which its current cash flow projections are based by examining the causes of differences between past cash flow projections and actual cash flows.

(b) should ensure that the assumptions on which its current cash flow projections are based are consistent with past actual outcomes, provided the effects of subsequent events or circumstances that did not exist when those actual cash flows were generated make this appropriate.

IN8 SSAP 31 required the cash flow projections used to measure value in use to be based on the most recent financial budgets/ forecasts approved by management. The Standard carries forward this requirement, but clarifies that the cash flow projections exclude any estimated cash inflows or outflows expected to arise from:

(a) future restructurings to which the entity is not yet committed; or

(b) improving or enhancing the asset's performance.

IN9 Additional guidance on using present value techniques in measuring an asset's value in use is included in Appendix A of the Standard. In addition, the guidance in SSAP 31 on estimating the discount rate when an asset-specific rate is not directly available from the market has been relocated to Appendix A.

Identifying the cash-generating unit to which an asset belongs

IN10 The Standard carries forward from SSAP 31 the requirement that if an active market exists for the output produced by an asset or a group of assets, that asset or group of assets should be identified as a cash-generating unit, even if some or all of the output is used internally. However, SSAP 31 required that, in such circumstances, management's best estimate of future market prices for the output should be used in estimating the future cash flows used to determine the unit's value in use. It also required that when an entity was estimating future cash flows to determine the value in use of cash-generating units using the output, management's best estimate of future market prices for the output should be used. The Standard requires that if the cash inflows generated by *any* asset or cash-generating unit are affected by internal transfer pricing, an entity should use management's best estimate of future price(s) that could be achieved in arm's length transactions in estimating:

(a) the future cash inflows used to determine the asset's or cash-generating unit's value in use; and

(b) the future cash outflows used to determine the value in use of other assets or cash-generating units affected by the internal transfer pricing.

Allocating goodwill to cash-generating units

IN11 SSAP 31 required goodwill acquired in a business combination to be tested for impairment as part of impairment testing the cash-generating unit(s) to which it related. It employed a 'bottom-up/top-down' approach under which the goodwill was, in effect, tested for impairment by allocating its carrying amount to each cash-generating unit or smallest group of cash-generating units to which a portion of that carrying amount could be allocated on a reasonable and consistent basis. The Standard similarly requires goodwill acquired in a business combination to be tested for impairment as part of impairment testing the cash-generating unit(s) to which it relates. However, the Standard clarifies that:

(a) the goodwill should, from the acquisition date, be allocated to each of the acquirer's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the business combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units.

(b) each unit or group of units to which the goodwill is allocated should:

(i) represent the lowest level within the entity at which the goodwill is monitored for internal management purposes; and

(ii) not be larger than an operating segment determined in accordance with HKFRS 8 *Operating Segments*.

IN12 The Standard also clarifies the following:

(a) if the initial allocation of goodwill acquired in a business combination cannot be completed before the end of the annual period in which the business combination occurs, that initial allocation should be completed before the end of the first annual period beginning after the acquisition date.

(b) when an entity disposes of an operation within a cash-generating unit (group of units) to which goodwill has been allocated, the goodwill associated with that operation should be:

(i) included in the carrying amount of the operation when determining the gain or loss on disposal; and

(ii) measured on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit (group of units) retained, unless the entity can demonstrate that some other method better reflects the goodwill associated with the operation disposed of.

(c) when an entity reorganises its reporting structure in a manner that changes the composition of cash-generating units (groups of units) to which goodwill has been allocated, the goodwill should be reallocated to the units (groups of units) affected. This reallocation should be performed using a relative value approach similar to that used when an entity disposes of an operation within a cash-generating unit (group of units), unless the entity can demonstrate that some other method better reflects the goodwill associated with the reorganised units (groups of units).

Timing of impairment tests for goodwill

IN13 The Standard permits:

(a) the annual impairment test for a cash-generating unit (group of units) to which goodwill has been allocated to be performed at any time during an annual reporting period, provided the test is performed at the same time every year.

(b) different cash-generating units (groups of units) to be tested for impairment at different times.

However, if some of the goodwill allocated to a cash-generating unit (group of units) was acquired in a business combination during the current annual period, the Standard requires that unit (group of units) to be tested for impairment before the end of the current period.

IN14 The Standard permits the most recent detailed calculation made in a preceding period of the recoverable amount of a cash-generating unit (group of units) to which goodwill has been allocated to be used in the impairment test for that unit (group of units) in the current period, provided specified criteria are met.

Reversals of impairment losses for goodwill

IN15 SSAP 31 required an impairment loss recognised for goodwill in a previous period to be reversed when the impairment loss was caused by a specific external event of an exceptional nature that is not expected to recur and subsequent external events have occurred that reverse the effect of that event. The Standard prohibits the recognition of reversals of impairment losses for goodwill.

Disclosure

IN16 The Standard requires that if any portion of the goodwill acquired in a business combination during the period has not been allocated to a cash-generating unit at the end of the reporting period, an entity should disclose the amount of the unallocated goodwill together with the reasons why that amount remains unallocated.

IN17 The Standard requires disclosure of information for each cash-generating unit (group of units) for which the carrying amount of goodwill or intangible assets with indefinite useful lives allocated to that unit (group of units) is significant in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite lives. That information is concerned primarily with the key assumptions used to measure the recoverable amounts of such units (groups of units).

IN18 The Standard also requires specified information to be disclosed if some or all of the carrying amount of goodwill or intangible assets with indefinite lives is allocated across multiple cash-generating units (groups of units), and the amount so allocated to each unit (group of units) is not significant in comparison with the total carrying amount of goodwill or intangible assets with indefinite lives. Further disclosures are required if, in such circumstances, the recoverable amounts of any of those units (groups of units) are based on the same key assumption(s) and the aggregate carrying amount of goodwill or intangible assets with indefinite lives allocated to them is significant in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite lives.

Hong Kong Accounting Standard 36
Impairment of Assets

Objective

1 The objective of this Standard is to prescribe the procedures that an entity applies to ensure that its assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and the Standard requires the entity to recognise an impairment loss. The Standard also specifies when an entity should reverse an impairment loss and prescribes disclosures.

Scope

2 This Standard shall be applied in accounting for the impairment of all assets, other than:

(a) inventories (see HKAS 2 *Inventories*);

(b) assets arising from construction contracts (see HKAS 11 *Construction Contracts*);

(c) deferred tax assets (see HKAS 12 *Income Taxes*);

(d) assets arising from employee benefits (see HKAS 19 *Employee Benefits*);

(e) financial assets that are within the scope of HKAS 39 *Financial Instruments: Recognition and Measurement*;

(f) investment property that is measured at fair value (see HKAS 40 *Investment Property*);

(g) biological assets related to agricultural activity that are measured at fair value less costs to sell (see HKAS 41 *Agriculture*);

(h) deferred acquisition costs, and intangible assets, arising from an insurer's contractual rights under insurance contracts within the scope of HKFRS 4 *Insurance Contracts*; and

(i) non-current assets (or disposal groups) classified as held for sale in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

3 This Standard does not apply to inventories, assets arising from construction contracts, deferred tax assets, assets arising from employee benefits, or assets classified as held for sale (or included in a disposal group that is classified as held for sale) because existing HKFRSs applicable to these assets contain requirements for recognising and measuring these assets.

4 This Standard applies to financial assets classified as:

(a) subsidiaries, as defined in ~~HKAS 27~~HKFRS 10 *Consolidated ~~and Separate~~ Financial Statement*s;

(b) associates, as defined in HKAS 28 *Investments in Associates and Joint Ventures*; and

(c) joint ventures, as defined in ~~HKAS 31 *Interests in Joint Ventures*~~*HKFRS 11 Joint Arrangements*.

For impairment of other financial assets, refer to HKAS 39.

5 This Standard does not apply to financial assets within the scope of HKAS 39, investment property measured at fair value ~~in accordance with~~ within the scope of HKAS 40, or biological assets related to agricultural activity measured at fair value less costs to sell ~~in accordance with~~ within the scope of HKAS 41. However, this Standard applies to assets that are carried at revalued amount (ie fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses) in accordance with other HKFRSs, such as the revaluation model in HKAS 16 *Property, Plant and Equipment* and HKAS 38 *Intangible Assets*. The only difference between an assets fair value and its fair value less costs of disposal is the direct incremental costs attributable to the disposal of the asset. ~~Identifying whether a revalued asset may be impaired depends on the basis used to determine fair value~~:

(a) ~~if the asset's fair value is its market value, the only difference between the asset's fair value and its fair value less costs to sell is the direct incremental costs to dispose of the asset:~~

~~(i)~~ I~~i~~f the disposal costs are negligible, the recoverable amount of the revalued asset is necessarily close to, or greater than, its revalued amount ~~(ie fair value)~~. In this case, after the revaluation requirements have been applied, it is unlikely that the revalued asset is impaired and recoverable amount need not be estimated.

~~(ii) if the disposal costs are not negligible, the fair value less costs to sell of the revalued asset is necessarily less than its fair value. Therefore, the revalued asset will be impaired if its value in use is less than its revalued amount (ie fair value). In this case, after the revaluation requirements have been applied, an entity applies this Standard to determine whether the asset may be impaired.~~

(b) [deleted] ~~if the asset's fair value is determined on a basis other than its market value, its revalued amount (ie fair value) may be greater or lower than its recoverable amount. Hence, after the revaluation requirements have been applied, an entity applies this Standard to determine whether the asset may be impaired.~~

(c) If the disposal costs are not negligible, the fair value less costs of disposal of the revalued asset is necessarily less than its fair value. Therefore, the revalued asset will be impaired if its value in use is less than its revalued amount. In this case, after the revaluation requirements have been applied, an entity applies this Standard to determine whether the asset may be impaired.

Definitions

6 **The following terms are used in this Standard with the meanings specified:**

~~**An** *active market* **is a market in which all the following conditions exist:**~~
~~**(a) the items traded within the market are homogeneous;**~~
~~**(b) willing buyers and sellers can normally be found at any time; and**~~
~~**(c) prices are available to the public.**~~

Carrying amount **is the amount at which an asset is recognised after deducting any accumulated depreciation (amortisation) and accumulated impairment losses thereon.**

A *cash-generating unit* **is 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.**

Corporate assets **are assets other than goodwill that contribute to the future cash flows of both the cash-generating unit under review and other cash-generating units.**

Costs of disposal **are incremental costs directly attributable to the disposal of an asset or cash-generating unit, excluding finance costs and income tax expense.**

Depreciable amount **is the cost of an asset, or other amount substituted for cost in the financial statements, less its residual value.**

Depreciation (Amortisation) **is the systematic allocation of the depreciable amount of an asset over its useful life.***

Fair value ~~*less costs to sell*~~ ~~**is the amount obtainable from the sale of an asset or cash-generating unit in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal.**~~ **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. (See HKFRS 13** ***Fair Value Measurement.*****)**

An *impairment loss* **is the amount by which the carrying amount of an asset or a cash-generating unit exceeds its recoverable amount.**

The *recoverable amount* **of an asset or a cash-generating unit is the higher of its fair value less costs** ~~**to sell**~~ **of disposal and its value in use.**

Useful life **is either:**

(a) the period of time over which an asset is expected to be used by the entity; or

(b) the number of production or similar units expected to be obtained from the asset by the entity.

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

* In the case of an intangible asset, the term 'amortisation' is generally used instead of 'depreciation'. The two terms have the same meaning.

Identifying an asset that may be impaired

7 Paragraphs 8-17 specify when recoverable amount shall be determined. These requirements use the term 'an asset' but apply equally to an individual asset or a cash-generating unit. The remainder of this Standard is structured as follows:

(a) paragraphs 18-57 set out the requirements for measuring recoverable amount. These requirements also use the term 'an asset' but apply equally to an individual asset and a cash-generating unit.

(b) paragraphs 58-108 set out the requirements for recognising and measuring impairment losses. Recognition and measurement of impairment losses for individual assets other than goodwill are dealt with in paragraphs 58-64. Paragraphs 65-108 deal with the recognition and measurement of impairment losses for cash-generating units and goodwill.

(c) paragraphs 109-116 set out the requirements for reversing an impairment loss recognised in prior periods for an asset or a cash-generating unit. Again, these requirements use the term 'an asset' but apply equally to an individual asset or a cash-generating unit. Additional requirements for an individual asset are set out in paragraphs 117-121, for a cash-generating unit in paragraphs 122 and 123, and for goodwill in paragraphs 124 and 125.

(d) paragraphs 126-133 specify the information to be disclosed about impairment losses and reversals of impairment losses for assets and cash-generating units. Paragraphs 134-137 specify additional disclosure requirements for cash-generating units to which goodwill or intangible assets with indefinite useful lives have been allocated for impairment testing purposes.

8 An asset is impaired when its carrying amount exceeds its recoverable amount. Paragraphs 12-14 describe some indications that an impairment loss may have occurred. If any of those indications is present, an entity is required to make a formal estimate of recoverable amount. Except as described in paragraph 10, this Standard does not require an entity to make a formal estimate of recoverable amount if no indication of an impairment loss is present.

9 An entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset.

10 Irrespective of whether there is any indication of impairment, an entity shall also:

(a) test an intangible asset with an indefinite useful life or an intangible asset not yet available for use for impairment annually by comparing its carrying amount with its recoverable amount. This impairment test may be performed at any time during an annual period, provided it is performed at the same time every year. Different intangible assets may be tested for impairment at different times. However, if such an intangible asset was initially recognised during the current annual period, that intangible asset shall be tested for impairment before the end of the current annual period.

(b) test goodwill acquired in a business combination for impairment annually in accordance with paragraphs 80-99.

11 The ability of an intangible asset to generate sufficient future economic benefits to recover its carrying amount is usually subject to greater uncertainty before the asset is available for use than after it is available for use. Therefore, this Standard requires an entity to test for impairment, at least annually, the carrying amount of an intangible asset that is not yet available for use.

12 In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, the following indications:

External sources of information

(a) ~~during the period, an~~ there are observable indications that the asset's ~~market~~ value has declined during the period significantly more than would be expected as a result of the passage of time or normal use.

(b) significant changes with an adverse effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which an asset is dedicated.

(c) market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect the discount rate used in calculating an asset's value in use and decrease the asset's recoverable amount materially.

(d) the carrying amount of the net assets of the entity is more than its market capitalisation.

Internal sources of information

(e) evidence is available of obsolescence or physical damage of an asset.

(f) significant changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, plans to dispose of an asset before the previously expected date, and reassessing the useful life of an asset as finite rather than indefinite.*

(g) evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected.

Dividend from a subsidiary, joint~~ly~~ ~~controlled entity~~venture or associate

(h) for an investment in a subsidiary, jointly controlled entity or associate, the investor recognises a dividend from the investment and evidence is available that:

(i) the carrying amount of the investment in the separate financial statements exceeds the carrying amounts in the consolidated

* 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 this Standard and is accounted for in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

financial statements of the investee's net assets, including associated goodwill; or

(ii) the dividend exceeds the total comprehensive income of the subsidiary, joint~~ly~~ ~~controlled entity~~venture or associate in the period the dividend is declared.

13 The list in paragraph 12 is not exhaustive. An entity may identify other indications that an asset may be impaired and these would also require the entity to determine the asset's recoverable amount or, in the case of goodwill, perform an impairment test in accordance with paragraphs 80-99.

14 Evidence from internal reporting that indicates that an asset may be impaired includes the existence of:

(a) cash flows for acquiring the asset, or subsequent cash needs for operating or maintaining it, that are significantly higher than those originally budgeted;

(b) actual net cash flows or operating profit or loss flowing from the asset that are significantly worse than those budgeted;

(c) a significant decline in budgeted net cash flows or operating profit, or a significant increase in budgeted loss, flowing from the asset; or

(d) operating losses or net cash outflows for the asset, when current period amounts are aggregated with budgeted amounts for the future.

15 As indicated in paragraph 10, this Standard requires an intangible asset with an indefinite useful life or not yet available for use and goodwill to be tested for impairment, at least annually. Apart from when the requirements in paragraph 10 apply, the concept of materiality applies in identifying whether the recoverable amount of an asset needs to be estimated. For example, 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. Similarly, previous analysis may show that an asset's recoverable amount is not sensitive to one (or more) of the indications listed in paragraph 12.

16 As an illustration of paragraph 15, if market interest rates or other market rates of return on investments have increased during the period, an entity is not required to make a formal estimate of an asset's recoverable amount in the following cases:

(a) if the discount rate used in calculating the asset's value in use is unlikely to be affected by the increase in these market rates. For example, increases in short-term interest rates may not have a material effect on the discount rate used for an asset that has a long remaining useful life.

(b) if the discount rate used in calculating the asset's value in use is likely to be affected by the increase in these market rates but previous sensitivity analysis of recoverable amount shows that:

(i) it is unlikely that there will be a material decrease in recoverable amount because future cash flows are also likely to increase (eg in some cases, an entity may be able to demonstrate that it adjusts its revenues to compensate for any increase in market rates); or

(ii) the decrease in recoverable amount is unlikely to result in a material impairment loss.

17 If there is an indication that an asset may be impaired, this may indicate that the remaining useful life, the depreciation (amortisation) method or the residual value for the asset needs to be reviewed and adjusted in accordance with the Standard applicable to the asset, even if no impairment loss is recognised for the asset.

Measuring recoverable amount

18 This Standard defines recoverable amount as the higher of an asset's or cash-generating unit's fair value less costs ~~to sell~~ of disposal and its value in use. Paragraphs 19-57 set out the requirements for measuring recoverable amount. These requirements use the term 'an asset' but apply equally to an individual asset or a cash-generating unit.

19 It is not always necessary to determine both an asset's fair value less costs ~~to sell~~ of disposal and its value in use. If either of these amounts exceeds the asset's carrying amount, the asset is not impaired and it is not necessary to estimate the other amount.

20 It may be possible to ~~determine~~ measure fair value less costs ~~to sell~~of disposal, even if there is not a quoted price in an active market for an identical asset ~~is not traded in an active market~~. However, sometimes it will not be possible to ~~determine~~ measure fair value less costs ~~to sell~~ of disposal because there is no basis for making a reliable estimate of the ~~amount obtainable from the sale of the asset in an arm's length transaction between knowledgeable and willing parties~~ price at which an orderly transaction to sell the asset would take place between market participants at the measurement date under current market conditions. In this case, the entity may use the asset's value in use as its recoverable amount.

21 If there is no reason to believe that an asset's value in use materially exceeds its fair value less costs ~~to sell~~of disposal, the asset's fair value less costs ~~to sell~~of disposal may be used as its recoverable amount. This will often be the case for an asset that is held for disposal. This is because the value in use of an asset held for disposal will consist mainly of the net disposal proceeds, as the future cash flows from continuing use of the asset until its disposal are likely to be negligible.

22 Recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. If this is the case, recoverable amount is determined for the cash-generating unit to which the asset belongs (see paragraphs 65-103), unless either:

(a) the asset's fair value less costs ~~to sell~~of disposal is higher than its carrying amount; or

(b) the asset's value in use can be estimated to be close to its fair value less costs ~~to sell~~of disposal and fair value less costs ~~to sell~~of disposal can be ~~determined~~measured.

23 In some cases, estimates, averages and computational short cuts may provide reasonable approximations of the detailed computations illustrated in this Standard for determining fair value less costs ~~to sell~~of disposal or value in use.

Measuring the recoverable amount of an intangible asset with an indefinite useful life

24 Paragraph 10 requires an intangible asset with an indefinite useful life to be tested for impairment annually by comparing its carrying amount with its recoverable amount, irrespective of whether there is any indication that it may be impaired. However, 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:

(a) if the intangible asset does not generate cash inflows from continuing use that are largely independent of those from other assets or groups of assets and is therefore tested for impairment as part of the cash-generating unit to which it belongs, the assets and liabilities making up that unit have not changed significantly since the most recent recoverable amount calculation;

(b) the most recent recoverable amount calculation resulted in an amount that exceeded the asset's carrying amount by a substantial margin; and

(c) 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.

Fair value less costs ~~to sell~~ of disposal

25 [Deleted] ~~The best evidence of an asset's fair value less costs to sell is a price in a binding sale agreement in an arm's length transaction, adjusted for incremental costs that would be directly attributable to the disposal of the asset.~~

26 [Deleted] ~~If there is no binding sale agreement but an asset is traded in an active market, fair value less costs to sell is the asset's market price less the costs of disposal. The appropriate market price is usually the current bid price. When current bid prices are unavailable, the price of the most recent transaction may provide a basis from which to estimate fair value less costs to sell, provided that there has not been a significant change in economic circumstances between the transaction date and the date as at which the estimate is made.~~

27 [Deleted]~~If there is no binding sale agreement or active market for an asset, fair value less costs to sell is based on the best information available to reflect the amount that an entity could obtain, at the end of the reporting period, from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the costs of disposal. In determining this amount, an entity considers the outcome of recent transactions for similar assets within the same industry. Fair value less costs to sell does not reflect a forced sale, unless management is compelled to sell immediately.~~

28 Costs of disposal, other than those that have been recognised as liabilities, are deducted in ~~determining~~ measuring fair value less costs ~~to sell~~ of disposal. Examples of such costs are legal costs, stamp duty and similar transaction taxes, costs of removing the asset, and direct incremental costs to bring an asset into condition for its sale. However, termination benefits (as defined in HKAS 19) and costs associated with reducing or reorganising a business following the disposal of an asset are not direct incremental costs to dispose of the asset.

29 Sometimes, the disposal of an asset would require the buyer to assume a liability and only a single fair value less costs ~~to sell~~ of disposal is available for both the asset and the liability. Paragraph 78 explains how to deal with such cases.

Value in use

30 The following elements shall be reflected in the calculation of an asset's value in use:

(a) an estimate of the future cash flows the entity expects to derive from the asset;

(b) expectations about possible variations in the amount or timing of those future cash flows;

(c) the time value of money, represented by the current market risk-free rate of interest;

(d) the price for bearing the uncertainty inherent in the asset; and

(e) other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset.

31 Estimating the value in use of an asset involves the following steps:

(a) estimating the future cash inflows and outflows to be derived from continuing use of the asset and from its ultimate disposal; and

(b) applying the appropriate discount rate to those future cash flows.

32 The elements identified in paragraph 30(b), (d) and (e) can be reflected either as adjustments to the future cash flows or as adjustments to the discount rate. Whichever approach an entity adopts to reflect expectations about possible variations in the amount or timing of future cash flows, the result shall be to reflect the expected present value of the future cash flows, ie the weighted average of all possible outcomes. Appendix A provides additional guidance on the use of present value techniques in measuring an asset's value in use.

Basis for estimates of future cash flows

33 In measuring value in use an entity shall:

(a) base cash flow projections on reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions that will exist over the remaining useful life of the asset. Greater weight shall be given to external evidence.

(b) base cash flow projections on the most recent financial budgets/forecasts approved by management, but shall exclude any estimated future cash inflows or outflows expected to arise from future restructurings or from improving or enhancing the asset's performance. Projections based on these budgets/forecasts shall cover a maximum period of five years, unless a longer period can be justified.

(c) estimate cash flow projections beyond the period covered by the most recent budgets/forecasts by extrapolating the projections based on the budgets/forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified. This growth rate shall not

exceed the long-term average growth rate for the products, industries, or country or countries in which the entity operates, or for the market in which the asset is used, unless a higher rate can be justified.

34 Management assesses the reasonableness of the assumptions on which its current cash flow projections are based by examining the causes of differences between past cash flow projections and actual cash flows. Management shall ensure that the assumptions on which its current cash flow projections are based are consistent with past actual outcomes, provided the effects of subsequent events or circumstances that did not exist when those actual cash flows were generated make this appropriate.

35 Detailed, explicit and reliable financial budgets/forecasts of future cash flows for periods longer than five years are generally not available. For this reason, management's estimates of future cash flows are based on the most recent budgets/forecasts for a maximum of five years. Management may use cash flow projections based on financial budgets/forecasts over a period longer than five years if it is confident that these projections are reliable and it can demonstrate its ability, based on past experience, to forecast cash flows accurately over that longer period.

36 Cash flow projections until the end of an asset's useful life are estimated by extrapolating the cash flow projections based on the financial budgets/forecasts 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. If appropriate, the growth rate is zero or negative.

37 When conditions are favourable, competitors are likely to enter the market and restrict growth. Therefore, entities will have difficulty in exceeding the average historical growth rate over the long term (say, twenty years) for the products, industries, or country or countries in which the entity operates, or for the market in which the asset is used.

38 In using information from financial budgets/forecasts, an entity considers whether the information reflects reasonable and supportable assumptions and represents management's best estimate of the set of economic conditions that will exist over the remaining useful life of the asset.

Composition of estimates of future cash flows

39 Estimates of future cash flows shall include:

(a) projections of cash inflows from the continuing use of the asset;

(b) projections of cash outflows that are necessarily incurred to generate the cash inflows from continuing use of the asset (including cash outflows to prepare the asset for use) and can be directly attributed, or allocated on a reasonable and consistent basis, to the asset; and

(c) net cash flows, if any, to be received (or paid) for the disposal of the asset at the end of its useful life.

40 Estimates of future cash flows and the discount rate reflect consistent assumptions about price increases attributable to general inflation. Therefore, if the discount rate includes the effect of price increases attributable to general inflation, future cash flows are estimated in nominal terms. If the discount rate excludes the effect of price increases attributable to general inflation, future cash flows are estimated in real terms

(but include future specific price increases or decreases).

41 Projections of cash outflows include those for the day-to-day servicing of the asset as well as future overheads that can be attributed directly, or allocated on a reasonable and consistent basis, to the use of the asset.

42 When the carrying amount of an asset does not yet include all the cash outflows to be incurred before it is ready for use or sale, the estimate of future cash outflows includes an estimate of any further cash outflow that is expected to be incurred before the asset is ready for use or sale. For example, this is the case for a building under construction or for a development project that is not yet completed.

43 To avoid double-counting, estimates of future cash flows do not include:

(a) cash inflows from assets that generate cash inflows that are largely independent of the cash inflows from the asset under review (for example, financial assets such as receivables); and

(b) cash outflows that relate to obligations that have been recognised as liabilities (for example, payables, pensions or provisions).

44 Future cash flows shall be estimated for the asset in its current condition. Estimates of future cash flows shall not include estimated future cash inflows or outflows that are expected to arise from:

(a) a future restructuring to which an entity is not yet committed; or

(b) improving or enhancing the asset's performance.

45 Because future cash flows are estimated for the asset in its current condition, value in use does not reflect:

(a) future cash outflows or related cost savings (for example reductions in staff costs) or benefits that are expected to arise from a future restructuring to which an entity is not yet committed; or

(b) future cash outflows that will improve or enhance the asset's performance or the related cash inflows that are expected to arise from such outflows.

46 A restructuring is a programme that is planned and controlled by management and materially changes either the scope of the business undertaken by an entity or the manner in which the business is conducted. HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets* contains guidance clarifying when an entity is committed to a restructuring.

47 When an entity becomes committed to a restructuring, some assets are likely to be affected by this restructuring. Once the entity is committed to the restructuring:

(a) its estimates of future cash inflows and cash outflows for the purpose of determining value in use reflect the cost savings and other benefits from the restructuring (based on the most recent financial budgets/forecasts approved by management); and

(b) its estimates of future cash outflows for the restructuring are included in a restructuring provision in accordance with HKAS 37.

Illustrative Example 5 illustrates the effect of a future restructuring on a value in use calculation.

48 Until an entity 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 increase in economic benefits associated with the cash outflow (see Illustrative Example 6).

49 Estimates of future cash flows include future cash outflows necessary to maintain the level of economic benefits expected to arise from the asset in its current condition. When a cash-generating unit 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 is considered to be part of the day-to-day servicing of the unit when estimating the future cash flows associated with the unit. Similarly, when a single asset consists of components with different estimated useful lives, the replacement of components with shorter lives is considered to be part of the day-to-day servicing of the asset when estimating the future cash flows generated by the asset.

50 Estimates of future cash flows shall not include:

(a) cash inflows or outflows from financing activities; or

(b) income tax receipts or payments.

51 Estimated future cash flows reflect assumptions that are consistent with the way the discount rate is determined. Otherwise, the effect of some assumptions will be counted twice or ignored. Because the time value of money is considered by discounting the estimated future cash flows, these cash flows exclude cash inflows or outflows from financing activities. Similarly, because the discount rate is determined on a pre-tax basis, future cash flows are also estimated on a pre-tax basis.

52 The estimate of net cash flows to be received (or paid) for the disposal of an asset at the end of its useful life shall be the amount that an entity expects to obtain from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the estimated costs of disposal.

53 The estimate of net cash flows to be received (or paid) for the disposal of an asset at the end of its useful life is determined in a similar way to an asset's fair value less costs ~~to sell~~ of disposal, except that, in estimating those net cash flows:

(a) an entity uses prices prevailing at the date of the estimate for similar assets that have reached the end of their useful life and have operated under conditions similar to those in which the asset will be used.

(b) the entity adjusts those prices for the effect of both future price increases due to general inflation and specific future price increases or decreases. However, if estimates of future cash flows from the asset's continuing use and the discount rate exclude the effect of general inflation, the entity also excludes this effect from the estimate of net cash flows on disposal.

53A Fair value differs from value in use. Fair value reflects the assumptions market participants would use when pricing the asset. In contrast, value in use reflects the effects of factors that may be specific to the entity and not applicable to entities in general. For example, fair value does not reflect any of the following factors to the extent that they would not be generally available to market participants:

(a) additional value derived from the grouping of assets (such as the creation of a portfolio of investment properties in different locations);

(b) synergies between the asset being measured and other assets;

(c) legal rights or legal restrictions that are specific only to the current owner of the asset; and

(d) tax benefits or tax burdens that are specific to the current owner of the asset.

Foreign currency future cash flows

54 Future cash flows are estimated in the currency in which they will be generated and then discounted using a discount rate appropriate for that currency. An entity translates the present value using the spot exchange rate at the date of the value in use calculation.

Discount rate

55 The discount rate (rates) shall be a pre-tax rate (rates) that reflect(s) current market assessments of:

(a) the time value of money; and

(b) the risks specific to the asset for which the future cash flow estimates have not been adjusted.

56 A rate that reflects current market assessments of the time value of money and the risks specific to the asset is 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. This rate is estimated from the rate implicit in current market transactions for similar assets or from the weighted average cost of capital 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. However, the discount rate(s) used to measure an asset's value in use shall not reflect risks for which the future cash flow estimates have been adjusted. Otherwise, the effect of some assumptions will be double-counted.

57 When an asset-specific rate is not directly available from the market, an entity uses surrogates to estimate the discount rate. Appendix A provides additional guidance on estimating the discount rate in such circumstances.

Recognising and measuring an impairment loss

58 Paragraphs 59-64 set out the requirements for recognising and measuring impairment losses for an individual asset other than goodwill. Recognising and measuring impairment losses for cash-generating units and goodwill are dealt with in paragraphs 65-108.

59 If, and only if, the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset shall be reduced to its recoverable amount. That reduction is an impairment loss.

60 An impairment loss shall be recognised immediately in profit or loss, unless the asset is carried at revalued amount in accordance with another Standard (for example, in accordance with the revaluation model in HKAS 16). Any impairment loss of a revalued asset shall be treated as a revaluation decrease in accordance with that other Standard.

61 An impairment loss on a non-revalued asset is recognised in profit or loss. However, an impairment loss on a revalued asset is recognised in other comprehensive income to the extent that the impairment loss does not exceed the amount in the revaluation surplus for that same asset. Such an impairment loss on a revalued asset reduces the revaluation surplus for that asset.

62 When the amount estimated for an impairment loss is greater than the carrying amount of the asset to which it relates, an entity shall recognise a liability if, and only if, that is required by another Standard.

63 After the recognition of an impairment loss, the depreciation (amortisation) charge for the asset shall be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

64 If an impairment loss is recognised, any related deferred tax assets or liabilities are determined in accordance with HKAS 12 by comparing the revised carrying amount of the asset with its tax base (see Illustrative Example 3).

Cash-generating units and goodwill

65 Paragraphs 66-108 and Appendix C set out the requirements for identifying the cash-generating unit to which an asset belongs and determining the carrying amount of, and recognising impairment losses for, cash-generating units and goodwill.

Identifying the cash-generating unit to which an asset belongs

66 If there is any indication that an asset may be impaired, recoverable amount shall be estimated for the individual asset. If it is not possible to estimate the recoverable amount of the individual asset, an entity shall determine the recoverable amount of the cash-generating unit to which the asset belongs (the asset's cash-generating unit).

67 The recoverable amount of an individual asset cannot be determined if:

(a) the asset's value in use cannot be estimated to be close to its fair value less costs ~~to sell~~ of disposal (for example, when the future cash flows from continuing use of the asset cannot be estimated to be negligible); and

(b) the asset does not generate cash inflows that are largely independent of those from other assets.

In such cases, value in use and, therefore, recoverable amount, can be determined only for the asset's cash-generating unit.

Example
A mining entity owns a private railway to support its mining activities. The private railway could be sold only for scrap value and it does not generate cash inflows that are largely independent of the cash inflows from the other assets of the mine. *It is not possible to estimate the recoverable amount of the private railway because its value in use cannot be determined and is probably different from scrap value. Therefore, the entity estimates the recoverable amount of the cash-generating unit to which the private railway belongs, ie the mine as a whole.*

68 As defined in paragraph 6, an asset's cash-generating unit is the smallest group of assets that includes the asset and generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Identification of an asset's cash-generating unit involves judgement. If recoverable amount cannot be determined for an individual asset, an entity identifies the lowest aggregation of assets that generate largely independent cash inflows.

Example
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. *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 cash-generating unit for each route is the bus company as a whole.*

69 Cash inflows are inflows of cash and cash equivalents received from parties external to the entity. In identifying whether cash inflows from an asset (or group of assets) 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 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. Illustrative Example 1 gives examples of identification of a cash-generating unit.

70 If an active market exists for the output produced by an asset or group of assets, that asset or group of assets shall be identified as a cash-generating unit, even if some or all of the output is used internally. If the cash inflows generated by any asset or cash-generating unit are affected by internal transfer pricing, an entity shall use management's best estimate of future price(s) that could be achieved in arm's length transactions in estimating:

(a) the future cash inflows used to determine the asset's or cash-generating unit's value in use; and

(b) the future cash outflows used to determine the value in use of any other assets or cash-generating units that are affected by the internal transfer pricing.

71 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 (for example, products at an intermediate stage of a production process), this asset or group of assets forms a separate cash-generating unit 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. In using information based on financial budgets/forecasts that relates to such a cash-generating unit, or to any other asset or cash-generating unit affected by internal transfer pricing, an entity adjusts this information if internal transfer prices do not reflect management's best estimate of future prices that could be achieved in arm's length transactions.

72 Cash-generating units shall be identified consistently from period to period for the same asset or types of assets, unless a change is justified.

73 If an entity determines that an asset belongs to a cash-generating unit different from that in previous periods, or that the types of assets aggregated for the asset's cash-generating unit have changed, paragraph 130 requires disclosures about the cash-generating unit, if an impairment loss is recognised or reversed for the cash-generating unit.

Recoverable amount and carrying amount of a cash-generating unit

74 The recoverable amount of a cash-generating unit is the higher of the cash-generating unit's fair value less costs ~~to sell~~ of disposal and its value in use. For the purpose of determining the recoverable amount of a cash-generating unit, any reference in paragraphs 19-57 to 'an asset' is read as a reference to 'a cash-generating unit'.

75 The carrying amount of a cash-generating unit shall be determined on a basis consistent with the way the recoverable amount of the cash-generating unit is determined.

76 The carrying amount of a cash-generating unit:

(a) includes the carrying amount of only those assets that can be attributed directly, or allocated on a reasonable and consistent basis, to the cash-generating unit and will generate the future cash inflows used in determining the cash-generating unit's value in use; and

(b) does not include the carrying amount of any recognised liability, unless the recoverable amount of the cash-generating unit cannot be determined without consideration of this liability.

This is because fair value less costs ~~to sell~~ of disposal and value in use of a cash-generating unit are determined excluding cash flows that relate to assets that are not part of the cash-generating unit and liabilities that have been recognised (see paragraphs 28 and 43).

77 When assets are grouped for recoverability assessments, it is important to include in the cash-generating unit all assets that generate or are used to generate the relevant stream of cash inflows. Otherwise, the cash-generating unit may appear to be fully recoverable when in fact an impairment loss has occurred. In some cases, although some assets contribute to the estimated future cash flows of a cash-generating unit, they cannot be allocated to the cash-generating unit on a reasonable and consistent basis. This might be the case for goodwill or corporate assets such as head office assets. Paragraphs 80-103 explain how to deal with these assets in testing a cash-generating unit for impairment.

78 It may be necessary to consider some recognised liabilities to determine the recoverable amount of a cash-generating unit. This may occur if the disposal of a cash-generating unit would require the buyer to assume the liability. In this case, the fair value less costs ~~to sell~~ of disposal (or the estimated cash flow from ultimate disposal) of the cash-generating unit is the ~~estimated selling~~ price to sell ~~for~~ the assets of the cash-generating unit and the liability together, less the costs of disposal. To perform a meaningful comparison between the carrying amount of the cash-generating unit and its recoverable amount, the carrying amount of the liability is deducted in determining both the cash-generating unit's value in use and its carrying amount.

Example
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 cash-generating unit for the mine is the mine as a whole. The entity has received various offers to buy the mine at a price of around CU800. This price reflects the fact that the buyer will assume the obligation to restore the overburden. Disposal costs for the mine are negligible. The value in use of the mine is approximately CU1,200, excluding restoration costs. The carrying amount of the mine is CU1,000. *The cash-generating unit's fair value less costs ~~to sell~~ of disposal is CU800. This amount considers restoration costs that have already been provided for. As a consequence, the value in use for the cash-generating unit is determined after consideration of the restoration costs and is estimated to be CU700 (CU1,200 less CU500). The carrying amount of the cash-generating unit 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 cash-generating unit exceeds its carrying amount.*

* In this Standard, monetary amounts are denominated in 'currency units' (CU).

79 For practical reasons, the recoverable amount of a cash-generating unit is sometimes determined after consideration of assets that are not part of the cash-generating unit (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 cash-generating unit is increased by the carrying amount of those assets and decreased by the carrying amount of those liabilities.

Goodwill

Allocating goodwill to cash-generating units

80 For the purpose of impairment testing, goodwill acquired in a business combination shall, from the acquisition date, be allocated to each of the acquirer's cash-generating units, or groups of cash-generating units, that is expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated shall:

(a) represent the lowest level within the entity at which the goodwill is monitored for internal management purposes; and

(b) not be larger than an operating segment as defined by paragraph 5 of HKFRS 8 *Operating Segments* before aggregation.

81 Goodwill recognised in a business combination is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised. Goodwill does not generate cash flows independently of other assets or groups of assets, and often contributes to the cash flows of multiple cash-generating units. Goodwill sometimes cannot be allocated on a non-arbitrary basis to individual cash-generating units, but only to groups of cash-generating units. As a result, the lowest level within the entity at which the goodwill is monitored for internal management purposes sometimes comprises a number of cash-generating units to which the goodwill relates, but to which it cannot be allocated. References in paragraphs 83-99 and Appendix C to a cash-generating unit to which goodwill is allocated should be read as references also to a group of cash-generating units to which goodwill is allocated.

82 Applying the requirements in paragraph 80 results in goodwill being tested for impairment at a level that reflects the way an entity manages its operations and with which the goodwill would naturally be associated. Therefore, the development of additional reporting systems is typically not necessary.

83 A cash-generating unit to which goodwill is allocated for the purpose of impairment testing may not coincide with the level at which goodwill is allocated in accordance with HKAS 21 *The Effects of Changes in Foreign Exchange Rates* for the purpose of measuring foreign currency gains and losses. For example, if an entity is required by HKAS 21 to allocate goodwill to relatively low levels for the purpose of measuring foreign currency gains and losses, it is not required to test the goodwill for impairment at that same level unless it also monitors the goodwill at that level for internal management purposes.

84 If the initial allocation of goodwill acquired in a business combination cannot be completed before the end of the annual period in which the business combination is effected, that initial allocation shall be completed before the end of the first annual period beginning after the acquisition date.

85 In accordance with HKFRS 3 *Business Combinations*, if the initial accounting for a business combination can be determined only provisionally by the end of the period in which the combination is effected, the acquirer:

(a) accounts for the combination using those provisional values; and

(b) recognises any adjustments to those provisional values as a result of completing the initial accounting within the measurement period, which shall not exceed twelve months from the acquisition date.

In such circumstances, it might also not be possible to complete the initial allocation of the goodwill recognised in the combination before the end of the annual period in which the combination is effected. When this is the case, the entity discloses the information required by paragraph 133.

86 If goodwill has been allocated to a cash-generating unit and the entity disposes of an operation within that unit, the goodwill associated with the operation disposed of shall be:

(a) included in the carrying amount of the operation when determining the gain or loss on disposal; and

(b) measured on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit retained, unless the entity can demonstrate that some other method better reflects the goodwill associated with the operation disposed of.

Example
An entity sells for CU100 an operation that was part of a cash-generating unit to which goodwill has been allocated. The goodwill allocated to the unit cannot be identified or associated with an asset group at a level lower than that unit, except arbitrarily. The recoverable amount of the portion of the cash-generating unit retained is CU300. *Because the goodwill allocated to the cash-generating unit cannot be non-arbitrarily identified or associated with an asset group at a level lower than that unit, 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 cash-generating unit is included in the carrying amount of the operation that is sold.*

87 **If an entity reorganises its reporting structure in a way that changes the composition of one or more cash-generating units to which goodwill has been allocated, the goodwill shall be reallocated to the units affected. This reallocation shall be performed using a relative value approach similar to that used when an entity disposes of an operation within a cash-generating unit, unless the entity can demonstrate that some other method better reflects the goodwill associated with the reorganised units.**

Example
Goodwill had previously been allocated to cash-generating unit A. The goodwill allocated to A cannot be identified or associated with an asset group at a level lower than A, except arbitrarily. A is to be divided and integrated into three other cash-generating units, B, C and D. *Because the goodwill allocated to A cannot be non-arbitrarily identified or associated with an asset group at a level lower than A, it is reallocated to units B, C and D on the basis of the relative values of the three portions of A before those portions are integrated with B, C and D.*

Testing cash-generating units with goodwill for impairment

88 **When, as described in paragraph 81, goodwill relates to a cash-generating unit but has not been allocated to that unit, the unit shall be tested for impairment, whenever there is an indication that the unit may be impaired, by comparing the unit's carrying amount, excluding any goodwill, with its recoverable amount. Any impairment loss shall be recognised in accordance with paragraph 104.**

89 If a cash-generating unit described in paragraph 88 includes in its carrying amount an intangible asset that has an indefinite useful life or is not yet available for use and that asset can be tested for impairment only as part of the cash-generating unit, paragraph 10 requires the unit also to be tested for impairment annually.

90 **A cash-generating unit to which goodwill has been allocated shall be tested for impairment annually, and whenever there is an indication that the unit may be impaired, by comparing the carrying amount of the unit, including the goodwill, with the recoverable amount of the unit. If the recoverable amount of the unit exceeds the carrying amount of the unit, the unit and the goodwill allocated to that unit shall be regarded as not impaired. If the carrying amount of the unit exceeds the recoverable amount of the unit, the entity shall recognise the impairment loss in accordance with paragraph 104.**

91-95 [Deleted]

Timing of impairment tests

96 **The annual impairment test for a cash-generating unit to which goodwill has been allocated may be performed at any time during an annual period, provided the test is performed at the same time every year. Different cash-generating units may be tested for impairment at different times. However, if some or all of the goodwill allocated to a cash-generating unit was acquired in a business combination during the current annual period, that unit shall be tested for impairment before the end of the current annual period.**

97 **If the assets constituting the cash-generating unit to which goodwill has been allocated are tested for impairment at the same time as the unit containing the goodwill, they shall be tested for impairment before the unit containing the goodwill. Similarly, if the cash-generating units constituting a group of cash-generating units to which goodwill has been allocated are tested for impairment at the same time as the group of units containing the goodwill, the individual units shall be tested for impairment before the group of units containing the goodwill.**

98 At the time of impairment testing a cash-generating unit to which goodwill has been allocated, there may be an indication of an impairment of an asset within the unit containing the goodwill. In such circumstances, the entity tests the asset for impairment first, and recognises any impairment loss for that asset before testing for impairment the cash-generating unit containing the goodwill. Similarly, there may be an indication of an impairment of a cash-generating unit within a group of units containing the goodwill. In such circumstances, the entity tests the cash-generating unit for impairment first, and recognises any impairment loss for that unit, before testing for impairment the group of units to which the goodwill is allocated.

99 **The most recent detailed calculation made in a preceding period of the recoverable amount of a cash-generating unit 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:**

(a) the assets and liabilities making up the unit have not changed significantly since the most recent recoverable amount calculation;

(b) the most recent recoverable amount calculation resulted in an amount that exceeded the carrying amount of the unit by a substantial margin; and

(c) 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.

Corporate assets

100 Corporate assets include group or divisional assets such as the building of a headquarters or a division of the entity, EDP equipment or a research centre. The structure of an entity determines whether an asset meets this Standard’s definition of corporate assets for a particular cash-generating unit. The 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 cash-generating unit under review.

101 Because corporate assets do not generate separate cash inflows, the recoverable amount of an individual corporate asset cannot be determined unless management has decided to dispose of the asset. As a consequence, if there is an indication that a corporate asset may be impaired, recoverable amount is determined for the cash-generating unit or group of cash-generating units to which the corporate asset belongs, and is compared with the carrying amount of this cash-generating unit or group of cash-generating units. Any impairment loss is recognised in accordance with paragraph 104.

102 In testing a cash-generating unit for impairment, an entity shall identify all the corporate assets that relate to the cash-generating unit under review. If a portion of the carrying amount of a corporate asset:

(a) can be allocated on a reasonable and consistent basis to that unit, the entity shall compare the carrying amount of the unit, including the portion of the carrying amount of the corporate asset allocated to the unit, with its recoverable amount. Any impairment loss shall be recognised in accordance with paragraph 104.

(b) cannot be allocated on a reasonable and consistent basis to that unit, the entity shall:

(i) compare the carrying amount of the unit, excluding the corporate asset, with its recoverable amount and recognise any impairment loss in accordance with paragraph 104;

(ii) identify the smallest group of cash-generating units that includes the cash-generating unit under review and to which a portion of the carrying amount of the corporate asset can be allocated on a reasonable and consistent basis; and

(iii) compare the carrying amount of that group of cash-generating units, including the portion of the carrying amount of the corporate asset allocated to that group of units, with the recoverable amount of the group of units. Any impairment loss shall be recognised in accordance with paragraph 104.

103 Illustrative Example 8 illustrates the application of these requirements to corporate assets.

Impairment loss for a cash-generating unit

104 An impairment loss shall be recognised for a cash-generating unit (the smallest group of cash-generating units to which goodwill or a corporate asset has been allocated) if, and only if, the recoverable amount of the unit (group of units) is less than the carrying amount of the unit (group of units). The impairment loss shall be allocated to reduce the carrying amount of the assets of the unit (group of units) in the following order:

(a) first, to reduce the carrying amount of any goodwill allocated to the cash-generating unit (group of units); and

(b) then, to the other assets of the unit (group of units) pro rata on the basis of the carrying amount of each asset in the unit (group of units).

These reductions in carrying amounts shall be treated as impairment losses on individual assets and recognised in accordance with paragraph 60.

105 In allocating an impairment loss in accordance with paragraph 104, an entity shall not reduce the carrying amount of an asset below the highest of:

(a) its fair value less costs ~~to sell~~ of disposal (if ~~determinable~~ measurable);

(b) its value in use (if determinable); and

(c) zero.

The amount of the impairment loss that would otherwise have been allocated to the asset shall be allocated pro rata to the other assets of the unit (group of units).

106 If it is not practicable to estimate the recoverable amount of each individual asset of a cash-generating unit, this Standard requires an arbitrary allocation of an impairment loss between the assets of that unit, other than goodwill, because all assets of a cash-generating unit work together.

107 If the recoverable amount of an individual asset cannot be determined (see paragraph 67):

(a) an impairment loss is recognised for the asset if its carrying amount is greater than the higher of its fair value less costs ~~to sell~~ of disposal and the results of the allocation procedures described in paragraphs 104 and 105; and

(b) no impairment loss is recognised for the asset if the related cash-generating unit is not impaired. This applies even if the asset's fair value less costs ~~to sell~~ of disposal is less than its carrying amount.

Example
A machine has suffered physical damage but is still working, although not as well as before it was damaged. The machine's fair value less costs ~~to sell~~ of disposal 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. Assumption 1: budgets/forecasts approved by management reflect no commitment of management to replace the machine. *The recoverable amount of the machine alone cannot be estimated because the machine's value in use:* *(a) may differ from its fair value less costs ~~to sell~~ of disposal; and* *(b) can be determined only for the cash-generating unit 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. Perhaps a shorter depreciation period or a faster*

depreciation method is required to reflect the expected remaining useful life of the machine or the pattern in which economic benefits are expected to be consumed by the entity.

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

The machine's value in use can be estimated to be close to its fair value less costs ~~to sell~~ of disposal. Therefore, the recoverable amount of the machine can be determined and no consideration is given to the cash-generating unit to which the machine belongs (ie the production line). Because the machine's fair value less costs ~~to sell~~ of disposal is less than its carrying amount, an impairment loss is recognised for the machine.

108 After the requirements in paragraphs 104 and 105 have been applied, a liability shall be recognised for any remaining amount of an impairment loss for a cash-generating unit if, and only if, that is required by another HKFRS.

Reversing an impairment loss

109 Paragraphs 110-116 set out the requirements for reversing an impairment loss recognised for an asset or a cash-generating unit in prior periods. These requirements use the term 'an asset' but apply equally to an individual asset or a cash-generating unit. Additional requirements for an individual asset are set out in paragraphs 117-121, for a cash-generating unit in paragraphs 122 and 123 and for goodwill in paragraphs 124 and 125.

110 An entity shall assess at the end of each reporting period whether there is any indication that an impairment loss recognised in prior periods for an asset other than goodwill may no longer exist or may have decreased. If any such indication exists, the entity shall estimate the recoverable amount of that asset.

111 In assessing whether there is any indication that an impairment loss recognised in prior periods for an asset other than goodwill may no longer exist or may have decreased, an entity shall consider, as a minimum, the following indications:

External sources of information

(a) there are observable indications that the asset's ~~market~~ value has increased significantly during the period.

(b) significant changes with a favourable effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which the asset is dedicated.

(c) market interest rates or other market rates of return on investments have decreased during the period, and those decreases are likely to affect the discount rate used in calculating the asset's value in use and increase the asset's recoverable amount materially.

Internal sources of information

(d) significant changes with a favourable effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, the asset is used or is expected to be used. These changes include costs incurred during the period to improve or enhance the asset's performance or restructure the operation to which the asset belongs.

(e) evidence is available from internal reporting that indicates that the economic performance of the asset is, or will be, better than expected.

112 Indications of a potential decrease in an impairment loss in paragraph 111 mainly mirror the indications of a potential impairment loss in paragraph 12.

113 If there is an indication that an impairment loss recognised for an asset other than goodwill may no longer exist or may have decreased, this may indicate that the remaining useful life, the depreciation (amortisation) method or the residual value may need to be reviewed and adjusted in accordance with the HKFRS applicable to the asset, even if no impairment loss is reversed for the asset.

114 An impairment loss recognised in prior periods for an asset other than goodwill shall be reversed if, and only if, there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If this is the case, the carrying amount of the asset shall, except as described in paragraph 117, be increased to its recoverable amount. That increase is a reversal of an impairment loss.

115 A 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 an impairment loss for that asset. Paragraph 130 requires an entity to identify the change in estimates that causes the increase in estimated service potential. Examples of changes in estimates include:

(a) a change in the basis for recoverable amount (ie whether recoverable amount is based on fair value less costs ~~to sell~~ of disposal or value in use);

(b) if recoverable amount was based on value in use, a change in the amount or timing of estimated future cash flows or in the discount rate; or

(c) if recoverable amount was based on fair value less costs ~~to sell~~ of disposal, a change in estimate of the components of fair value less costs ~~to sell~~ of disposal.

116 An asset's value in use may become greater than the asset's carrying amount simply because the present value of future cash inflows increases as they become closer. However, the service potential of the asset has not increased. Therefore, an impairment loss is not reversed just because of the passage of time (sometimes called the 'unwinding' of the discount), even if the recoverable amount of the asset becomes higher than its carrying amount.

Reversing an impairment loss for an individual asset

117 The increased carrying amount of an asset other than goodwill attributable to a reversal of an impairment loss shall not 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.

118 Any increase in the carrying amount of an asset other than goodwill above 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 is a revaluation. In accounting for such a revaluation, an entity applies the HKFRS applicable to the asset.

119 A reversal of an impairment loss for an asset other than goodwill shall be recognised immediately in profit or loss, unless the asset is carried at revalued amount in accordance with another HKFRS (for example, the revaluation model in HKAS 16). Any reversal of an impairment loss of a revalued asset shall be treated as a revaluation increase in accordance with that other HKFRS.

120 A reversal of an impairment loss on a revalued asset is recognised in other comprehensive income and increases the revaluation surplus for that asset. However, to the extent that an impairment loss on the same revalued asset was previously recognised in profit or loss, a reversal of that impairment loss is also recognised in profit or loss.

121 After a reversal of an impairment loss is recognised, the depreciation (amortisation) charge for the asset shall be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

Reversing an impairment loss for a cash-generating unit

122 A reversal of an impairment loss for a cash-generating unit shall be allocated to the assets of the unit, except for goodwill, pro rata with the carrying amounts of those assets. These increases in carrying amounts shall be treated as reversals of impairment losses for individual assets and recognised in accordance with paragraph 119.

123 In allocating a reversal of an impairment loss for a cash-generating unit in accordance with paragraph 122, the carrying amount of an asset shall not be increased above the lower of:

(a) its recoverable amount (if determinable); and

(b) the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior periods.

The amount of the reversal of the impairment loss that would otherwise have been allocated to the asset shall be allocated pro rata to the other assets of the unit, except for goodwill.

Reversing an impairment loss for goodwill

124 An impairment loss recognised for goodwill shall not be reversed in a subsequent period.

125 HKAS 38 *Intangible Assets* prohibits the recognition of internally generated goodwill. Any increase in the recoverable amount of goodwill in the periods following the recognition of an impairment loss for that goodwill is likely to be an increase in internally generated goodwill, rather than a reversal of the impairment loss recognised for the acquired goodwill.

Disclosure

126 An entity shall disclose the following for each class of assets:

(a) the amount of impairment losses recognised in profit or loss during the period and the line item(s) of the statement of comprehensive income in which those impairment losses are included.

(b) the amount of reversals of impairment losses recognised in profit or loss during the period and the line item(s) of the statement of comprehensive income in which those impairment losses are reversed.

(c) the amount of impairment losses on revalued assets recognised in other comprehensive income during the period.

(d) the amount of reversals of impairment losses on revalued assets recognised in other comprehensive income during the period.

127 A class of assets is a grouping of assets of similar nature and use in an entity's operations.

128 The information required in paragraph 126 may be presented with other information disclosed for the class of assets. For example, this information may be included in a reconciliation of the carrying amount of property, plant and equipment, at the beginning and end of the period, as required by HKAS 16.

129 An entity that reports segment information in accordance with HKFRS 8 shall disclose the following for each reportable segment:

(a) the amount of impairment losses recognised in profit or loss and in other comprehensive income during the period.

(b) the amount of reversals of impairment losses recognised in profit or loss and in other comprehensive income during the period.

130 An entity shall disclose the following for each material impairment loss recognised or reversed during the period for an individual asset, including goodwill, or a cash-generating unit:

(a) the events and circumstances that led to the recognition or reversal of the impairment loss.

(b) the amount of the impairment loss recognised or reversed.

(c) for an individual asset:

(i) the nature of the asset; and

(ii) if the entity reports segment information in accordance with HKFRS 8, the reportable segment to which the asset belongs.

(d) for a cash-generating unit:

(i) a description of the cash-generating unit (such as whether it is a product line, a plant, a business operation, a geographical area, or a reportable segment as defined in HKFRS 8);

(ii) the amount of the impairment loss recognised or reversed by class of assets and, if the entity reports segment information in accordance with HKFRS 8, by reportable segment; and

(iii) if the aggregation of assets for identifying the cash-generating unit has changed since the previous estimate of the cash-generating unit's recoverable amount (if any), a description of the current and former way of aggregating assets and the reasons for changing the way the cash-generating unit is identified.

(e) whether the recoverable amount of the asset (cash-generating unit) is its fair value less costs ~~to sell~~ of disposal or its value in use.

(f) if recoverable amount is fair value less costs ~~to sell~~of disposal, the basis used to ~~determine~~ measure fair value less costs ~~to sell~~ of disposal (such as whether fair value was ~~determined~~ measured by reference to a quoted price in an active market for an identical asset). An entity is not required to provide the disclosures required by HKFRS 13.

(g) if recoverable amount is value in use, the discount rate(s) used in the current estimate and previous estimate (if any) of value in use.

131 An entity shall disclose the following information for the aggregate impairment losses and the aggregate reversals of impairment losses recognised during the period for which no information is disclosed in accordance with paragraph 130:

(a) the main classes of assets affected by impairment losses and the main classes of assets affected by reversals of impairment losses.

(b) the main events and circumstances that led to the recognition of these impairment losses and reversals of impairment losses.

132 An entity is encouraged to disclose assumptions used to determine the recoverable amount of assets (cash-generating units) during the period. However, paragraph 134 requires an entity to disclose information about the estimates used to measure the recoverable amount of a cash-generating unit when goodwill or an intangible asset with an indefinite useful life is included in the carrying amount of that unit.

133 If, in accordance with paragraph 84, any portion of the goodwill acquired in a business combination during the period has not been allocated to a cash-generating unit (group of units) at the end of the reporting period, the amount of the unallocated goodwill shall be disclosed together with the reasons why that amount remains unallocated.

Estimates used to measure recoverable amounts of cash-generating units containing goodwill or intangible assets with indefinite useful lives

134 **An entity shall disclose the information required by (a)-(f) for each cash-generating unit (group of units) for which the carrying amount of goodwill or intangible assets with indefinite useful lives allocated to that unit (group of units) is significant in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite useful lives:**

(a) the carrying amount of goodwill allocated to the unit (group of units).

(b) the carrying amount of intangible assets with indefinite useful lives allocated to the unit (group of units).

(c) the recoverable amount of the unit (or group of units) and the basis on which the unit's (group of units') recoverable amount has been determined (ie value in use or fair value less costs ~~to sell~~ of disposal).

(d) if the unit's (group of units') recoverable amount is based on value in use:

(i) ~~a description of~~ each key assumption on which management has based its cash flow projections for the period covered by the most recent budgets/forecasts. Key assumptions are those to which the unit's (group of units') recoverable amount is most sensitive.

(ii) a description of management's approach to determining the value(s) assigned to each key assumption, whether those value(s) reflect past experience or, if appropriate, are consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information.

(iii) the period over which management has projected cash flows based on financial budgets/forecasts approved by management and, when a period greater than five years is used for a cash-generating unit (group of units), an explanation of why that longer period is justified.

(iv) the growth rate used to extrapolate cash flow projections beyond the period covered by the most recent budgets/forecasts, and the justification for using any growth rate that exceeds the long-term average growth rate for the products, industries, or country or countries in which the entity operates, or for the market to which the unit (group of units) is dedicated.

(v) the discount rate(s) applied to the cash flow projections.

(e) if the unit's (group of units') recoverable amount is based on fair value less costs ~~to sell~~ of disposal, the ~~methodology~~ valuation techniques used to ~~determine~~ measure fair value less costs ~~to sell~~ of disposal. An entity is not required to provide the disclosures required by HKFRS 13. If fair value less costs ~~to sell~~ of disposal is not ~~determined~~ measured using ~~an observable market~~a quoted price for ~~the~~an identical unit (group of units), an entity shall disclose the following information ~~shall also be disclosed~~:

(i) **~~a description of~~ each key assumption on which management has based its determination of fair value less costs ~~to sell~~ of disposal. Key assumptions are those to which the unit's (group of units') recoverable amount is most sensitive.**

(ii) **a description of management's approach to determining the value (or values) assigned to each key assumption, whether those values reflect past experience or, if appropriate, are consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information.**

(iiA) **the 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').**

(iiB) **if there has been a change in valuation technique, the change and the reason(s) for making it.**

If fair value less costs ~~to sell~~ of disposal is ~~determined~~ measured using discounted cash flow projections, an entity shall disclose the following information ~~shall also be disclosed~~:

(iii) **the period over which management has projected cash flows.**

(iv) **the growth rate used to extrapolate cash flow projections.**

(v) **the discount rate(s) applied to the cash flow projections.**

(f) **if a reasonably possible change in a key assumption on which management has based its determination of the unit's (group of units') recoverable amount would cause the unit's (group of units') carrying amount to exceed its recoverable amount:**

(i) **the amount by which the unit's (group of units') recoverable amount exceeds its carrying amount.**

(ii) **the value assigned to the key assumption.**

(iii) **the amount by which the value assigned to the key assumption must change, after incorporating any consequential effects of that change on the other variables used to measure recoverable amount, in order for the unit's (group of units') recoverable amount to be equal to its carrying amount.**

135 **If some or all of the carrying amount of goodwill or intangible assets with indefinite useful lives is allocated across multiple cash-generating units (groups of units), and the amount so allocated to each unit (group of units) is not significant in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite useful lives, that fact shall be disclosed, together with the aggregate carrying amount of goodwill or intangible assets with indefinite useful lives allocated to those units (groups of units). In addition, if the recoverable amounts of any of those units (groups of units) are based on the same key assumption(s) and the aggregate carrying amount of goodwill or intangible assets with indefinite useful lives allocated to them is significant in comparison with the**

entity's total carrying amount of goodwill or intangible assets with indefinite useful lives, an entity shall disclose that fact, together with:

(a) the aggregate carrying amount of goodwill allocated to those units (groups of units).

(b) the aggregate carrying amount of intangible assets with indefinite useful lives allocated to those units (groups of units).

(c) a description of the key assumption(s).

(d) a description of management's approach to determining the value(s) assigned to the key assumption(s), whether those value(s) reflect past experience or, if appropriate, are consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information.

(e) if a reasonably possible change in the key assumption(s) would cause the aggregate of the units' (groups of units') carrying amounts to exceed the aggregate of their recoverable amounts:

(i) the amount by which the aggregate of the units' (groups of units') recoverable amounts exceeds the aggregate of their carrying amounts.

(ii) the value(s) assigned to the key assumption(s).

(iii) the amount by which the value(s) assigned to the key assumption(s) must change, after incorporating any consequential effects of the change on the other variables used to measure recoverable amount, in order for the aggregate of the units' (groups of units') recoverable amounts to be equal to the aggregate of their carrying amounts.

136 The most recent detailed calculation made in a preceding period of the recoverable amount of a cash-generating unit (group of units) may, in accordance with paragraph 24 or 99, be carried forward and used in the impairment test for that unit (group of units) in the current period provided specified criteria are met. When this is the case, the information for that unit (group of units) that is incorporated into the disclosures required by paragraphs 134 and 135 relate to the carried forward calculation of recoverable amount.

137 Illustrative Example 9 illustrates the disclosures required by paragraphs 134 and 135.

Transitional provisions and effective date

138 [Deleted]

139 An entity shall apply this Standard:

(a) to goodwill and intangible assets acquired in business combinations for which the agreement date is on or after 1 January 2005; and

(b) to all other assets prospectively from the beginning of the first annual period beginning on or after 1 January 2005.

140 Entities to which paragraph 139 applies are encouraged to apply the requirements of this Standard before the effective dates specified in paragraph 139. However, if an entity applies this Standard before those effective dates, it also shall apply HKFRS 3 and HKAS 38 at the same time.

140A HKAS 1 *Presentation of Financial Statements* (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraphs 61, 120, 126 and 129. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

140B HKFRS 3 (as revised in 2008) amended paragraphs 65, 81, 85 and 139, deleted paragraphs 91-95 and 138 and added Appendix C. An entity shall apply those amendments for annual periods beginning on or after 1 July 2009. If an entity applies HKFRS 3 (revised 2008) for an earlier period, the amendments shall also be applied for that earlier period.

140C Paragraph 134(e) was amended by *Improvements to HKFRSs* issued in October 2008. An entity shall apply that amendment for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies the amendment for an earlier period it shall disclose that fact.

140D *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* (Amendments to HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* and HKAS 27), issued in October 2008, added paragraph 12(h). An entity shall apply that amendment prospectively for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies the related amendments in paragraphs 4 and 38A of HKAS 27 for an earlier period, it shall apply the amendment in paragraph 12(h) at the same time.

140E *Improvements to HKFRSs* issued in May 2009 amended paragraph 80(b). An entity shall apply that amendment prospectively for annual periods beginning on or after 1 January 2010. Earlier application is permitted. If an entity applies the amendment for an earlier period it shall disclose that fact.

140F *[This paragraph refers to amendments with an effective date after 1 January 2013, and is therefore not included in this edition.]*

140G *[This paragraph refers to amendments with an effective date after 1 January 2013, and is therefore not included in this edition.]*

140H HKFRS 10 and HKFRS 11, issued in June 2011, amended paragraph 4, the heading above paragraph 12(h) and paragraph 12(h). An entity shall apply those amendments when it applies HKFRS 10 and HKFRS 11.

140I HKFRS 13, issued in June 2011, amended paragraphs 5, 6, 12, 20, 22, 28, 78, 105, 111, 130 and 134, deleted paragraphs 25-27 and added paragraph 53A. An entity shall apply those amendments when it applies HKFRS 13.

Withdrawal of SSAP 31

141 This Standard supersedes SSAP 31 *Impairment of Assets* (issued in 2001).

Appendix A

Using present value techniques to measure value in use

This appendix is an integral part of the Standard. It provides guidance on the use of present value techniques in measuring value in use. Although the guidance uses the term 'asset', it equally applies to a group of assets forming a cash-generating unit.

The components of a present value measurement

A1 The following elements together capture the economic differences between assets:

(a) an estimate of the future cash flow, or in more complex cases, series of future cash flows the entity expects to derive from the asset;

(b) expectations about possible variations in the amount or timing of those cash flows;

(c) the time value of money, represented by the current market risk-free rate of interest;

(d) the price for bearing the uncertainty inherent in the asset; and

(e) other, sometimes unidentifiable, factors (such as illiquidity) that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset.

A2 This appendix contrasts two approaches to computing present value, either of which may be used to estimate the value in use of an asset, depending on the circumstances. Under the 'traditional' approach, adjustments for factors (b)-(e) described in paragraph A1 are embedded in the discount rate. Under the 'expected cash flow' approach, factors (b), (d) and (e) cause adjustments in arriving at risk-adjusted expected cash flows. Whichever approach an entity adopts to reflect expectations about possible variations in the amount or timing of future cash flows, the result should be to reflect the expected present value of the future cash flows, ie the weighted average of all possible outcomes.

General principles

A3 The techniques used to estimate future cash flows and interest rates will vary from one situation to another depending on the circumstances surrounding the asset in question. However, the following general principles govern any application of present value techniques in measuring assets:

(a) interest rates used to discount cash flows should reflect assumptions that are consistent with those inherent in the estimated cash flows. Otherwise, the effect of some assumptions will be double-counted or ignored. For example, a discount rate of 12 per cent might be applied to contractual cash flows of a loan receivable. That rate reflects expectations about future defaults from loans with particular characteristics. That same 12 per cent rate should not be used to discount expected cash flows because those cash flows already reflect assumptions about future defaults.

(b) estimated cash flows and discount rates should be free from both bias and factors unrelated to the asset in question. For example, deliberately understating estimated net cash flows to enhance the apparent future profitability of an asset introduces a bias into the measurement.

(c) estimated cash flows or discount rates should reflect the range of possible outcomes rather than a single most likely, minimum or maximum possible amount.

Traditional and expected cash flow approaches to present value

Traditional approach

A4 Accounting applications of present value have traditionally used a single set of estimated cash flows and a single discount rate, often described as 'the rate commensurate with the risk'. In effect, the traditional approach assumes that a single discount rate convention can incorporate all the expectations about the future cash flows and the appropriate risk premium. Therefore, the traditional approach places most of the emphasis on selection of the discount rate.

A5 In some circumstances, such as those in which comparable assets can be observed in the marketplace, a traditional approach is relatively easy to apply. For assets with contractual cash flows, it is consistent with the manner in which marketplace participants describe assets, as in 'a 12 per cent bond'.

A6 However, the traditional approach may not appropriately address some complex measurement problems, such as the measurement of non-financial assets for which no market for the item or a comparable item exists. A proper search for 'the rate commensurate with the risk' requires analysis of at least two items—an asset that exists in the marketplace and has an observed interest rate and the asset being measured. The appropriate discount rate for the cash flows being measured must be inferred from the observable rate of interest in that other asset. To draw that inference, the characteristics of the other asset's cash flows must be similar to those of the asset being measured. Therefore, the measurer must do the following:

(a) identify the set of cash flows that will be discounted;

(b) identify another asset in the marketplace that appears to have similar cash flow characteristics;

(c) compare the cash flow sets from the two items to ensure that they are similar (for example, are both sets contractual cash flows, or is one contractual and the other an estimated cash flow?);

(d) evaluate whether there is an element in one item that is not present in the other (for example, is one less liquid than the other?); and

(e) evaluate whether both sets of cash flows are likely to behave (ie vary) in a similar fashion in changing economic conditions.

Expected cash flow approach

A7 The expected cash flow approach is, in some situations, a more effective measurement tool than the traditional approach. In developing a measurement, the expected cash flow approach uses all expectations about possible cash flows instead of the single most likely cash flow. For example, a cash flow might be CU100, CU200 or CU300 with probabilities of 10 per cent, 60 per cent and 30 per cent, respectively. The expected cash flow is CU220. The expected cash flow approach thus differs from the traditional approach by focusing on direct analysis of the cash flows in question and on more explicit statements of the assumptions used in the measurement.

A8 The expected cash flow approach also allows use of present value techniques when the timing of cash flows is uncertain. For example, a cash flow of CU1,000 may be received in one year, two years or three years with probabilities of 10 per cent, 60 per cent and 30 per cent, respectively. The example below shows the computation of expected present value in that situation.

Present value of CU1,000 in 1 year at 5%	CU952.38	
Probability	10.00%	CU95.24
Present value of CU1,000 in 2 years at 5.25%	CU902.73	
Probability	60.00%	CU541.64
Present value of CU1,000 in 3 years at 5.50%	CU851.61	
Probability	30.00%	CU255.48
Expected present value		CU892.36

A9 The expected present value of CU892.36 differs from the traditional notion of a best estimate of CU902.73 (the 60 per cent probability). A traditional present value computation applied to this example requires a decision about which of the possible timings of cash flows to use and, accordingly, would not reflect the probabilities of other timings. This is because the discount rate in a traditional present value computation cannot reflect uncertainties in timing.

A10 The use of probabilities is an essential element of the expected cash flow approach. Some question whether assigning probabilities to highly subjective estimates suggests greater precision than, in fact, exists. However, the proper application of the traditional approach (as described in paragraph A6) requires the same estimates and subjectivity without providing the computational transparency of the expected cash flow approach.

A11 Many estimates developed in current practice already incorporate the elements of expected cash flows informally. In addition, accountants often face the need to measure an asset using limited information about the probabilities of possible cash flows. For example, an accountant might be confronted with the following situations:

(a) the estimated amount falls somewhere between CU50 and CU250, but no amount in the range is more likely than any other amount. Based on that limited information, the estimated expected cash flow is CU150 [(50 + 250)/2].

(b) the estimated amount falls somewhere between CU50 and CU250, and the most likely amount is CU100. However, the probabilities attached to each amount are unknown. Based on that limited information, the estimated expected cash flow is CU133.33 [(50 + 100 + 250)/3].

(c) the estimated amount will be CU50 (10 per cent probability), CU250 (30 per cent probability), or CU100 (60 per cent probability). Based on that limited information, the estimated expected cash flow is CU140 [(50 × 0.10) + (250 × 0.30) + (100 × 0.60)].

In each case, the estimated expected cash flow is likely to provide a better estimate of value in use than the minimum, most likely or maximum amount taken alone.

A12 The application of an expected cash flow approach is subject to a cost-benefit constraint. In some cases, an entity may have access to extensive data and may be able to develop many cash flow scenarios. In other cases, an entity may not be able to develop more than general statements about the variability of cash flows without incurring substantial cost. The entity needs to balance the cost of obtaining additional information against the additional reliability that information will bring to the measurement.

A13 Some maintain that expected cash flow techniques are inappropriate for measuring a single item or an item with a limited number of possible outcomes. They offer an example of an asset with two possible outcomes: a 90 per cent probability that the cash flow will be CU10 and a 10 per cent probability that the cash flow will be CU1,000. They observe that the expected cash flow in that example is CU109 and criticise that result as not representing either of the amounts that may ultimately be paid.

A14 Assertions like the one just outlined reflect underlying disagreement with the measurement objective. If the objective is accumulation of costs to be incurred, expected cash flows may not produce a representationally faithful estimate of the expected cost. However, this Standard is concerned with measuring the recoverable amount of an asset. The recoverable amount of the asset in this example is not likely to be CU10, even though that is the most likely cash flow. This is because a measurement of CU10 does not incorporate the uncertainty of the cash flow in the measurement of the asset. Instead, the uncertain cash flow is presented as if it were a certain cash flow. No rational entity would sell an asset with these characteristics for CU10.

Discount rate

A15 Whichever approach an entity adopts for measuring the value in use of an asset, interest rates used to discount cash flows should not reflect risks for which the estimated cash flows have been adjusted. Otherwise, the effect of some assumptions will be double-counted.

A16 When an asset-specific rate is not directly available from the market, an entity uses surrogates to estimate the discount rate. The purpose is to estimate, as far as possible, a market assessment of:

(a) the time value of money for the periods until the end of the asset's useful life; and

(b) factors (b), (d) and (e) described in paragraph A1, to the extent those factors have not caused adjustments in arriving at estimated cash flows.

A17 As a starting point in making such an estimate, the entity might take into account the following rates:

(a) the entity's weighted average cost of capital determined using techniques such as the Capital Asset Pricing Model;

(b) the entity's incremental borrowing rate; and

(c) other market borrowing rates.

A18 However, these rates must be adjusted:

(a) to reflect the way that the market would assess the specific risks associated with the asset's estimated cash flows; and

(b) to exclude risks that are not relevant to the asset's estimated cash flows or for which the estimated cash flows have been adjusted.

Consideration should be given to risks such as country risk, currency risk and price risk.

A19 The discount rate is independent of the entity's capital structure and the way the entity financed the purchase of the asset, because the future cash flows expected to arise from an asset do not depend on the way in which the entity financed the purchase of the asset.

A20 Paragraph 55 requires the discount rate used to be a pre-tax rate. Therefore, when the basis used to estimate the discount rate is post-tax, that basis is adjusted to reflect a pre-tax rate.

A21 An entity normally uses a single discount rate for the estimate of an asset's value in use. However, an entity uses separate discount rates for different future periods where value in use is sensitive to a difference in risks for different periods or to the term structure of interest rates.

Appendix B

Amendment to HKAS 16

The amendment in this appendix shall be applied when an entity applies HKAS 16 Property, Plant and Equipment . *This appendix is superseded when HKAS 36* Impairment of Assets *becomes effective. This appendix replaces the consequential amendments made by HKAS 16 to SSAP 31(which is referred to in HKAS 16 Appendix paragraph A4 as "HKAS 36"). HKAS 36 incorporates the requirements of the paragraphs in this appendix. Consequently, the amendments from HKAS 16 are not necessary once an entity is subject to HKAS 36 . Accordingly, this appendix is applicable only to entities that elect to apply HKAS 16 before its effective date.*

* * *

The amendments contained in this appendix when this Standard was issued have been incorporated into the relevant Standards.

Appendix C

Impairment testing cash-generating units with goodwill and non-controlling interests

This appendix is an integral part of the Standard.

C1 In accordance with HKFRS 3 (as revised in 2008), the acquirer measures and recognises goodwill as of the acquisition date as the excess of (a) over (b) below:

(a) the aggregate of:

(i) the consideration transferred measured in accordance with HKFRS 3, which generally requires acquisition-date fair value;

(ii) the amount of any non-controlling interest in the acquiree measured in accordance with HKFRS 3; and

(iii) in a business combination achieved in stages, the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree.

(b) the net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed measured in accordance with HKFRS 3.

Allocation of goodwill

C2 Paragraph 80 of this Standard requires goodwill acquired in a business combination to be allocated to each of the acquirer's cash-generating units, or groups of cash-generating units, expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units, or groups of units. It is possible that some of the synergies resulting from a business combination will be allocated to a cash-generating unit in which the non-controlling interest does not have an interest.

Testing for impairment

C3 Testing for impairment involves comparing the recoverable amount of a cash-generating unit with the carrying amount of the cash-generating unit.

C4 If an entity measures non-controlling interests as its proportionate interest in the net identifiable assets of a subsidiary at the acquisition date, rather than at fair value, goodwill attributable to non-controlling interests is included in the recoverable amount of the related cash-generating unit but is not recognised in the parent's consolidated financial statements. As a consequence, an entity shall gross up the carrying amount of goodwill allocated to the unit to include the goodwill attributable to the non-controlling interest. This adjusted carrying amount is then compared with the recoverable amount of the unit to determine whether the cash-generating unit is impaired.

Allocating an impairment loss

C5 Paragraph 104 requires any identified impairment loss to be allocated first to reduce the carrying amount of goodwill allocated to the unit and then to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit.

C6 If a subsidiary, or part of a subsidiary, with a non-controlling interest is itself a cash-generating unit, the impairment loss is allocated between the parent and the non-controlling interest on the same basis as that on which profit or loss is allocated.

C7 If a subsidiary, or part of a subsidiary, with a non-controlling interest is part of a larger cash-generating unit, goodwill impairment losses are allocated to the parts of the cash-generating unit that have a non-controlling interest and the parts that do not. The impairment losses should be allocated to the parts of the cash-generating unit on the basis of:

(a) to the extent that the impairment relates to goodwill in the cash-generating unit, the relative carrying values of the goodwill of the parts before the impairment; and

(b) to the extent that the impairment relates to identifiable assets in the cash-generating unit, the relative carrying values of the net identifiable assets of the parts before the impairment. Any such impairment is allocated to the assets of the parts of each unit pro rata on the basis of the carrying amount of each asset in the part.

In those parts that have a non-controlling interest, the impairment loss is allocated between the parent and the non-controlling interest on the same basis as that on which profit or loss is allocated.

C8 If an impairment loss attributable to a non-controlling interest relates to goodwill that is not recognised in the parent's consolidated financial statements (see paragraph C4), that impairment is not recognised as a goodwill impairment loss. In such cases, only the impairment loss relating to the goodwill that is allocated to the parent is recognised as a goodwill impairment loss.

C9 Illustrative Example 7 illustrates the impairment testing of a non-wholly-owned cash-generating unit with goodwill.

Appendix D

Amendments ~~resulting from other HKFRSs~~to HKAS 36 – Recoverable Amount Disclosures for Non-Financial Assets

The following sets out amendments required for this Standard resulting from other newly issued pronouncements that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

Paragraphs 130 and 134 and the heading above paragraph 138 are amended and paragraph 140J is added. New text is underlined and deleted text is struck through.

Disclosure

…

130 **An entity shall disclose the following for an individual asset (including goodwill) or a cash-generating unit, for which an ~~each material~~ impairment loss has been recognised or reversed during the period ~~for an individual asset, including goodwill, or a cash-generating unit~~:**

(a) …

(e) **the recoverable amount of the asset (cash-generating unit) and whether the recoverable amount of the asset (cash-generating unit) is its fair value less costs of disposal or its value in use.**

(f) **if the recoverable amount is fair value less costs of disposal, ~~the basis used to measure fair value less costs of disposal (such as whether fair value was measured by reference to a quoted price in an active market for an identical asset). An entity is not required to provide the disclosures required by HKFRS 13.~~ the entity shall disclose the following information:**

(i) **the level of the fair value hierarchy (see HKFRS 13) within which the fair value measurement of the asset (cash-generating unit) is categorised in its entirety (without taking into account whether the 'costs of disposal' are observable);**

(ii) **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 fair value less costs of disposal. If there has been a change in valuation technique, the entity shall disclose that change and the reason(s) for making it; and**

(iii) **for fair value measurements categorised within Level 2 and Level 3 of the fair value hierarchy, each key assumption on which management has based its determination of fair value less costs of disposal. Key assumptions are those to which the asset's (cash-generating unit's) recoverable amount is most sensitive. The entity shall also disclose the discount rate(s) used in the current measurement and previous measurement if fair value less costs of disposal is measured using a present value technique.**

(g) …

…

Estimates used to measure recoverable amounts of cash-generating units containing goodwill or intangible assets with indefinite useful lives

134 An entity shall disclose the information required by (a)–(f) for each cash-generating unit (group of units) for which the carrying amount of goodwill or intangible assets with indefinite useful lives allocated to that unit (group of units) is significant in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite useful lives:

(a) ...

(c) **~~the recoverable amount of the unit (or group of units) and~~ the basis on which the unit's (group of units') recoverable amount has been determined (ie value in use or fair value less costs of disposal).**

(d) **…**

…

Transitional ~~al~~ provisions and effective date

138 ...

140J In June 2013 paragraphs 130 and 134 and the heading above paragraph 138 were amended. An entity shall apply those amendments retrospectively for annual periods beginning on or after 1 January 2014. Earlier application is permitted. An entity shall not apply those amendments in periods (including comparative periods) in which it does not also apply HKFRS 13.

Appendix E

Comparison with International Accounting Standards

This comparison appendix, which was prepared as at August 2004 and deals only with significant differences in the standards extant, is produced for information only and does not form part of the standards in HKAS 36.

The International Accounting Standard comparable with HKAS 36 is IAS 36 *Impairment of Assets.*

There are no major textual differences between HKAS 36 and IAS 36.

HKAS 36 BC
Revised ~~June 2013~~June 2014

Basis for Conclusions on
Hong Kong Accounting Standard 36

Impairment of Assets

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

BASIS FOR CONCLUSIONS ON IAS 36 *IMPAIRMENT OF ASSETS*

HKAS 36 is based on IAS 36 *Impairment of Assets*. In approving HKAS 36, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IAS 36. Accordingly, there are no significant differences between HKAS 36 and IAS 36. The IASB's Basis for Conclusions is reproduced below for reference. The paragraph numbers of IAS 36 referred to below generally correspond with those in HKAS 36.

CONTENTS

* In IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, issued by the IASB in 2004, the term, 'net selling price' was replaced in IAS 36 by 'fair value less costs to sell'.

Basis for Conclusions on
on IAS 36 Impairment of Assets

The International Accounting Standards Board revised IAS 36 as part of its project on business combinations. It was not the Board's intention to reconsider as part of that project all of the requirements in IAS 36.

The previous version of IAS 36 was accompanied by a Basis for Conclusions summarising the former International Accounting Standards Committee's considerations in reaching some of its conclusions in that Standard. For convenience the Board has incorporated into its own Basis for Conclusions material from the previous Basis for Conclusions that discusses (a) matters the Board did not reconsider and (b) the history of the development of a standard on impairment of assets. That material is contained in paragraphs denoted by numbers with the prefix BCZ. Paragraphs describing the Board's considerations in reaching its own conclusions are numbered with the prefix BC.

In this Basis for Conclusions the terminology has not been amended to reflect the changes made by IAS 1 Presentation of Financial Statements *(as revised in 2007).*

In developing IFRS 13 Fair Value Measurement, *issued in May 2011, the Board changed the definition of fair value less costs to sell. As a consequence all references to 'fair value less costs to sell' in IAS 36 were replaced with 'fair value less costs of disposal'. This Basis for Conclusions has not been amended to reflect that change.*

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching the conclusions in IAS 36 *Impairment of Assets*. Individual Board members gave greater weight to some factors than to others.

BC2 The International Accounting Standards Committee (IASC) issued the previous version of IAS 36 in 1998. It has been revised by the Board as part of its project on business combinations. That project had two phases. The first resulted in the Board issuing simultaneously in 2004 IFRS 3 *Business Combinations* and revised versions of IAS 36 and IAS 38 *Intangible Assets*. The Board's intention in revising IAS 36 as part of the first phase of the project was not to reconsider all of the requirements in IAS 36. The changes to IAS 36 were primarily concerned with the impairment tests for intangible assets with indefinite useful lives (hereafter referred to as 'indefinite-lived intangibles') and goodwill. The second phase of the project on business combinations resulted in the Board issuing simultaneously in 2008 a revised IFRS 3 and an amended version of IAS 27 *Consolidated and Separate Financial Statements*.[*] The Board amended IAS 36 to reflect its decisions on the measurement of a non-controlling interest in an acquiree (see paragraph BC170A). The Board has not deliberated the other requirements in IAS 36. Those other requirements will be considered by the Board as part of a future project on impairment of assets.

[*] The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011.

BC3 The previous version of IAS 36 was accompanied by a Basis for Conclusions summarising IASC's considerations in reaching some of its conclusions in that Standard. For convenience, the Board has incorporated into this Basis for Conclusions material from the previous Basis for Conclusions that discusses matters the Board did not consider. That material is contained in paragraphs denoted by numbers with the prefix BCZ. The views expressed in paragraphs denoted by numbers with the prefix BCZ are those of IASC.

Scope (paragraph 2)

BCZ4 IAS 2 *Inventories* requires an enterprise to measure the recoverable amount of inventory at its net realisable value. IASC believed that there was no need to revise this requirement because it was well accepted as an appropriate test for recoverability of inventories. No major difference exists between IAS 2 and the requirements included in IAS 36 (see paragraphs BCZ37-BCZ39).

BCZ5 IAS 11 *Construction Contracts* and IAS 12 *Income Taxes* already deal with the impairment of assets arising from construction contracts and deferred tax assets respectively. Under both IAS 11 and IAS 12, recoverable amount is, in effect, determined on an undiscounted basis. IASC acknowledged that this was inconsistent with the requirements of IAS 36. However, IASC believed that it was not possible to eliminate that inconsistency without fundamental changes to IAS 11 and IAS 12. IASC had no plans to revise IAS 11 or IAS 12.

BCZ6 IAS 19 *Employee Benefits* contains an upper limit on the amount at which an enterprise should recognise an asset arising from employee benefits. Therefore, IAS 36 does not deal with such assets. The limit in IAS 19 is determined on a discounted basis that is broadly compatible with the requirements of IAS 36. ~~The limit does not override the deferred recognition of certain actuarial losses and certain past service costs.~~[*]

BCZ7 IAS 39 *Financial Instruments: Recognition and Measurement* sets out the requirements for impairment of financial assets.

BCZ8 IAS 36 is applicable to all assets, unless specifically excluded, regardless of their classification as current or non-current. Before IAS 36 was issued, there was no International Accounting Standard on accounting for the impairment of current assets other than inventories.

Measuring recoverable amount (paragraphs 18-57)

BCZ9 In determining the principles that should govern the measurement of recoverable amount, IASC considered, as a first step, what an enterprise will do if it discovers that an asset is impaired. IASC concluded that, in such cases, an enterprise will either keep the asset or dispose of it. For example, if an enterprise discovers that the service potential of an asset has decreased:

(a) the enterprise may decide to sell the asset if the net proceeds from the sale would provide a higher return on investment than continuing use in operations; or

[*] sentence deleted when IAS 19 *Employee Benefits* was amended in 2011.

(b) the enterprise may decide to keep the asset and use it, even if its service potential is lower than originally expected. Some reasons may be that:

(i) the asset cannot be sold or disposed of immediately;

(ii) the asset can be sold only at a low price;

(iii) the asset's service potential can still be recovered but only with additional efforts or expenditure; or

(iv) the asset could still be profitable although not to the same extent as expected originally.

IASC concluded that the resulting decision from a rational enterprise is, in substance, an investment decision based on estimated net future cash flows expected from the asset.

BCZ10 IASC then considered which of the following four alternatives for determining the recoverable amount of an asset would best reflect this conclusion:

(a) recoverable amount should be the sum of undiscounted future cash flows.

(b) recoverable amount should be the asset's fair value: more specifically, recoverable amount should be derived primarily from the asset's market value. If market value cannot be determined, then recoverable amount should be based on the asset's value in use as a proxy for market value.[#]

(c) recoverable amount should be the asset's value in use.

(d) recoverable amount should be the higher of the asset's net selling price and value in use.[*]

Each of these alternatives is discussed below.

BCZ11 It should be noted that fair value, net selling price and value in use all reflect a present value calculation (implicit or explicit) of estimated net future cash flows expected from an asset:

(a) fair value[†] reflects the market's expectation of the present value of the future cash flows to be derived from the asset;

(b) net selling price reflects the market's expectation of the present value of the future cash flows to be derived from the asset, less the direct incremental costs to dispose of the asset; and

[#] IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value. As a result the term 'market value' has been changed to 'fair value'.

[*] In IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, issued by the IASB in 2004, the term, 'net selling price' was replaced in IAS 36 by 'fair value less costs to sell'.

[†] IFRS 13, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

(c) value in use is the enterprise's estimate of the present value of the future cash flows to be derived from continuing use and disposal of the asset.

These bases all consider the time value of money and the risks that the amount and timing of the actual cash flows to be received from an asset might differ from estimates. Fair value and net selling price may differ from value in use because the market may not use the same assumptions as an individual enterprise.

Recoverable amount based on the sum of undiscounted cash flows

BCZ12 Some argue that recoverable amount should be measured as the sum of undiscounted future cash flows from an asset. They argue that:

(a) historical cost accounting is not concerned with measuring the economic value of assets. Therefore, the time value of money should not be considered in estimating the amount that will be recovered from an asset.

(b) it is premature to use discounting techniques without further research and debates on:

(i) the role of discounting in the financial statements; and

(ii) how assets should be measured generally.

If financial statements include assets that are carried on a variety of different bases (historical cost, discounted amounts or other bases), this will be confusing for users.

(c) identifying an appropriate discount rate will often be difficult and subjective.

(d) discounting will increase the number of impairment losses recognised. This, coupled with the requirement for reversals of impairment losses, introduces a volatile element into the income statement. It will make it harder for users to understand the performance of an enterprise. A minority of commentators on E55 *Impairment of Assets* supported this view.

BCZ13 IASC rejected measurement of recoverable amount based on the sum of undiscounted cash flows because:

(a) the objective of the measurement of recoverable amount is to reflect an investment decision. Money has a time value, even when prices are stable. If future cash flows were not discounted, two assets giving rise to cash flows of the same amount but with different timings would show the same recoverable amount. However, their current market values would be different because all rational economic transactions take account of the time value of money.

(b) measurements that take into consideration the time value of money are more relevant to investors, other external users of financial statements and management for resource allocation decisions, regardless of the general measurement basis adopted in the financial statements.

(c) many enterprises were already familiar with the use of discounting techniques, particularly for supporting investment decisions.

(d) discounting was already required for other areas of financial statements that are based on expectations of future cash flows, such as long-term provisions and employee benefit obligations.

(e) users are better served if they are aware on a timely basis of assets that will not generate sufficient returns to cover, at least, the time value of money.

Recoverable amount based on fair value

BCZ14 IAS 32 *Financial Instruments: Disclosure and Presentation*[†] and a number of other International Accounting Standards define fair value[#] as:

> "... the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction..."

BCZ15 International Accounting Standards include the following requirements or guidance for measuring fair value[Ω]:

(a) for the purpose of revaluation of an item of property, plant or equipment to its fair value, IAS 16 *Property, Plant and Equipment* indicates that fair value is usually an asset's market value, normally determined by appraisal undertaken by professionally qualified valuers and, if no market exists, fair value is based on the asset's depreciated replacement cost.

(b) for the purpose of revaluation of an intangible asset to its fair value, IASC proposed in E60 *Intangible Assets* that fair value be determined by reference to market values obtained from an active market. E60 proposed a definition of an active market.[*]

(c) IASC proposed revisions to IAS 22 (see E61 *Business Combinations*) so that fair value would be determined without consideration of the acquirer's intentions for the future use of an asset.[Φ]

(d) IAS 39[δ] indicates that if an active market exists, the fair value of a financial instrument is based on a quoted market price. If there is no active market, fair value is determined by using estimation techniques such as market values of similar types of financial instruments, discounted cash flow analysis and option pricing models.

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† In 2005 the IASB amended IAS 32 as *Financial Instruments: Presentation.*

\# IFRS 13, issued in May 2011, defines fair value as an exit price.

Ω IFRS 13, issued in May 2011, defines fair value and contains the requirements for measuring fair value. As a consequence the relevant requirements in IAS 16 and IAS 39 have been deleted from those Standards.

* IASC approved an International Accounting Standard on intangible assets in 1998

Φ IASC approved revisions to IAS 22 *Business Combinations* in 1998.

δ The IASB's project to revise IAS 32 and IAS 39 in 2003 resulted in the relocation of the requirements on fair value measurement from IAS 32 to IAS 39. In 2011 the IASB's project on fair value measurement resulted in the relocation of the requirement for measuring fair value to IFRS 13.

BCZ16 Some argue that the only appropriate measurement for the recoverable amount of an asset is fair value (based on observable market prices or, if no observable market prices exist, estimated considering prices for similar assets and the results of discounted future cash flow calculations).[β] Proponents of fair value argue that:

(a) the purpose of measuring recoverable amount is to estimate a market value, not an enterprise-specific value. An enterprise's estimate of the present value of future cash flows is subjective and in some cases may be abused. Observable market prices that reflect the judgement of the marketplace are a more reliable measurement of the amounts that will be recovered from an asset. They reduce the use of management's judgement.

(b) if an asset is expected to generate greater net cash inflows for the enterprise than for other participants, the superior returns are almost always generated by internally generated goodwill stemming from the synergy of the business and its management team. For consistency with IASC's proposals in E60 that internally generated goodwill should not be recognised as an asset, these above-market cash flows should be excluded from assessments of an asset's recoverable amount.

(c) determining recoverable amount as the higher of net selling price and value in use is tantamount to determining two diverging measures whilst there should be only one measure to estimate recoverable amount.

A minority of commentators on E55 supported measuring recoverable amount at fair value (based on observable market prices or, if no observable market prices exist, estimated considering prices for similar assets and the results of discounted future cash flow calculations).

BCZ17 IASC rejected the proposal that an asset's recoverable amount should be determined by reference to its fair value (based on observable market prices or, if no observable market prices exist, estimated considering prices for similar assets and the results of discounted future cash flow calculations). The reasons are the following:

(a) IASC believed that no preference should be given to the market's expectation of the recoverable amount of an asset (basis for fair value when market values are available and for net selling price) over a reasonable estimate performed by the individual enterprise that owns the asset (basis for fair value when market values are not available and for value in use). For example, an enterprise may have information about future cash flows that is superior to the information available in the marketplace. Also, an enterprise may plan to use an asset in a manner different from the market's view of the best use.

(b) market values are a way to estimate fair value but only if they reflect the fact that both parties, the acquirer and the seller, are willing to enter a transaction. If an enterprise can generate greater cash flows by using an asset than by selling it, it would be misleading to base recoverable amount on the market price of the asset because a rational enterprise would not be willing to sell the asset. Therefore, recoverable amount should not refer only to a transaction between two parties (which is unlikely to happen) but should also consider an asset's service potential from its use by the enterprise.

(c) IASC believed that in assessing the recoverable amount of an asset, it is the amount that an enterprise can expect to recover from that asset, including the effect of synergy with other assets, that is relevant.

[β] IFRS 13, issued in May 2011, describes valuation techniques for measuring the fair value of an asset that is being used (and would not be sold) by an entity, eg a current replacement cost valuation technique.

The following two examples illustrate the proposal (rejected by IASC) that an enterprise should measure an asset's recoverable amount at its fair value (primarily based on observable market values if these values are available).

Example 1
10 years ago, an enterprise bought its headquarters building for 2,000. Since then, the real estate market has collapsed and the building's market value at balance sheet date is estimated to be 1,000. Disposal costs of the building would be negligible. The building's carrying amount at the balance sheet date is 1,500 and its remaining useful life is 30 years. The building meets all the enterprise's expectations and it is likely that these expectations will be met for the foreseeable future. As a consequence, the enterprise has no plans to move from its current headquarters. The value in use of the building cannot be determined because the building does not generate independent cash inflows. Therefore, the enterprise assesses the recoverable amount of the building's cash-generating unit, that is, the enterprise as a whole. That calculation shows that the building's cash-generating unit is not impaired. *Proponents of fair value (primarily based on observable market values if these values are available) would measure the recoverable amount of the building at its market value (1,000) and, hence, would recognise an impairment loss of 500 (1,500 less 1,000), even though calculations show that the building's cash-generating unit is not impaired.* *IASC did not support this approach and believed that the building was not impaired. IASC believed that, in the situation described, the enterprise would not be willing to sell the building for 1,000 and that the assumption of a sale was not relevant.*

Example 2
At the end of 20X0, an enterprise purchased a computer for 100 for general use in its operations. The computer is depreciated over 4 years on a straight-line basis. Residual value is estimated to be nil. At the end of 20X2, the carrying amount of the computer is 50. There is an active market for second-hand computers of this type. The market value of the computer is 30. The enterprise does not intend to replace the computer before the end of its useful life. The computer's cash-generating unit is not impaired. *Proponents of fair value (primarily based on observable market values if these values are available) would measure the recoverable amount of the computer at its market value (30) and, therefore, would recognise an impairment loss of 20 (50 less 30) even though the computer's cash-generating unit is not impaired.* *IASC did not support this approach and believed that the computer was not impaired as long as:* *(a) the enterprise was not committed to dispose of the computer before the end of its expected useful life; and* *(b) the computer's cash-generating unit was not impaired.*

BCZ18 If no deep and liquid market exists for an asset, IASC considered that value in use would be a reasonable estimate of fair value. This is likely to happen for many assets within the scope of IAS 36: observable market prices are unlikely to exist for goodwill, most intangible assets and many items of property, plant and equipment. Therefore, it is likely that the recoverable amount of these assets, determined in accordance with IAS 36, will be similar to the recoverable amount based on the fair value of these assets.

BCZ19 For some assets within the scope of IAS 36, observable market prices exist or consideration of prices for similar assets is possible. In such cases, the asset's net selling price will differ from the asset's fair value only by the direct incremental costs of disposal. IASC acknowledged that recoverable amount as the higher of net selling price and value in use would sometimes differ from fair value primarily based on market prices (even if the disposal costs are negligible). This is because, as explained in paragraph BCZ17(a), the market may not use the same assumptions about future cash flows as an individual enterprise.*

BCZ20 IASC believed that IAS 36 included sufficient requirements to prevent an enterprise from using assumptions different from the marketplace that are unjustified. For example, an enterprise is required to determine value in use using:

(a) cash flow projections based on reasonable and supportable assumptions and giving greater weight to external evidence; and

(b) a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

Recoverable amount based on value in use

BCZ21 Some argue that value in use is the only appropriate measurement for the recoverable amount of an asset because:

(a) financial statements are prepared under a going concern assumption. Therefore, no consideration should be given to an alternative measurement that reflects a disposal, unless this reflects the enterprise's intentions.

(b) assets should not be carried at amounts higher than their service potential from use by the enterprise. Unlike value in use, a market value does not necessarily reflect the service potential of an asset.

Few commentators on E55 supported this view.

BCZ22 IASC rejected this proposal because:

(a) if an asset's net selling price is higher than its value in use, a rational enterprise will dispose of the asset. In this situation, it is logical to base recoverable amount on the asset's net selling price to avoid recognising an impairment loss that is unrelated to economic reality.

(b) if an asset's net selling price is greater than its value in use, but management decides to keep the asset, the extra loss (the difference between net selling price and value in use) properly falls in later periods because it results from management's decision in these later periods to keep the asset.

* IFRS 13, issued in May 2011, describes the objective of a fair value measurement and the use of market participant assumptions.

Recoverable amount based on the higher of net selling price and value in use*

BCZ23 The requirement that recoverable amount should be the higher of net selling price and value in use stems from the decision that measurement of the recoverable amount of an asset should reflect the likely behaviour of a rational management. Furthermore, no preference should be given to the market's expectation of the recoverable amount of an asset (basis for net selling price) over a reasonable estimate performed by the individual enterprise which owns the asset (basis for value in use) or vice versa (see paragraphs BCZ17-BCZ20 and BCZ22). It is uncertain whether the assumptions of the market or the enterprise are more likely to be true. Currently, perfect markets do not exist for many of the assets within the scope of IAS 36 and it is unlikely that predictions of the future will be entirely accurate, regardless of who makes them.

BCZ24 IASC acknowledged that an enterprise would use judgement in determining whether an impairment loss needed to be recognised. For this reason, IAS 36 included some safeguards to limit the risk that an enterprise may make an over-optimistic (pessimistic) estimate of recoverable amount:

(a) IAS 36 requires a formal estimate of recoverable amount whenever there is an indication that:

  (i) an asset may be impaired; or

  (ii) an impairment loss may no longer exist or may have decreased. For this purpose, IAS 36 includes a relatively detailed (although not exhaustive) list of indicators that an asset may be impaired (see paragraphs 12 and 111 of IAS 36).

(b) IAS 36 provides guidelines for the basis of management's projections of future cash flows to be used to estimate value in use (see paragraph 33 of IAS 36).

BCZ25 IASC considered the cost of requiring an enterprise to determine both net selling price and value in use, if the amount determined first is below an asset's carrying amount. IASC concluded that the benefits of such a requirement outweigh the costs.

BCZ26 The majority of the commentators on E55 supported IASC's view that recoverable amount should be measured at the higher of net selling price and value in use.

Assets held for disposal

BCZ27 IASC considered whether the recoverable amount of an asset held for disposal should be measured only at the asset's net selling price. When an enterprise expects to dispose of an asset within the near future, the net selling price of the asset is normally close to its value in use. Indeed, the value in use usually consists mostly of the net proceeds to be received for the asset, since future cash flows from continuing use are usually close to nil. Therefore, IASC believed that the definition of recoverable amount as included in IAS 36 is appropriate for assets held for disposal without a need for further requirements or guidance.

* In IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, issued by the IASB in 2004, the term, 'net selling price' was replaced in IAS 36 by 'fair value less costs to sell'.

Other refinements to the measurement of recoverable amount

Replacement cost as a ceiling

BCZ28 Some argue that the replacement cost of an asset should be adopted as a ceiling for its recoverable amount. They argue that the value of an asset to the business would not exceed the amount that the enterprise would be willing to pay for the asset at the balance sheet date.

BCZ29 IASC believed that replacement cost techniques are not appropriate to measuring the recoverable amount of an asset. This is because replacement cost measures the cost of an asset and not the future economic benefits recoverable from its use and/or disposal.

Appraisal values

BCZ30 In some cases, an enterprise might seek external appraisal of recoverable amount. External appraisal is not a separate technique in its own right. IASC believed that if appraisal values are used, an enterprise should verify that the external appraisal follows the requirements of IAS 36.

Net selling price (paragraphs 25-29)*

BCZ31 IAS 36 defines net selling price as the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the incremental costs directly attributable to the disposal of the asset.

BCZ32 In other words, net selling price reflects the market's expectations of the future cash flows for an asset after the market's consideration of the time value of money and the risks inherent in receiving those cash flows, less the disposal costs.

BCZ33 Some argue that direct incremental costs of disposal should not be deducted from the amount obtainable from the sale of an asset because, unless management has decided to dispose of the asset, the going concern assumption should apply.

BCZ34 IASC believed that it is appropriate to deduct direct incremental costs of disposal in determining net selling price because the purpose of the exercise is to determine the net amount that an enterprise could recover from the sale of an asset at the date of the measurement and to compare it with the alternative of keeping the asset and using it.

BCZ35 IAS 36 indicates that termination benefits (as defined in IAS 19 *Employee Benefits*) and costs associated with reducing or reorganising a business following the disposal of an asset are not direct incremental costs to dispose of the asset. IASC considered these costs as incidental to (rather than a direct consequence of) the disposal of an asset. In addition, this guidance is consistent with the direction of the project on provisions.+ .

BCZ36 Although the definition of 'net selling price' would be similar to a definition of 'net fair value', IASC decided to use the term 'net selling price' instead of 'net fair value'. IASC believed that the term 'net selling price' better describes the amount that an enterprise should determine and that will be compared with an asset's value in use.

* In IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, issued by the IASB in 2004, the term, 'net selling price' was replaced in IAS 36 by 'fair value less costs to sell'.

\+ IASC approved an International Accounting Standard on provisions, contingent liabilities and contingent assets in 1998.

Net realisable value

BCZ37 IAS 2 *Inventories* defines net realisable value as:

"... the estimated selling price in the ordinary course of business … less the estimated costs necessary to make the sale..."

BCZ38 For the purpose of determining recoverable amount, IASC decided not to use the term 'net realisable value' as defined in IAS 2 because:

(a) IAS 2's definition of net realisable value does not refer explicitly to transactions carried out on an arm's length basis.

(b) net realisable value refers to an estimated selling price in the ordinary course of business. In certain cases, net selling price will reflect a forced sale, if management is compelled to sell immediately.

(c) it is important that net selling price uses, as a starting point, a selling price agreed between knowledgeable, willing buyers and sellers. This is not explicitly mentioned in the definition of net realisable value.

BCZ39 In most cases, net selling price and net realisable value will be similar. However, IASC did not believe that it was necessary to change the definition of net realisable value used in IAS 2 because, for inventories, the definition of net realisable value is well understood and seems to work satisfactorily.

Value in use (paragraphs 30-57 and the Appendix)

BCZ40 IAS 36 defines value in use as the present value of the future cash flows expected to be derived from an asset.

Expected value approach

BCZ41 Some argue that, to better reflect uncertainties in timing and amounts inherent in estimated future cash flows, expected future cash flows should be used in determining value in use. An expected value approach considers all expectations about possible future cash flows instead of the single, most likely, future cash flows.

Example
An enterprise estimates that there are two scenarios for future cash flows: a first possibility of future cash flows amounts to 120 with a 40 per cent probability and a second possibility amounts to 80 with a 60 per cent probability. *The most likely future cash flows would be 80 and the expected future cash flows would be 96 (80 × 60% + 120 × 40%).*

BCZ42 In most cases, it is likely that budgets/forecasts that are the basis for cash flow projections will reflect a single estimate of future cash flows only. For this reason, IASC decided that an expected value approach should be permitted but not required.

Future cash flows from internally generated goodwill and synergy with other assets

BCZ43 IASC rejected a proposal that estimates of future cash inflows should reflect only future cash inflows relating to the asset that was initially recognised (or the remaining portion of that asset if part of it has already been consumed or sold). The purpose of such a requirement would be to avoid including in an asset's value in use future cash inflows from internally generated goodwill or from synergy with other assets. This would be consistent with IASC's proposal in E60 *Intangible Assets* to prohibit the recognition of internally generated goodwill as an asset.*

BCZ44 In many cases, it will not be possible in practice to distinguish future cash inflows from the asset initially recognised from the future cash inflows from internally generated goodwill or a modification of the asset. This is particularly true when businesses are merged or once an asset has been enhanced by subsequent expenditure. IASC concluded that it is more important to focus on whether the carrying amount of an asset will be recovered rather than on whether the recovery stems partly from internally generated goodwill.

BCZ45 The proposal—that future cash inflows should reflect only future cash inflows relating to the asset that was initially recognised— would also conflict with the requirement under IAS 36 that cash flow projections should reflect reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the remaining useful life of the asset (see paragraph 33 of IAS 36). Therefore, the Standard requires that future cash inflows should be estimated for an asset in its current condition, whether or not these future cash inflows are from the asset that was initially recognised or from its subsequent enhancement or modification.

Example
Several years ago, an enterprise purchased a customer list with 10,000 addresses that it recognised as an intangible asset. The enterprise uses this list for direct marketing of its products. Since initial recognition, about 2,000 customer addresses have been deleted from the list and 3,000 new customer addresses added to it. The enterprise is determining the value in use of the customer list. *Under the proposal (rejected by IASC) that an enterprise should reflect only future cash inflows relating to the asset that was initially recognised, the enterprise would consider only those future cash inflows generated by the remaining 8,000 (10,000 less 2,000) customers from the list acquired.* *Under IAS 36, an enterprise considers the future cash inflows generated by the customer list in its current condition, ie by all 11,000 customers (8,000 plus 3,000).*

* IASC approved an International Accounting Standard on intangible assets in 1998.

Value in use estimated in a foreign currency (paragraph 54)

BCZ46 In response to comments from field test participants, paragraph 54 of IAS 36 includes guidance on calculating the value in use of an asset that generates future cash flows in a foreign currency. IAS 36 indicates that value in use in a foreign currency is translated into the reporting currency* using the spot exchange rate at the balance sheet date.

BCZ47 If a currency is freely convertible and traded in an active market, the spot rate reflects the market's best estimate of future events that will affect that currency. Therefore, the only available unbiased estimate of a future exchange rate is the current spot rate, adjusted by the difference in expected future rates of general inflation in the two countries to which the currencies belong.

BCZ48 A value in use calculation already deals with the effect of general inflation since it is calculated either by:

(a) estimating future cash flows in nominal terms (ie including the effect of general inflation and specific price changes) and discounting them at a rate that includes the effects of general inflation; or

(b) estimating future cash flows in real terms (ie excluding the effect of general inflation but including the effect of specific price changes) and discounting them at a rate that excludes the effect of general inflation.

BCZ49 To use a forward rate to translate value in use expressed in a foreign currency would be inappropriate. This is because a forward rate reflects the market's adjustment for the differential in interest rates. Using such a rate would result in double-counting the time value of money (first in the discount rate and then in the forward rate).

BCZ50 Even if a currency is not freely convertible or is not traded in an active market—with the consequence that it can no longer be assumed that the spot exchange rate reflects the market's best estimate of future events that will affect that currency—IAS 36 indicates that an enterprise uses the spot exchange rate at the balance sheet date to translate value in use estimated in a foreign currency. This is because IASC believed that it is unlikely that an enterprise can make a more reliable estimate of future exchange rates than the current spot exchange rate.

BCZ51 An alternative to estimating the future cash flows in the currency in which they are generated would be to estimate them in another currency as a proxy and discount them at a rate appropriate for this other currency. This solution may be simpler, particularly where cash flows are generated in the currency of a hyperinflationary economy (in such cases, some would prefer using a hard currency as a proxy) or in a currency other than the reporting currency. However, this solution may be misleading if the exchange rate varies for reasons other than changes in the differential between the general inflation rates in the two countries to which the currencies belong. In addition, this solution is inconsistent with the approach under IAS 29 *Financial Reporting in Hyperinflationary Economies*, which does not allow, if the reporting currency* is the currency of a hyperinflationary economy, translation into a hard currency as a proxy for restatement in terms of the measuring unit current at the balance sheet date.

* In IAS 21 *The Effects of Changes in Foreign Exchange Rates*, as revised by the IASB in 2003, the term 'reporting currency' was replaced by 'functional currency'.

Discount rate (paragraphs 55-57 and A15-A21)

BCZ52 The purpose of discounting future cash flows is to reflect the time value of money and the uncertainties attached to those cash flows:

(a) assets that generate cash flows soon are worth more than those generating the same cash flows later. All rational economic transactions will take account of the time value of money. The cost of not receiving a cash inflow until some date in the future is an opportunity cost that can be measured by considering what income has been lost by not investing that money for the period. The time value of money, before consideration of risk, is given by the rate of return on a risk-free investment, such as government bonds of the same duration.

(b) the value of the future cash flows is affected by the variability (ie the risks) associated with the cash flows. Therefore, all rational economic transactions will take risk into account.

BCZ53 As a consequence IASC decided:

(a) to reject a discount rate based on a historical rate—ie the effective rate implicit when an asset was acquired. A subsequent estimate of recoverable amount has to be based on prevailing interest rates because management's decisions about whether to keep the asset are based on prevailing economic conditions. Historical rates do not reflect prevailing economic conditions.

(b) to reject a discount rate based on a risk-free rate, unless the future cash flows have been adjusted for all the risks specific to the asset.

(c) to require that the discount rate should be a rate that reflects current market assessments of the time value of money and the risks specific to the asset. This rate is 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 enterprise expects to derive from the asset.

BCZ54 In principle, value in use should be an enterprise-specific measure determined in accordance with the enterprise's own view of the best use of that asset. Logically, the discount rate should be based on the enterprise's own assessment both of the time value of money and of the risks specific to the future cash flows from the asset. However, IASC believed that such a rate could not be verified objectively. Therefore, IAS 36 requires that the enterprise should make its own estimate of future cash flows but that the discount rate should reflect, as far as possible, the market's assessment of the time value of money. Similarly, the discount rate should reflect the premium that the market would require from uncertain future cash flows based on the distribution estimated by the enterprise.

BCZ55 IASC acknowledged that a current asset-specific market-determined rate would rarely exist for the assets covered by IAS 36. Therefore, an enterprise uses current market-determined rates for other assets (as similar as possible to the asset under review) as a starting point and adjusts these rates to reflect the risks specific to the asset for which the cash flow projections have not been adjusted.

Additional guidance included in the Standard in 2004

Elements reflected in value in use (paragraphs 30-32)

BC56 The Exposure Draft of Proposed Amendments to IAS 36 proposed, and the revised Standard includes, additional guidance to clarify:

(a) the elements that are reflected in an asset's value in use; and

(b) that some of those elements (ie expectations about possible variations in the amount or timing of future cash flows, the price for bearing the uncertainty inherent in the asset, and other factors that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset) can be reflected either as adjustments to the future cash flows or as adjustments to the discount rate.

The Board decided to include this additional guidance in the Exposure Draft in response to a number of requests from its constituents for clarification of the requirements in the previous version of IAS 36 on measuring value in use.

BC57 Respondents to the Exposure Draft generally agreed with the proposals. Those that disagreed varied widely in their views, arguing that:

(a) IAS 36 should be amended to permit entities to measure value in use using methods other than discounting of future cash flows.

(b) when measuring the value in use of an intangible asset, entities should be required to reflect the price for bearing the uncertainty inherent in the asset as adjustments to the future cash flows.

(c) it is inconsistent with the definition of value in use to reflect in that measure the other factors that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset—this element refers to market pricing of an asset rather than to the value to the entity of the asset. Other factors should be reflected in value in use only to the extent that they affect the cash flows the entity can achieve from the asset.

BC58 In considering (a) above, the Board observed that the measure of recoverable amount in IAS 36 (ie higher of value in use and fair value less costs to sell) stems from IASC's decision that an asset's recoverable amount should reflect the likely behaviour of a rational management, with no preference given to the market's expectation of the recoverable amount of an asset (ie fair value less costs to sell) over a reasonable estimate performed by the entity that controls the asset (ie value in use) or vice versa (see paragraph BCZ23). In developing the Exposure Draft and revising IAS 36, the Board concluded that it would be inappropriate to modify the measurement basis adopted in the previous version of IAS 36 for determining recoverable amount until the Board considers and resolves the broader question of the appropriate measurement objective(s) in accounting. Moreover, IAS 36 does not preclude the use of other valuation techniques in estimating fair value less costs to sell. For example, paragraph 27 of the Standard states that 'If there is no binding sale agreement or active market for an asset, fair value less costs to sell is based on the best information available to reflect the amount that an entity could obtain, at the balance sheet date, from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the costs of disposal.'[*]

[*] IFRS 13, issued in May 2011, contains the requirements for measuring fair value. As a consequence paragraph 27 of IAS 36 has been deleted.

BC59 In considering (b) above, the Board observed that the previous version of IAS 36 permitted risk adjustments to be reflected either in the cash flows or in the discount rate, without indicating a preference. The Board could see no justification for amending this approach to require risk adjustments for uncertainty to be factored into the cash flows, particularly given the Board's inclination to avoid modifying the requirements in the previous version of IAS 36 for determining recoverable amount until it considers and resolves the broader question of measurement in accounting. Additionally, the Board as part of its consultative process conducted field visits and round-table discussions during the comment period for the Exposure Draft.* Many field visit participants indicated a preference for reflecting such risk adjustments in the discount rate.

BC60 In considering (c) above, the Board observed that the measure of value in use adopted in IAS 36 is not a pure 'entity-specific' measure. Although the cash flows used as the starting point in the calculation represent entity-specific cash flows (ie they are derived from the most recent financial budgets/forecasts approved by management and represent management's best estimate of the set of economic conditions that will exist over the remaining useful life of the asset), their present value is required to be determined using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Paragraph 56 of the Standard (paragraph 49 of the previous version of IAS 36) clarifies that "A rate that reflects current market assessments of the time value of money and the risks specific to the asset is 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." In other words, an asset's value in use reflects how the market would price the cash flows that management expects to derive from that asset.

BC61 Therefore, the Board concluded that:

(a) it is consistent with the measure of value in use adopted in IAS 36 to include in the list of elements the other factors that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset.

(b) all of the elements proposed in the Exposure Draft (and listed in paragraph 30 of the revised Standard) should be reflected in the calculation of an asset's value in use.

Estimates of future cash flows (paragraphs 33, 34 and 44)

BC62 The Exposure Draft proposed requiring cash flow projections used in measuring value in use to be based on reasonable and supportable assumptions that take into account both past actual cash flows and management's past ability to forecast cash flows accurately.

* The field visits were conducted from early December 2002 to early April 2003, and involved IASB members and staff in meetings with 41 companies in Australia, France, Germany, Japan, South Africa, Switzerland and the United Kingdom. IASB members and staff also took part in a series of round-table discussions with auditors, preparers, accounting standard-setters and regulators in Canada and the United States on implementation issues encountered by North American companies during first-time application of US Statements of Financial Accounting Standards 141 *Business Combinations* and 142 *Goodwill and Other Intangible Assets*, and the equivalent Canadian Handbook Sections, which were issued in June 2001.

BC63 Many respondents to the Exposure Draft disagreed with this proposal, arguing that:

(a) the reasons for past cash flow forecasts differing from actual cash flows may be irrelevant to the current projections. For example, if there has been a major change in management, management's past ability to forecast cash flows might not be relevant to the current projections. Additionally, a poor record of forecasting cash flows accurately might be the result of factors outside of management's control (such as the events of September 11, 2001), rather than indicative of management bias.

(b) it is unclear how, in practice, the assumptions on which the cash flow projections are based could take into account past differences between management's forecasts and actual cash flows.

(c) the proposal is inconsistent with the requirement to base cash flow projections on the most recent financial budgets/forecasts approved by management.

BC64 The Board observed that, as worded, the proposal would have *required* the assumptions on which the cash flow forecasts are based to be adjusted for past actual cash flows and management's past ability to forecast cash flows accurately. The Board agreed with respondents that it is not clear how, in practice, this might be achieved, and that in some circumstances past actual cash flows and management's past ability to forecast cash flows accurately might not be relevant to the development of current forecasts. However, the Board remained of the view that in developing the assumptions on which the cash flow forecasts are based, management should remain mindful of, and when appropriate make the necessary adjustments for, an entity's actual past performance or previous history of management consistently overstating or understating cash flow forecasts.

BC65 Therefore, the Board decided not to proceed with the proposal, but instead to include in paragraph 34 of the Standard guidance clarifying that management:

(a) should assess the reasonableness of the assumptions on which its current cash flow projections are based by examining the causes of differences between past cash flow projections and actual cash flows; and

(b) should ensure that the assumptions on which its current cash flow projections are based are consistent with past actual outcomes, provided the effects of subsequent events or circumstances that did not exist when those actual cash flows were generated make this appropriate.

BC66 In finalising the Standard the Board also considered two issues identified by respondents to the Exposure Draft and referred to the Board by the International Financial Reporting Interpretations Committee. Both issues related to the application of paragraphs 27(b) and 37 of the previous version of IAS 36 (now paragraphs 33(b) and 44). The Board did not reconsider those paragraphs when developing the Exposure Draft.

BC67 Paragraph 27(b) required the cash flow projections used to measure value in use to be based on the most recent financial budgets/forecasts that have been approved by management. Paragraph 37, however, required the future cash flows to be estimated for the asset [or cash-generating unit] in its current condition and excluded estimated future cash inflows or outflows that are expected to arise from: (a) a future restructuring to which an enterprise is not yet committed; or (b) future capital expenditure that will improve or enhance the asset [or cash-generating unit] in excess of its originally assessed standard of performance.*

BC68 The first issue the Board considered related to the acquisition of a cash-generating unit when:

(a) the price paid for the unit was based on projections that included a major restructuring expected to result in a substantial increase in the net cash inflows derived from the unit; and

(b) there is no observable market from which to estimate the unit's fair value less costs to sell.#

Respondents expressed concern that if the net cash inflows arising from the restructuring were not reflected in the unit's value in use, comparison of the unit's recoverable amount and carrying amount immediately after the acquisition would result in the recognition of an impairment loss.

BC69 The Board agreed with respondents that, all else being equal, the value in use of a newly acquired unit would, in accordance with IAS 36, be less than the price paid for the unit to the extent that the price includes the net benefits of a future restructuring to which the entity is not yet committed. However, this does not mean that a comparison of the unit's recoverable amount with its carrying amount immediately after the acquisition will result in the recognition of an impairment loss. The Board observed that:†

(a) recoverable amount is measured in accordance with IAS 36 as the higher of value in use and fair value less costs to sell. Fair value less costs to sell is defined in the Standard as 'the amount obtainable from the sale of an asset or cash-generating unit in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal.'

(b) paragraphs 25-27 of the Standard provide guidance on estimating fair value less costs to sell. In accordance with that guidance, the best evidence of a recently acquired unit's fair value less costs to sell is likely to be the arm's length price the entity paid to acquire the unit, adjusted for disposal costs and for any changes in economic circumstances between the transaction date and the date at which the estimate is made.

(c) if the unit's fair value less costs to sell were to be otherwise estimated, it would also reflect the market's assessment of the expected net benefits any acquirer would be able to derive from restructuring the unit or from future capital expenditure on the unit.

* The requirement to exclude future capital expenditure that will improve or enhance the asset in excess of its originally assessed standard of performance was amended in 2003 as a consequential amendment arising from the revision of IAS 16 *Property, Plant and Equipment*. Paragraph 44 of IAS 36 now requires estimates of future cash flows to exclude future cash inflows or outflows that are expected to arise from improving or enhancing the asset's performance.

IFRS 13, issued in May 2011, contains the requirements for measuring fair value.

† IFRS 13, issued in May 2011, contains the requirements for measuring fair value. As a consequence paragraphs 25-27 of IAS 36 have been deleted.

BC70 Therefore, all else being equal, the unit's recoverable amount would be its fair value less costs to sell, rather than its value in use. As such, the net benefits of the restructuring would be reflected in the unit's recoverable amount, meaning that an impairment loss would arise only to the extent of any material disposal costs.

BC71 The Board acknowledged that treating the newly acquired unit's fair value less costs to sell as its recoverable amount seems inconsistent with the reason underpinning a "higher of fair value less costs to sell and value in use" recoverable amount measurement objective. Measuring recoverable amount as the higher of fair value less costs to sell and value in use is intended to reflect the economic decisions that are made when an asset becomes impaired: is it better to sell or keep using the asset?

BC72 Nevertheless, the Board concluded that:

(a) amending IAS 36 to include in value in use calculations the costs and benefits of future restructurings to which the entity is not yet committed would be a significant change to the concept of value in use adopted in the previous version of IAS 36. That concept is 'value in use for the asset in its current condition'.

(b) the concept of value in use in IAS 36 should not be modified as part of the Business Combinations project, but should be reconsidered only once the Board considers and resolves the broader question of the appropriate measurement objectives in accounting.

BC73 The second issue the Board considered related to what some respondents suggested was a conflict between the requirements in paragraphs 27(b) and 37 of the previous version of IAS 36 (now paragraphs 33(b) and 44). Paragraph 27(b) required value in use to be based on the most recent forecasts approved by management— which would be likely to reflect management's intentions in relation to future restructurings and future capital expenditure—whereas paragraph 37 required value in use to exclude the effects of a future restructuring to which the enterprise is not yet committed and future capital expenditure that will improve or enhance the asset in excess of its originally assessed standard of performance.[*]

BC74 The Board concluded that it is clear from the Basis for Conclusions on the previous version of IAS 36 that IASC's intention was that value in use should be calculated using estimates of future cash inflows for an asset in its current condition. The Board nevertheless agreed with respondents that the requirement for value in use to be based on the most recent forecasts approved by management could be viewed as inconsistent with paragraph 37 of the previous version of IAS 36 when those forecasts include either future restructurings to which the entity is not yet committed or future cash flows associated with improving or enhancing the asset's performance.

[*] The requirement to exclude future capital expenditure that will improve or enhance the asset in excess of its originally assessed standard of performance was amended in 2003 as a consequential amendment arising from the revision of IAS 16 *Property, Plant and Equipment*. Paragraph 44 of IAS 36 now requires estimates of future cash flows to exclude future cash inflows or outflows that are expected to arise from improving or enhancing the asset's performance.

BC75 Therefore, the Board decided to clarify, in what is now paragraph 33(b) of the revised Standard, that cash flow projections should be based on the most recent financial budgets/forecasts that have been approved by management, but should exclude any estimated future cash inflows or outflows expected to arise from future restructurings or from improving or enhancing the asset's performance. The Board also decided to clarify that when a cash-generating unit contains assets with different estimated useful lives (or, similarly, when an asset comprises components with different estimated useful lives), the replacement of assets (components) with shorter lives is 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).

Using present value techniques to measure value in use (paragraphs A1-A14)

BC76 The Exposure Draft proposed additional application guidance on using present value techniques in measuring value in use. The Board decided to include this additional guidance in the Exposure Draft in response to requests for clarification of the requirements in the previous version of IAS 36 on measuring value in use.

BC77 Respondents to the Exposure Draft were generally supportive of the additional guidance. Those that were not varied in their views, suggesting that:

(a) limiting the guidance to a brief appendix to IAS 36 is insufficient.

(b) although the guidance is useful, it detracts from the main purpose of IAS 36, which is to establish accounting principles for impairment testing assets. Therefore, the guidance should be omitted from the Standard.

(c) entities should be required to use an expected cash flow approach to measure value in use.

(d) an expected cash flow approach is not consistent with how transactions are priced by management and should be prohibited.

BC78 In considering (a) and (b) above, the Board noted that the respondents that commented on the additional guidance generally agreed that it is useful and sufficient.

BC79 In considering (c) and (d) above, the Board observed that the previous version of IAS 36 did not require value in use to be calculated using an expected cash flow approach, nor did it prohibit such an approach. The Board could see no justification for requiring or prohibiting the use of an expected cash flow approach, particularly given the Board's inclination to avoid modifying the requirements in the previous version of IAS 36 for determining recoverable amount until it considers and resolves the broader measurement issues in accounting. Additionally, in relation to (d), some field visit participants said that they routinely undertake sensitivity and statistical analysis as the basis for using an expected value approach to budgeting/forecasting and strategic decision-making.

BC80 Therefore, the Board decided to include in the revised Standard the application guidance on using present value techniques that was proposed in the Exposure Draft.

Income taxes

Consideration of future tax cash flows

BCZ81 Future income tax cash flows may affect recoverable amount. It is convenient to analyse future tax cash flows into two components:

(a) the future tax cash flows that would result from any difference between the tax base of an asset (the amount attributed to it for tax purposes) and its carrying amount, after recognition of any impairment loss. Such differences are described in IAS 12 *Income Taxes* as 'temporary differences'.

(b) the future tax cash flows that would result if the tax base of the asset were equal to its recoverable amount.

BCZ82 For most assets, an enterprise recognises the tax consequences of temporary differences as a deferred tax liability or deferred tax asset in accordance with IAS 12. Therefore, to avoid double-counting, the future tax consequences of those temporary differences—the first component referred to in paragraph BCZ81—are not considered in determining recoverable amount (see further discussion in paragraphs BCZ86-BCZ89).

BCZ83 The tax base of an asset on initial recognition is normally equal to its cost. Therefore, net selling price* implicitly reflects market participants' assessment of the future tax cash flows that would result if the tax base of the asset were equal to its recoverable amount. Therefore, no adjustment is required to net selling price to reflect the second component referred to in paragraph BCZ81.

BCZ84 In principle, value in use should include the present value of the future tax cash flows that would result if the tax base of the asset were equal to its value in use—the second component referred to in paragraph BCZ81. Nevertheless it may be burdensome to estimate the effect of that component. This is because:

(a) to avoid double-counting, it is necessary to exclude the effect of temporary differences; and

(b) value in use would need to be determined by an iterative and possibly complex computation so that value in use itself reflects a tax base equal to that value in use.

For these reasons, IASC decided to require an enterprise to determine value in use by using pre-tax future cash flows and, hence, a pre-tax discount rate.

Determining a pre-tax discount rate

BCZ85 In theory, discounting post-tax cash flows at a post-tax discount rate and discounting pre-tax cash flows at a pre-tax discount rate should give the same result, as long as the pre-tax discount rate is the post-tax discount rate adjusted to reflect the specific amount and timing of the future tax cash flows. The pre-tax discount rate is not always the post-tax discount rate grossed up by a standard rate of tax.

* In IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, issued by the IASB in 2004, the term, 'net selling price' was replaced in IAS 36 by 'fair value less costs to sell'.

Example

This example illustrates that a post-tax discount rate grossed-up by a standard rate of tax is not always an appropriate pre-tax discount rate.

At the end of 20X0, the carrying amount of an asset is 1,757 and its remaining useful life is 5 years. The tax base in 20X0 is the cost of the asset. The cost is fully deductible at the end of 20X1. The tax rate is 20%. The discount rate for the asset can be determined only on a post-tax basis and is estimated to be 10%. At the end of 20X0, cash flow projections determined on a pre-tax basis are as follows:

	20X1	20X2	20X3	20X4	20X5
(1) Pre-tax cash flows (CF)	800	600	500	200	100

Value in use determined using post-tax cash flows and a post-tax discount rate

End of 20X0	*20X1*	*20X2*	*20X3*	*20X4*	*20X5*
(2) Deduction of the cost of the asset	*(1,757)*	-	-	-	-
*(3) Tax CF [((1)-(2))*20%]*	*(191)*	*120*	*100*	*40*	*20*
(4) Post-tax CF [(1)-(3)]	*991*	*480*	*400*	*160*	*80*
(5) Post-tax CF discounted at 10%	*901*	*396*	*301*	*109*	*50*
Value in use [∑(5)] =					*1,757*

Value in use determined using pre-tax cash flows and a pre-tax discount rate (determined by grossing-up the post-tax discount rate)

Pre-tax discount rate (grossed-up) [10%/(100%-20%)] 12.5%

End of 20X0	*20X1*	*20X2*	*20X3*	*20X4*	*20X5*
(6) Pre-tax CF discounted at 12.5%	*711*	*475*	*351*	*125*	*55*
Value in use [∑(6)] =					*1,717*

Determination of the 'real' pre-tax discount rate

A pre-tax discount rate can be determined by an iterative computation so that value in use determined using pre-tax cash flows and a pre-tax discount rate equals value in use determined using post-tax cash flows and a post-tax discount rate. In the example, the pre-tax discount rate would be 11.2%.

continued…

…continued

End of 20X0	*20X1*	*20X2*	*20X3*	*20X4*	*20X5*
(7) Pre-tax CF discounted at 11.2%	*718*	*485*	*364*	*131*	*59*
Value in use [∑(7)] =					*1,757*

The 'real' pre-tax discount rate differs from the post-tax discount rate grossed-up by the standard rate of tax depending on the tax rate, the post-tax discount rate, the timing of the future tax cash flows and the useful life of the asset. Note that the tax base of the asset in this example has been set equal to its cost at the end of 20X0. Therefore, there is no deferred tax to consider in the balance sheet.

Interaction with IAS 12

BCZ86 IAS 36 requires that recoverable amount should be based on present value calculations, whereas under IAS 12 an enterprise determines deferred tax assets and liabilities by comparing the carrying amount of an asset (a present value if the carrying amount is based on recoverable amount) with its tax base (an undiscounted amount).

BCZ87 One way to eliminate this inconsistency would be to measure deferred tax assets and liabilities on a discounted basis. In developing the revised version of IAS 12 (approved in 1996), there was not enough support to require that deferred tax assets and liabilities should be measured on a discounted basis. IASC believed there was still not consensus to support such a change in existing practice. Therefore, IAS 36 requires an enterprise to measure the tax effects of temporary differences using the principles set out in IAS 12.

BCZ88 IAS 12 does not permit an enterprise to recognise certain deferred tax liabilities and assets. In such cases, some believe that the value in use of an asset, or a cash-generating unit, should be adjusted to reflect the tax consequences of recovering its pre-tax value in use. For example, if the tax rate is 25 per cent, an enterprise must receive pre-tax cash flows with a present value of 400 in order to recover a carrying amount of 300.

BCZ89 IASC acknowledged the conceptual merit of such adjustments but concluded that they would add unnecessary complexity. Therefore, IAS 36 neither requires nor permits such adjustments.

Comments by field visit participants and respondents to the December 2002 Exposure Draft

BC90 In revising IAS 36, the Board considered the requirement in the previous version of IAS 36 for:

(a) income tax receipts and payments to be excluded from the estimates of future cash flows used to measure value in use; and

(b) the discount rate used to measure value in use to be a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the future cash flow estimates have not been adjusted.

BC91 The Board had not considered these requirements when developing the Exposure Draft. However, some field visit participants and respondents to the Exposure Draft stated that using pre-tax cash flows and pre-tax discount rates would be a significant implementation issue for entities. This is because typically an entity's accounting and strategic decision-making systems are fully integrated and use post-tax cash flows and post-tax discount rates to arrive at present value measures.

BC92 In considering this issue, the Board observed that the definition of value in use in the previous version of IAS 36 and the associated requirements on measuring value in use were not sufficiently precise to give a definitive answer to the question of what tax attribute an entity should reflect in value in use. For example, although IAS 36 specified discounting pre-tax cash flows at a pre-tax discount rate— with the pre-tax discount rate being the post-tax discount rate adjusted to reflect the specific amount and timing of the future tax cash flows—it did not specify *which* tax effects the pre-tax rate should include. Arguments could be mounted for various approaches.

BC93 The Board decided that any decision to amend the requirement in the previous version of IAS 36 for pre-tax cash flows to be discounted at a pre-tax discount rate should be made only after the Board has resolved the issue of what tax attribute should be reflected in value in use. The Board decided that it should not try to resolve this latter issue as part of the Business Combinations project—decisions on the treatment of tax in value in use calculations should be made only as part of its conceptual project on measurement. Therefore, the Board concluded it should not amend as part of the current revision of IAS 36 the requirement to use pre-tax cash flows and pre-tax discount rates when measuring value in use.

BC94 However, the Board observed that, conceptually, discounting post-tax cash flows at a post-tax discount rate and discounting pre-tax cash flows at a pre-tax discount rate should give the same result, as long as the pre-tax discount rate is the post-tax discount rate adjusted to reflect the specific amount and timing of the future tax cash flows. The pre-tax discount rate is generally not the post-tax discount rate grossed up by a standard rate of tax.

Recognition of an impairment loss (paragraphs 58-64)

BCZ95 IAS 36 requires that an impairment loss should be recognised whenever the recoverable amount of an asset is below its carrying amount. IASC considered various criteria for recognising an impairment loss in the financial statements:

(a) recognition if it is considered that the impairment loss is permanent ('permanent criterion');

(b) recognition if it is considered probable that an asset is impaired, ie if it is probable that an enterprise will not recover the carrying amount of the asset ('probability criterion'); and

(c) immediate recognition whenever recoverable amount is below the carrying amount ('economic criterion').

Recognition based on a 'permanent' criterion

BCZ96 Supporters of the 'permanent' criterion argue that:

(a) this criterion avoids the recognition of temporary decreases in the recoverable amount of an asset.

(b) the recognition of an impairment loss refers to future operations; it is contrary to the historical cost system to account for future events. Also, depreciation (amortisation) will reflect these future losses over the expected remaining useful life of the asset.

This view was supported by only a few commentators on E55 *Impairment of Assets*.

BCZ97 IASC decided to reject the 'permanent' criterion because:

(a) it is difficult to identify whether an impairment loss is permanent. There is a risk that, by using this criterion, recognition of an impairment loss may be delayed.

(b) this criterion is at odds with the basic concept that an asset is a resource that will generate future economic benefits. Cost-based accrual accounting cannot reflect events without reference to future expectations. If the events that led to a decrease in recoverable amount have already taken place, the carrying amount should be reduced accordingly.

Recognition based on a 'probability' criterion

BCZ98 Some argue that an impairment loss should be recognised only if it is considered probable that the carrying amount of an asset cannot be fully recovered. Proponents of a 'probability' criterion are divided between:

(a) those who support the use of a recognition trigger based on the sum of the future cash flows (undiscounted and without allocation of interest costs) as a practical approach to implementing the 'probability' criterion; and

(b) those who support reflecting the requirements in IAS 10 (reformatted 1994) *Contingencies and Events Occurring After the Balance Sheet Date*.[*]

Sum of undiscounted future cash flows (without interest costs)

BCZ99 Some national standard-setters use the 'probability' criterion as a basis for recognition of an impairment loss and require, as a practical approach to implementing that criterion, that an impairment loss should be recognised only if the sum of the future cash flows from an asset (undiscounted and without allocation of interest costs) is less than the carrying amount of the asset. An impairment loss, when recognised, is measured as the difference between the carrying amount of the asset and its recoverable amount measured at fair value (based on quoted market prices or, if no quoted market prices exist, estimated considering prices for similar assets and the results of valuation techniques, such as the sum of cash flows discounted to their present value, option-pricing models, matrix pricing, option adjusted spread models and fundamental analysis).[#]

[*] The requirements relating to contingencies in the 1994 version of IAS 10 were replaced in 1998 with the requirements in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

[#] IFRS 13, issued in May 2011, contains the requirements for measuring fair value.

BCZ100 One of the characteristics of this approach is that the bases for recognition and measurement of an impairment loss are different. For example, even if the fair value of an asset is lower than its carrying amount, no impairment loss will be recognised if the sum of undiscounted cash flows (without allocation of interest costs) is greater than the asset's carrying amount. This might occur, especially if an asset has a long useful life.

BCZ101 Those who support using the sum of undiscounted future cash flows (without allocation of interest costs) as a recognition trigger argue that:

(a) using a recognition trigger based on undiscounted amounts is consistent with the historical cost framework.

(b) it avoids recognising temporary impairment losses and creating potentially volatile earnings that may mislead users of financial statements.

(c) net selling price* and value in use are difficult to substantiate— a price for the disposal of an asset or an appropriate discount rate is difficult to estimate.

(d) it is a higher threshold for recognising impairment losses. It should be relatively easy to conclude that the sum of undiscounted future cash flows will equal or exceed the carrying amount of an asset without incurring the cost of allocating projected cash flows to specific future periods.

This view was supported by a minority of commentators on E55 *Impairment of Assets*.

BCZ102 IASC considered the arguments listed above but rejected this approach because:

(a) when it identifies that an asset may be impaired, a rational enterprise will make an investment decision. Therefore, it is relevant to consider the time value of money and the risks specific to an asset in determining whether an asset is impaired. This is particularly true if an asset has a long useful life.

(b) IAS 36 does not require an enterprise to estimate the recoverable amount of each [depreciable] asset every year but only if there is an indication that an asset may be materially impaired. An asset that is depreciated (amortised) in an appropriate manner is unlikely to become materially impaired unless events or changes in circumstances cause a sudden reduction in the estimate of recoverable amount.

(c) probability factors are already encompassed in the determination of value in use, in projecting future cash flows and in requiring that recoverable amount should be the higher of net selling price and value in use.

(d) if there is an unfavourable change in the assumptions used to determine recoverable amount, users are better served if they are informed about this change in assumptions on a timely basis.

* In IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, issued by the IASB in 2004, the term, 'net selling price' was replaced in IAS 36 by 'fair value less costs to sell'.

Probability criterion based on IAS 10 (reformatted 1994)

BCZ103 IAS 10 required the amount of a contingent loss to be recognised as an expense and a liability if:

(a) it was probable that future events will confirm that, after taking into account any related probable recovery, an asset had been impaired or a liability incurred at the balance sheet date; and

(b) a reasonable estimate of the amount of the resulting loss could be made.

BCZ104 IASC rejected the view that an impairment loss should be recognised based on the requirements in IAS 10 because:

(a) the requirements in IAS 10 were not sufficiently detailed and would have made a 'probability' criterion difficult to apply.

(b) those requirements would have introduced another unnecessary layer of probability. Indeed, as mentioned above, probability factors are already encompassed in estimates of value in use and in requiring that recoverable amount should be the higher of net selling price and value in use.

Recognition based on an 'economic' criterion

BCZ105 IAS 36 relies on an 'economic' criterion for the recognition of an impairment loss—an impairment loss is recognised whenever the recoverable amount of an asset is below its carrying amount. This criterion was already used in many International Accounting Standards before IAS 36, such as IAS 9 *Research and Development Costs*, IAS 22 *Business Combinations*, and IAS 16 *Property, Plant and Equipment*.

BCZ106 IASC considered that an 'economic' criterion is the best criterion to give information which is useful to users in assessing future cash flows to be generated by the enterprise as a whole. In estimating the time value of money and the risks specific to an asset in determining whether the asset is impaired, factors, such as the probability or permanence of the impairment loss, are subsumed in the measurement.

BCZ107 The majority of commentators on E55 supported IASC's view that an impairment loss should be recognised based on an 'economic' criterion.

Revalued assets: recognition in the income statement versus directly in equity

BCZ108 IAS 36 requires that an impairment loss on a revalued asset should be recognised as an expense in the income statement[*] immediately, except that it should be recognised directly in equity[†] to the extent that it reverses a previous revaluation on the same asset.

[*] IAS 1 *Presentation of Financial Statements* (as revised in 2007) requires an entity to present all income and expense items in one statement of comprehensive income or in two statements (a separate income statement and a statement of comprehensive income).

[†] As a consequence of the revision of IAS 1 (revised 2007) an impairment loss is recognised in other comprehensive income.

BCZ109 Some argue that, when there is a clear reduction in the service potential (for example, physical damage) of a revalued asset, the impairment loss should be recognised in the income statement.

BCZ110 Others argue that an impairment loss should always be recognised as an expense in the income statement. The logic of this argument is that an impairment loss arises only where there is a reduction in the estimated future cash flows that form part of the business's operating activities. Indeed, according to IAS 16, whether or not an asset is revalued, the depreciation charge is always recognised in the income statement. Supporters of this view question why the treatment of an impairment loss on a revalued asset should be different to depreciation.

BCZ111 IASC believed that it would be difficult to identify whether an impairment loss is a downward revaluation or a reduction in service potential. Therefore, IASC decided to retain the treatment used in IAS 16 and to treat an impairment loss of a revalued asset as a revaluation decrease (and similarly, a reversal of an impairment loss as a subsequent revaluation increase).

BCZ112 For a revalued asset, the distinction between an 'impairment loss' ('reversal of an impairment loss') and another 'revaluation decrease' ('revaluation increase') is important for disclosure purposes. If an impairment loss that is material to the enterprise as a whole has been recognised or reversed, more information on how this impairment loss is measured is required by IAS 36 than for the recognition of a revaluation in accordance with IAS 16.

Cash-generating units (paragraphs 66-73)

BCZ113 Some support the principle of determining recoverable amount on an individual asset basis only. This view was expressed by a few commentators on E55. They argued that:

(a) it would be difficult to identify cash-generating units at a level other than the business as a whole and, therefore, impairment losses would never be recognised for individual assets; and

(b) it should be possible to recognise an impairment loss, regardless of whether an asset generates cash inflows that are independent from those of other assets or groups of assets. Commentators quoted examples of assets that have become under-utilised or obsolete but that are still in use.

BCZ114 IASC acknowledged that identifying the lowest level of independent cash inflows for a group of assets would involve judgement. However, IASC believed that the concept of cash-generating units is a matter of fact: assets work together to generate cash flows.

BCZ115 In response to requests from commentators on E55, IAS 36 includes additional guidance and examples for identifying cash-generating units and for determining the carrying amount of cash-generating units. IAS 36 emphasises that cash-generating units should be identified for the lowest level of aggregation of assets possible.

Internal transfer pricing (paragraph 70)

BC116 The previous version of IAS 36 required that if an active market exists for the output produced by an asset or a group of assets:

(a) that asset or group of assets should be identified as a cash-generating unit, even if some or all of the output is used internally; and

(b) management's best estimate of the future market prices for the output should be used in estimating:

(i) the future cash inflows that relate to the internal use of the output when determining the value in use of this cash-generating unit; and

(ii) the future cash outflows that relate to the internal use of the output when determining the value in use of the entity's other cash-generating units.

BC117 The requirement in (a) above has been carried forward in the revised Standard. However, some respondents to the Exposure Draft asked for additional guidance to clarify the role of internal transfer pricing versus prices in an arm's length transaction when developing cash flow forecasts. The Board decided to address this issue by amending the requirement in (b) above to deal more broadly with cash-generating units whose cash flows are affected by internal transfer pricing, rather than just cash-generating units whose internally consumed output could be sold on an active market.

BC118 Therefore, the Standard clarifies that if the cash inflows generated by *any* asset or cash-generating unit are affected by internal transfer pricing, an entity should use management's best estimate of future prices that could be achieved in arm's length transactions in estimating:

(a) the future cash inflows used to determine the asset's or cash-generating unit's value in use; and

(b) the future cash outflows used to determine the value in use of other assets or cash-generating units affected by the internal transfer pricing.

Testing indefinite-lived intangibles for impairment

BC119 As part of the first phase of its Business Combinations project, the Board concluded that:

(a) an intangible asset should be regarded as having an indefinite useful life when, based on an analysis of all relevant factors (eg legal, regulatory, contractual, competitive and economic), there is no foreseeable limit on the period over which the asset is expected to generate net cash inflows for the entity; and

(b) an indefinite-lived intangible should not be amortised, but should be tested regularly for impairment.

An outline of the Board's deliberations on each of these issues is provided in the Basis for Conclusions on IAS 38 *Intangible Assets*.

BC120 Having reached these conclusions, the Board then considered the form that the impairment test for indefinite-lived intangibles should take. The Board concluded that:

(a) an indefinite-lived intangible should be tested for impairment annually, or more frequently if there is any indication that it may be impaired; and

(b) the recoverable amounts of such assets should be measured, and impairment losses (and reversals of impairment losses) in respect of those assets should be accounted for, in accordance with the requirements in IAS 36 for assets other than goodwill.

Paragraphs BC121-BC126 outline the Board's deliberations in reaching its conclusion about the frequency and timing of impairment testing indefinite-lived intangibles. Paragraphs BC129 and BC130 outline the Board's deliberations in reaching its conclusions about measuring the recoverable amount of such assets and accounting for impairment losses and reversals of impairment losses.

Frequency and timing of impairment testing (paragraphs 9 and 10(a))

BC121 In developing the Exposure Draft, the Board observed that requiring assets to be remeasured when they are impaired is a valuation concept rather than one of cost allocation. This concept, which some have termed 'the recoverable cost concept', focuses on the benefits to be derived from the asset in the future, rather than on the process by which the cost or other carrying amount of the asset should be allocated to particular accounting periods. Therefore, the purpose of an impairment test is to assess whether the carrying amount of an asset will be recovered through use or sale of the asset. Nevertheless, allocating the depreciable amount of an asset with a limited useful life on a systematic basis over that life provides some assurance against the asset's carrying amount exceeding its recoverable amount. The Board acknowledged that non-amortisation of an intangible asset increases the reliance that must be placed on impairment reviews of that asset to ensure that its carrying amount does not exceed its recoverable amount.

BC122 Accordingly, the Exposure Draft proposed that indefinite-lived intangibles should be tested for impairment at the end of each annual reporting period. The Board concluded, however, that testing such assets annually for impairment is not a substitute for management being aware of events occurring or circumstances changing between annual tests that indicate a possible impairment. Therefore, the Exposure Draft also proposed that an entity should be required to test such assets for impairment whenever there is an indication of possible impairment, and not wait until the next annual test.

BC123 The respondents to the Exposure Draft generally supported the proposal to test indefinite-lived intangibles for impairment annually and whenever there is an indication of possible impairment. Those that disagreed argued that requiring an annual impairment test would be excessively burdensome, and recommended requiring an impairment test only when there is an indication that an indefinite-lived intangible might be impaired. After considering these comments the Board:

(a) reaffirmed its view that non-amortisation of an intangible asset increases the reliance that must be placed on impairment reviews of that asset to ensure that its carrying amount does not exceed its recoverable amount.

(b) concluded that IAS 36 should require indefinite-lived intangibles to be tested for impairment annually and whenever there is an indication of possible impairment.

BC124 However, as noted in paragraph BC122, the Exposure Draft proposed that the annual impairment tests for indefinite-lived intangibles should be performed at the end of each annual period. Many respondents to the Exposure Draft disagreed that IAS 36 should mandate the timing of the annual impairment tests. They argued that:

(a) it would be inconsistent with the proposal (now a requirement) that the annual impairment test for a cash-generating unit to which goodwill has been allocated may be performed at any time during an annual period, provided the test is performed at the same time every year. There is no justification for providing less flexibility in the timing of the annual impairment test for indefinite-lived intangibles.

(b) if the impairment test for an indefinite-lived intangible is linked to the impairment test for goodwill (ie if the indefinite lived intangible is assessed for impairment at the same cash-generating unit level as goodwill, rather than individually or as part of a smaller cash-generating unit), the requirement to measure its recoverable amount at the end of the annual period could result in the cash-generating unit to which it (and the goodwill) belongs being tested for impairment at least twice each annual period, which is too burdensome. For example, assume a cash-generating unit contains goodwill and an indefinite-lived intangible, and that the indefinite-lived intangible is assessed for impairment at the same cash-generating unit level as goodwill. Assume also that the entity reports quarterly, has a December year-end, and decides to test goodwill for impairment at the end of the third quarter to coincide with the completion of its annual strategic planning/budgeting process. The proposal that the annual impairment test for an indefinite-lived intangible should be performed at the end of each annual period would mean that the entity would be required:

(i) to calculate at the end of each September the recoverable amount of the cash-generating unit, compare it with its carrying amount, and, if the carrying amount exceeds the recoverable amount, recognise an impairment loss for the unit by reducing the carrying amount of goodwill and allocating any remaining impairment loss to the other assets in the unit, including the indefinite-lived intangible.

(ii) to perform the same steps again each December to test the indefinite-lived intangible for impairment.

(iii) to perform the same steps again at any other time throughout the annual period if there is an indication that the cash-generating unit, the goodwill or the indefinite-lived intangible may be impaired.

BC125 In considering these comments, the Board indicated a preference for requiring entities to perform the recoverable amount calculations for both goodwill and indefinite-lived intangibles at the end of the annual period. However, the Board acknowledged that, as outlined in paragraph BC124(b), impairment tests for indefinite-lived intangibles will sometimes be linked to impairment tests for goodwill, and that many entities would find it difficult to perform all those tests at the end of the annual period.

BC126 Therefore, consistently with the annual impairment test for goodwill, the Standard permits the annual impairment test for an indefinite-lived intangible to be performed at any time during an annual period, provided it is performed at the same time every year.

Carrying forward a recoverable amount calculation (paragraph 24)

BC127 The Standard permits the most recent detailed calculation of the recoverable amount of an indefinite-lived intangible to be carried forward from a preceding period for use in the current period's impairment test, provided all of the criteria in paragraph 24 of the Standard are met.

BC128 Integral to the Board's decision that indefinite-lived intangibles should be tested for impairment annually was the view that many entities should be able to conclude that the recoverable amount of such an asset is greater than its carrying amount without actually recomputing recoverable amount. However, the Board concluded that this would be the case only if the last recoverable amount determination exceeded the carrying amount by a substantial margin, and nothing had happened since then to make the likelihood of an impairment loss other than remote. The Board concluded that, in such circumstances, permitting a detailed calculation of the recoverable amount of an indefinite-lived intangible to be carried forward from the preceding period for use in the current period's impairment test would significantly reduce the costs of applying the impairment test, without compromising its integrity.

Measuring recoverable amount and accounting for impairment losses and reversals of impairment losses

BC129 The Board could see no compelling reason why the measurement basis adopted for determining recoverable amount and the treatment of impairment losses and reversals of impairment losses for one group of identifiable assets should differ from those applying to other identifiable assets. Adopting different methods would impair the usefulness of the information provided to users about an entity's identifiable assets, because both comparability and reliability, which rest on the notion that similar transactions are accounted for in the same way, would be diminished. Therefore, the Board concluded that the recoverable amounts of indefinite-lived intangibles should be measured, and impairment losses and reversals of impairment losses in respect of those assets should be accounted for, consistently with other identifiable assets covered by the Standard.

BC130 The Board expressed some concern over the measurement basis adopted in the previous version of IAS 36 for determining recoverable amount (ie higher of value in use and net selling price) and its treatment of impairment losses and reversals of impairment losses for assets other than goodwill. However, the Board's intention in revising IAS 36 was *not* to reconsider the general approach to impairment testing. Accordingly, the Board decided that it should address concerns over that general approach as part of its future re-examination of IAS 36 in its entirety, rather than as part of its Business Combinations project.

Testing goodwill for impairment (paragraphs 80-99)

BC131 [Deleted]

BC131A The Board concluded that goodwill should not be amortised and instead should be tested for impairment annually, or more frequently if events or changes in circumstances indicate that it might be impaired. IAS 22 *Business Combinations* required acquired goodwill to be amortised on a systematic basis over the best estimate of its useful life. There was a rebuttable presumption that its useful life did not exceed twenty years from initial recognition. If that presumption was rebutted, acquired goodwill was required to be tested for impairment in accordance with the previous version of IAS 36 at least at each financial year-end, even if there was no indication that it was impaired.

BC131B In considering the appropriate accounting for acquired goodwill after its initial recognition, the Board examined the following three approaches:

(a) straight-line amortisation but with an impairment test whenever there is an indication that the goodwill might be impaired;

(b) non-amortisation but with an impairment test annually or more frequently if events or changes in circumstances indicate that the goodwill might be impaired; and

(c) permitting entities a choice between approaches (a) and (b).

BC131C The Board concluded, and the respondents to ED 3 *Business Combinations* that expressed a clear view on this issue generally agreed, that entities should not be allowed a choice between approaches (a) and (b). Permitting such choices impairs the usefulness of the information provided to users of financial statements because both comparability and reliability are diminished.

BC131D The respondents to ED 3 who expressed a clear view on this issue generally supported approach (a). They put forward the following arguments in support of that approach:

(a) acquired goodwill is an asset that is consumed and replaced by internally generated goodwill. Therefore, amortisation ensures that the acquired goodwill is recognised in profit or loss and no internally generated goodwill is recognised as an asset in its place, consistently with the general prohibition in IAS 38 on the recognition of internally generated goodwill.

(b) conceptually, amortisation is a method of allocating the cost of acquired goodwill over the periods it is consumed, and is consistent with the approach taken to other intangible and tangible fixed assets that do not have indefinite useful lives. Indeed, entities are required to determine the useful lives of items of property, plant and equipment, and allocate their depreciable amounts on a systematic basis over those useful lives. There is no conceptual reason for treating acquired goodwill differently.

(c) the useful life of acquired goodwill cannot be predicted with a satisfactory level of reliability, nor can the pattern in which that goodwill diminishes be known. However, systematic amortisation over an albeit arbitrary period provides an appropriate balance between conceptual soundness and operationality at an acceptable cost: it is the only practical solution to an intractable problem.

BC131E In considering these comments, the Board agreed that achieving an acceptable level of reliability in the form of representational faithfulness while striking some balance with what is practicable was the primary challenge it faced in deliberating the subsequent accounting for goodwill. The Board observed that the useful life of acquired goodwill and the pattern in which it diminishes generally are not possible to predict, yet its amortisation depends on such predictions. As a result, the amount amortised in any given period can be described as at best an arbitrary estimate of the consumption of acquired goodwill during that period. The Board acknowledged that if goodwill is an asset, in some sense it must be true that goodwill acquired in a business combination is being consumed and replaced by internally generated goodwill, provided that an entity is able to maintain the overall value of goodwill (by, for example, expending resources on advertising and customer service). However, consistently with the view it reached in developing ED 3, the Board remained doubtful about the usefulness of an amortisation charge that reflects the consumption of acquired goodwill, when the internally generated goodwill replacing it is not recognised. Therefore, the Board reaffirmed the conclusion it reached in developing ED 3 that straight-line amortisation of goodwill over an arbitrary period fails to provide useful information. The Board noted that both anecdotal and research evidence supports this view.

BC131F In considering respondents' comments summarised in paragraph BC131D(b), the Board noted that although the useful lives of both goodwill and tangible fixed assets are directly related to the period over which they are expected to generate net cash inflows for the entity, the expected physical utility to the entity of a tangible fixed asset places an upper limit on the asset's useful life. In other words, unlike goodwill, the useful life of a tangible fixed asset could never extend beyond the asset's expected physical utility to the entity.

BC131G The Board reaffirmed the view it reached in developing ED 3 that if a rigorous and operational impairment test could be devised, more useful information would be provided to users of an entity's financial statements under an approach in which goodwill is not amortised, but instead tested for impairment annually or more frequently if events or changes in circumstances indicate that the goodwill might be impaired. After considering respondents' comments to the exposure draft of proposed amendments to IAS 36 on the form that such an impairment test should take, the Board concluded that a sufficiently rigorous and operational impairment test could be devised.

BC132 Paragraphs BC133-BC177 outline the Board's deliberations on the form that the impairment test for goodwill should take:

(a) paragraphs BC137-BC159 discuss the requirements relating to the allocation of goodwill to cash-generating units and the level at which goodwill is tested for impairment.

(b) paragraphs BC160-BC170 discuss the requirements relating to the recognition and measurement of impairment losses for goodwill, including the frequency of impairment testing.

(c) paragraphs BC171-BC177 discuss the requirements relating to the timing of goodwill impairment tests.

BC133 As a first step in its deliberations, the Board considered the objective of the goodwill impairment test and the measure of recoverable amount that should be adopted for such a test. The Board observed that recent North American standards use fair value as the basis for impairment testing goodwill, whereas the previous version of IAS 36 and the United Kingdom standard are based on an approach under which recoverable amount is measured as the higher of value in use and net selling price.

BC134 The Board also observed that goodwill acquired in a business combination represents a payment made by an acquirer in anticipation of future economic benefits from assets that are not capable of being individually identified and separately recognised. Goodwill does not generate cash flows independently of other assets or groups of assets and therefore cannot be measured directly. Instead, it is measured as a residual amount, being the excess of the cost of a business combination over the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities. Moreover, goodwill acquired in a business combination and goodwill generated after that business combination cannot be separately identified, because they contribute jointly to the same cash flows.[*]

BC135 The Board concluded that because it is not possible to measure separately goodwill generated internally after a business combination and to factor that measure into the impairment test for acquired goodwill, the carrying amount of goodwill will always be shielded from impairment by that internally generated goodwill. Therefore, the Board took the view that the objective of the goodwill impairment test could at best be to ensure that the carrying amount of goodwill is recoverable from future cash flows expected to be generated by both acquired goodwill and goodwill generated internally after the business combination.

BC136 The Board noted that because goodwill is measured as a residual amount, the starting point in any goodwill impairment test would have to be the recoverable amount of the operation or unit to which the goodwill relates, regardless of the measurement basis adopted for determining recoverable amount. The Board decided that until it considers and resolves the broader question of the appropriate measurement objective(s) in accounting, identifying the appropriate measure of recoverable amount for that unit would be problematic. Therefore, although the Board expressed concern over the measurement basis adopted in IAS 36 for determining recoverable amount, it decided that it should not depart from that basis when measuring the recoverable amount of a unit whose carrying amount includes acquired goodwill. The Board noted that this would have the added advantage of allowing the impairment test for goodwill to be integrated with the impairment test in IAS 36 for other assets and cash-generating units that include goodwill.

Allocating goodwill to cash-generating units (paragraphs 80-87)

BC137 The previous version of IAS 36 required goodwill to be tested for impairment as part of impairment testing the cash-generating units to which it relates. It employed a 'bottom-up/top-down' approach under which the goodwill was in effect tested for impairment by allocating its carrying amount to each of the smallest cash-generating units to which a portion of that carrying amount could be allocated on a reasonable and

[*] In the second phase of its business combinations project, the Board revised the definition and measurement of goodwill in IFRS 3. See paragraph 32 and Appendix A of IFRS 3 (as revised in 2008).

consistent basis.

BC138 Consistently with the previous version of IAS 36, the Exposure Draft proposed that:

(a) goodwill should be tested for impairment as part of impairment testing the cash-generating units to which it relates; and

(b) the carrying amount of goodwill should be allocated to each of the smallest cash-generating units to which a portion of that carrying amount can be allocated on a reasonable and consistent basis.

However, the Exposure Draft proposed additional guidance clarifying that a portion of the carrying amount of goodwill should be regarded as capable of being allocated to a cash-generating unit on a reasonable and consistent basis only when that unit represents the lowest level at which management monitors the return on investment in assets that include the goodwill. That cash-generating unit could not, however, be larger than a segment based on the entity's primary reporting format determined in accordance with IAS 14 *Segment Reporting*.

BC139 In developing this proposal, the Board noted that because acquired goodwill does not generate cash flows independently of other assets or groups of assets, it can be tested for impairment only as part of impairment testing the cash-generating units to which it relates. However, the Board was concerned that in the absence of any guidance on the precise meaning of 'allocated on a reasonable and consistent basis', some might conclude that when a business combination enhances the value of all of the acquirer's pre-existing cash-generating units, any goodwill acquired in that business combination should be tested for impairment only at the level of the entity itself. The Board concluded that this should not be the case. Rather, there should be a link between the level at which goodwill is tested for impairment and the level of internal reporting that reflects the way an entity manages its operations and with which the goodwill naturally would be associated. Therefore, it was important to the Board that goodwill should be tested for impairment at a level at which information about the operations of an entity and the assets that support them is provided for internal reporting purposes.

BC140 In redeliberating this issue, the Board noted that respondents' and field visit participants' comments indicated that the Board's intention relating to the allocation of goodwill had been widely misunderstood, with many concluding that goodwill would need to be allocated to a much lower level than that intended by the Board. For example, some respondents and field visit participants were concerned that the proposal to allocate goodwill to such a low level would force entities to allocate goodwill arbitrarily to cash-generating units, and therefore to develop new or additional reporting systems to perform the test. The Board confirmed that its intention was that there should be a link between the level at which goodwill is tested for impairment and the level of internal reporting that reflects the way an entity manages its operations. Therefore, except for entities that do not monitor goodwill at or below the segment level, the proposals relating to the level of the goodwill impairment test should *not* cause entities to allocate goodwill arbitrarily to cash-generating units. Nor should they create the need for entities to develop new or additional reporting systems.

BC141 The Board observed from its discussions with field visit participants that much of the confusion stemmed from the definition of a 'cash-generating unit', when coupled with the proposal in paragraph 73 of the Exposure Draft for goodwill to be allocated to each "smallest cash-generating unit to which a portion of the carrying amount of the goodwill can be allocated on a reasonable and consistent basis". Additionally, field visit participants and respondents were unclear about the reference in paragraph 74 of the

Exposure Draft to 'the lowest level at which management monitors the return on investments in assets that include goodwill', the most frequent question being 'what level of management?' (eg board of directors, chief executive officer, or segment management).

BC142 The Board noted that once its intention on this issue was clarified for field visit participants, they all, with the exception of one company that believes goodwill should be tested for impairment at the entity level, supported the level at which the Board believes goodwill should be tested for impairment.

BC143 The Board also noted the comment from a number of respondents and field visit participants that for some organisations, particularly those managed on a matrix basis, the proposal for cash-generating units to which the goodwill is allocated to be no larger than a segment based on the entity's *primary* reporting format could result in an outcome that is inconsistent with the Board's intention, ie that there should be a link between the level at which goodwill is tested for impairment and the level of internal reporting that reflects the way an entity manages its operations. The following example illustrates this point:

> A company managed on a matrix basis is organised primarily on a geographical basis, with product groups providing the secondary basis of segmentation. Goodwill is acquired as part of an acquisition of a product group that is present in several geographical regions, and is then monitored on an ongoing basis for internal reporting purposes as part of the product group/secondary segment. It is feasible that the secondary segment might, depending on the definition of 'larger', be 'larger' than a primary segment.

BC144 Therefore, the Board decided:

(a) that the Standard should require each unit or group of units to which goodwill is allocated to represent the lowest level within the entity at which the goodwill is monitored for internal management purposes.

(b) to clarify in the Standard that acquired goodwill should, from the acquisition date, be allocated to each of the acquirer's cash-generating units, or groups of cash-generating units, that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units.

(c) to replace the proposal for cash-generating units or groups of units to which goodwill is allocated to be no larger than a segment based on the entity's *primary* reporting format, with the requirement that they be no larger than a segment based on either the entity's primary or the entity's secondary reporting format. The Board concluded that this amendment is necessary to ensure that entities managed on a matrix basis are able to test goodwill for impairment at the level of internal reporting that reflects the way they manage their operations.*

BC145 Some respondents to the Exposure Draft raised the following additional concerns on the allocation of goodwill for impairment testing purposes:

(a) mandating that goodwill should be allocated to at least the segment level is inappropriate—it will often result in arbitrary allocations, and entities would need to develop new or additional reporting systems.

* In 2006 IAS 14 was replaced by IFRS 8 *Operating Segments*. IFRS 8 does not require disclosure of primary and secondary segment information. See paragraph BC150A.

(b) for convergence reasons, the level of the goodwill impairment test should be the same as the level in US Financial Accounting Standards Board Statement of Financial Accounting Standards No. 142 *Goodwill and Other Intangible Assets* (SFAS 142) (ie the reporting unit level).

(c) cash-generating units that constitute businesses with similar characteristics should, as is required by SFAS 142, be aggregated and treated as single units, notwithstanding that they may be monitored independently for internal purposes.

BC146 In relation to (a), the Board reaffirmed the conclusion it reached when developing the Exposure Draft that requiring goodwill to be allocated to at least the segment level is necessary to avoid entities erroneously concluding that, when a business combination enhances the value of all of the acquirer's pre-existing cash-generating units, any goodwill acquired in that combination could be tested for impairment only at the level of the entity itself.

BC147 In relation to (b), the Board noted that SFAS 142 requires goodwill to be tested for impairment at a level of reporting referred to as a 'reporting unit'. A reporting unit is an operating segment (as defined in SFAS 131 *Disclosures about Segments of an Enterprise and Related Information*[†]) or one level below an operating segment (referred to as a component). A component of an operating segment is a reporting unit if the component constitutes a business for which discrete financial information is available and segment management regularly reviews the operating results of that component. However, two or more components of an operating segment must be aggregated and deemed a single reporting unit if the components have similar economic characteristics. An operating segment is deemed to be a reporting unit if all of its components are similar, if none of its components is a reporting unit, or if it comprises only a single component.

BC148 Therefore, unlike IAS 36, SFAS 142 places a limit on how far goodwill can be 'pushed down' for impairment testing (ie one level below an operating segment).

BC149 In deciding not to converge with SFAS 142 on the level of the goodwill impairment test, the Board noted the following findings from the field visits and North American round-table discussions:

(a) most of the US registrant field visit participants stated that the Board's proposals on the level of the goodwill impairment test would result, in practice, in goodwill being tested for impairment at the same level at which it is tested in accordance with SFAS 142. However, several stated that under the Board's proposals, goodwill would be tested for impairment at a lower level than under SFAS 142. Nevertheless, they believe that the Board's approach provides users and management with more useful information.

[†] The basis for identifying 'operating segments' under SFAS 131 differs from the basis for identifying segments based on the entity's primary reporting format under IFRS 8. SFAS 131 defines an operating segment as a component of an enterprise (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 enterprise; (b) whose operating results are regularly reviewed by the enterprise's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance; and (c) for which discrete financial information is available. IAS 14 was replaced by IFRS 8 in 2006. See paragraph BC150A.

(b) several round-table participants stated that they (or, in the case of audit firm participants, their clients) manage and have available information about their investments in goodwill at a lower level than the level of the SFAS 142 impairment test. They expressed a high level of dissatisfaction at being prevented by SFAS 142 from recognising goodwill impairments that they knew existed at these lower levels, but which ‘disappeared’ once the lower level units were aggregated with other units containing sufficient ‘cushions’ to offset the impairment loss.

BC150 In considering suggestion (c) in paragraph BC145, the Board observed that aggregating units that constitute businesses with similar characteristics could result in the disappearance of an impairment loss that management *knows* exists in a cash-generating unit because the units with which it is aggregated contain sufficient cushions to offset the impairment loss. In the Board’s view, if, because of the way an entity is managed, information about goodwill impairment losses is available to management at a particular level, that information should also be available to the users of the entity’s financial statements.

BC150A In 2006 IFRS 8 replaced IAS 14 and changed the basis for identifying segments. Under IAS 14, two sets of segments were identified–one based on related products and services, and the other on geographical areas. Under IFRS 8, operating segments are identified on the basis of internal reports that are regularly reviewed by the entity’s chief operating decision maker in order to allocate resources to the segment and assess its performance. The objective of the change was to improve the disclosure of segment information, not to change the requirements of IAS 36 relating to the allocation of goodwill for impairment testing. The previous wording of the requirement in IAS 36 that each unit or group of units to which goodwill is allocated shall “not be larger than a segment based on either the entity’s primary or the entity’s secondary reporting format determined in accordance with IAS 14” has been amended by IFRS 8 to “not be larger than an operating segment determined in accordance with IFRS 8”. The arguments set out above in support of the original requirement based on segments determined in accordance with IAS 14 support the revised requirements based on segments determined in accordance with the requirements in IFRS 8.

BC150B Entities adopting IFRS 8 must reconsider the allocation of goodwill to cash-generating units because of the definition of operating segment introduced by IFRS 8. That definition affects the determination of the largest unit permitted by paragraph 80 of IAS 36 for testing goodwill for impairment. In 2008 the Board was made aware that divergent views had developed regarding the largest unit permitted by IAS 36 for impairment testing of goodwill. One view was that the unit is the operating segment level as defined in paragraph 5 of IFRS 8 *before* the aggregation permitted by paragraph 12 of IFRS 8. The other view was that the unit is the operating segment level as defined in paragraph 5 of IFRS 8 *after* the aggregation permitted by paragraph 12 of IFRS 8. The Board noted that the lowest level of the entity at which management monitors goodwill as required in paragraph 80(a) is the same as the lowest level of operating segments at which the chief operating decision maker regularly reviews operating results as defined in IFRS 8. The Board also noted that the linkage of the entity’s goodwill monitoring level with the entity’s internal reporting level is intentional, as described in paragraph BC140. The Board noted that aggregating operating segments for goodwill impairment testing into a unit larger than the level at which goodwill is monitored contradicts the rationale underlying IAS 36, as set out in paragraphs BC145–BC150. In addition, meeting the aggregation criteria of similar economic characteristics permitted in IFRS 8 does not automatically result in groups of cash-generating units that are expected to benefit from the synergies of allocated goodwill. Similarly, the aggregated segments do not necessarily represent business operations that are economically interdependent or work in concert to recover the goodwill being assessed for impairment. Therefore, in *Improvements to IFRSs* issued in April 2009, the Board amended paragraph 80(b) to state that the required unit for goodwill impairment in IAS 36 is not larger than the operating segment level as defined in paragraph 5 of IFRS 8 before the permitted aggregation.

Completing the initial allocation of goodwill (paragraphs 84 and 85)

BC151 If the initial allocation of goodwill acquired in a business combination cannot be completed before the end of the annual period in which the business combination is effected, the Exposure Draft proposed, and the revised Standard requires, that the initial allocation should be completed before the end of the first annual period beginning after the acquisition date. In contrast, ED 3 proposed, and IFRS 3 requires, that if the initial accounting for a business combination can be determined only provisionally by the end of the period in which the combination is effected, the acquirer should:

(a) account for the combination using those provisional values; and

(b) recognise any adjustments to those provisional values as a result of completing the initial accounting within twelve months of the acquisition date.*

BC152 Some respondents to the Exposure Draft questioned why the period to complete the initial allocation of goodwill should differ from the period to complete the initial accounting for a business combination. The Board's view is that acquirers should be allowed a longer period to complete the goodwill allocation, because that allocation often might not be able to be performed until after the initial accounting for the combination is complete. This is because the cost of the combination or the fair values at the acquisition date of the acquiree's identifiable assets, liabilities or contingent liabilities, and therefore the amount of goodwill acquired in the combination, would not be finalised until the initial accounting for the combination in accordance with IFRS 3 is complete.

Disposal of a portion of a cash-generating unit containing goodwill (paragraph 86)

BC153 The Exposure Draft proposed that when an entity disposes of an operation within a cash-generating unit to which goodwill has been allocated, the goodwill associated with that operation should be:

(a) included in the carrying amount of the operation when determining the gain or loss on disposal; and

(b) measured on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit retained.

BC154 This proposal has been carried forward in the Standard with one modification. The Standard requires the goodwill associated with the operation disposed of to be measured on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit retained, unless the entity can demonstrate that some other method better reflects the goodwill associated with the operation disposed of.

* In the second phase of its business combinations project, the Board clarified that adjustments to provisional values should be made only to reflect new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the measurement of the amounts recognised as of that date. Such adjustments should be made within the measurement period, which shall not exceed one year from the acquisition date.

BC155 In developing the Exposure Draft, the Board concluded that the proposed level of the impairment test would mean that goodwill could not be identified or associated with an asset group at a level lower than the cash-generating unit to which the goodwill is allocated, except arbitrarily. However, the Board also concluded that when an operation within that cash-generating unit is being disposed of, it is appropriate to presume that some amount of goodwill is associated with that operation. Thus, an allocation of the goodwill should be required when the part of the cash-generating unit being disposed of constitutes an operation.

BC156 Some respondents to the Exposure Draft suggested that although in most circumstances goodwill could not be identified or associated with an asset group at a level lower than the cash-generating unit or group of cash-generating units to which it is allocated for impairment testing, there may be some instances when this is not so. For example, assume an acquiree is integrated with one of the acquirer's pre-existing cash-generating units that did not include any goodwill in its carrying amount. Assume also that almost immediately after the business combination the acquirer disposes of a loss-making operation within the cash-generating unit. The Board agreed with respondents that in such circumstances, it might reasonably be concluded that no part of the carrying amount of goodwill has been disposed of, and therefore no part of its carrying amount should be derecognised by being included in the determination of the gain or loss on disposal.

Reorganisation of reporting structure (paragraph 87)

BC157 The Exposure Draft proposed that when an entity reorganises its reporting structure in a way that changes the composition of cash-generating units to which goodwill has been allocated, the goodwill should be reallocated to the units affected using a relative value approach similar to that used when an entity disposes of an operation within a cash-generating unit.

BC158 In developing the Exposure Draft, the Board concluded that a reorganisation that changes the composition of a cash-generating unit to which goodwill has been allocated gives rise to the same allocation problem as disposing of an operation within that unit. Therefore, the same allocation methodology should be used in both cases.

BC159 As a result, and consistently with the Board's decision to modify its proposal on allocating goodwill when an entity disposes of an operation, the revised Standard requires an entity that reorganises its reporting structure in a way that changes the composition of one or more cash-generating units to which goodwill has been allocated:

(a) to reallocate the goodwill to the units affected; and

(b) to perform this reallocation using a relative value approach similar to that used when an entity disposes of an operation within a cash-generating unit (group of cash-generating units), unless the entity can demonstrate that some other method better reflects the goodwill associated with the reorganised units (groups of units).

Recognition and measurement of impairment losses (paragraphs 88-99 and 104)

Background to the proposals in the Exposure Draft

BC160 The Exposure Draft proposed a two-step approach for impairment testing goodwill. The first step involved using a screening mechanism for identifying potential goodwill impairments, whereby goodwill allocated to a cash-generating unit would be identified as potentially impaired only when the carrying amount of the unit exceeded its recoverable amount. If an entity identified the goodwill allocated to a cash-generating unit as potentially impaired, an entity would then determine whether the goodwill allocated to the unit was impaired by comparing its recoverable amount, measured as the 'implied value' of the goodwill, with its carrying amount. The implied value of goodwill would be measured as a residual, being the excess of:

(a) the recoverable amount of the cash-generating unit to which the goodwill has been allocated, over

(a) the net fair value of the identifiable assets, liabilities and contingent liabilities the entity would recognise if it acquired the cash-generating unit in a business combination on the date of the impairment test (excluding any identifiable asset that was acquired in a business combination but not recognised separately from goodwill at the acquisition date).

BC161 In developing the Exposure Draft, the Board's discussion focused first on how the recoverable amount of goodwill allocated to a cash-generating unit could be separated from the recoverable amount of the unit as a whole, given that goodwill generated internally after a business combination could not be measured separately. The Board concluded that a method similar to the method an acquirer uses to allocate the cost of a business combination to the net assets acquired could be used to measure the recoverable amount of goodwill after its initial recognition. Thus, the Board decided that some measure of the net assets of a cash-generating unit to which goodwill has been allocated should be subtracted from the recoverable amount of that unit to determine a current implied value for the goodwill. The Board concluded that the measure of the net assets of a cash-generating unit described in paragraph BC160(b) would result in the best estimate of the current implied value of the goodwill, given that goodwill generated internally after a business combination could not be measured separately.

BC162 Having decided on the most appropriate measure of the recoverable amount of goodwill, the Board then considered how often an entity should be required to test goodwill for impairment. Consistently with its conclusions about indefinite-lived intangibles, the Board concluded that non-amortisation of goodwill increases the reliance that must be placed on impairment tests to ensure that the carrying amount of goodwill does not exceed its recoverable amount. Accordingly, the Board decided that goodwill should be tested for impairment annually. However, the Board also concluded that the annual test is not a substitute for management being aware of events occurring or circumstances changing between annual tests indicating a possible impairment of goodwill. Therefore, the Board decided that an entity should also be required to test goodwill for impairment whenever there is an indication of possible impairment.

BC163 After the Board decided on the frequency of impairment testing, it expressed some concern that the proposed test would not be cost-effective. This concern related primarily to the requirement to determine the fair value of each identifiable asset, liability and contingent liability within a cash-generating unit that would be recognised by the entity if it had acquired the cash-generating unit in a business combination on the date of the impairment test (to estimate the implied value of goodwill).

BC164 Therefore, the Board decided to propose as a first step in the impairment test for goodwill a screening mechanism similar to that in SFAS 142. Under SFAS 142, goodwill is tested for impairment by first comparing the fair value of the reporting unit to which the goodwill has been allocated for impairment testing purposes with the carrying amount of that unit. If the fair value of the unit exceeds its carrying amount, the goodwill is regarded as not impaired. An entity need estimate the implied fair value of goodwill (using an approach consistent with that described in paragraph BC160) only if the fair value of the unit is less than its carrying amount.

The Board's redeliberations

BC165 Many respondents disagreed with the proposal to adopt a two-step approach to impairment testing goodwill. In particular, the second step of the proposed impairment test and the method for measuring any impairment loss for the goodwill caused considerable concern. Respondents provided the following conceptual arguments against the proposed approach:

(a) by drawing on only some aspects of the SFAS 142 two-step approach, the result is a hybrid between fair values and value in use. More particularly, not measuring goodwill's implied value as the difference between the unit's fair value and the net fair value of the identifiable net assets in the unit, but instead measuring it as the difference between the unit's recoverable amount (ie higher of value in use and fair value less costs to sell) and the net fair value of the identifiable net assets in the unit, results in a measure of goodwill that conceptually is neither fair value nor recoverable amount. This raises questions about the conceptual validity of measuring goodwill impairment losses as the difference between goodwill's implied value and carrying amount.

(b) it seems inconsistent to consider goodwill separately for impairment testing when other assets within a unit are not considered separately but are instead considered as part of the unit as a whole, particularly given that goodwill, unlike many other assets, cannot generate cash inflows independently of other assets. The previous version of IAS 36 is premised on the notion that if a series of independent cash flows can be generated only by a group of assets operating together, impairment losses should be considered only for that group of assets as a whole—individual assets within the group should not be considered separately.

(c) concluding that the recoverable amount of goodwill—which cannot generate cash inflows independently of other assets— should be measured separately for measuring impairment losses makes it difficult to understand how the Board could in the future reasonably conclude that such an approach to measuring impairment losses is also not appropriate for other assets. In other words, if it adopts the proposed two-step approach for goodwill, the Board could in effect be committing itself to an 'individual asset/fair value' approach for measuring impairments of all other assets. A decision on this issue should be made only as part of a broad reconsideration of the appropriate measurement objective for impairment testing generally.

(d) if goodwill is considered separately for impairment testing using an implied value calculation when other assets within a unit are considered only as part of the unit as a whole, there will be asymmetry: unrecognised goodwill will shield the carrying value of other assets from impairment, but the unrecognised value of other assets will not shield the carrying amount of goodwill from impairment. This seems unreasonable given that the unrecognised value of those other assets cannot then be recognised. Additionally, the carrying amount of a unit will be less than its recoverable amount whenever an impairment loss for goodwill exceeds the unrecognised value of the other assets in the unit.

BC166 Additionally, respondents, field visit participants and North American round-table participants raised the following concerns about the practicability and costs of applying the proposed two-step approach:

(a) many companies would be required regularly to perform the second step of the impairment test, and therefore would need to determine the fair values of each identifiable asset, liability and contingent liability within the impaired unit(s) that the entity would recognise if it acquired the unit(s) in a business combination on the date of the impairment test. Although determining these fair values would not, for some companies, pose significant practical challenges (because, for example, fair value information for their significant assets is readily available), most would need to engage, on a fairly wide scale and at significant cost, independent valuers for some or all of the unit's assets. This is particularly the case for identifying and measuring the fair values of unrecognised internally generated intangible assets.

(b) determining the fair values of each identifiable asset, liability and contingent liability within an impaired unit is likely to be impracticable for multi-segmented manufacturers that operate multi-product facilities servicing more than one cash-generating unit. For example, assume an entity's primary basis of segmentation is geographical (eg Europe, North America, South America, Asia, Oceania and Africa) and that its secondary basis of segmentation is based on product groups (vaccinations, over-the-counter medicines, prescription medicines and vitamins/dietary supplements).[*] Assume also that:

(i) the lowest level within the entity at which the goodwill is monitored for internal management purposes is one level below primary segment (eg the vitamins business in North America), and that goodwill is therefore tested for impairment at this level;

(ii) the plants and distribution facilities in each geographical region manufacture and distribute for all product groups; and

(iii) to determine the carrying amount of each cash-generating unit containing goodwill, the carrying amount of each plant and distribution facility has been allocated between each product group it services.

If, for example, the recoverable amount of the North American vitamins unit were less than its carrying amount, measuring the implied value of goodwill in that unit would require a valuation exercise to be undertaken for *all* North American assets so that a portion of each asset's fair value can then be allocated to the North American vitamins

[*] In 2006 IAS 14 was replaced by IFRS 8 *Operating Segments*, which does not require disclosure of primary and secondary segment information. See paragraph BC150A.

unit. These valuations are likely to be extremely costly and virtually impossible to complete within a reasonable time period (field visit participants' estimates ranged from six to twelve months). The degree of impracticability will be even greater for those entities that monitor, and therefore test, goodwill at the segment level.

BC167 In considering the above comments, the Board noted that:

(a) all of the US registrant field visit participants and North American round-table participants that have had to perform the second step of the SFAS 142 impairment test were compelled to engage, at significant cost, independent valuers.

(b) the impairment model proposed in the Exposure Draft, although based on the two-step approach in SFAS 142, differed from the SFAS 142 test and would be unlikely to result in convergence for the following reasons:

(i) the recoverable amount of a unit to which goodwill is allocated in accordance with IAS 36 would be the higher of the unit's value in use and fair value less costs to sell, rather than fair value. Many of the US registrant field visit participants stated that the measure of recoverable amount they would use under IAS 36 would differ from the fair value measure they would be required to use under SFAS 142.

(ii) the level at which goodwill is tested for impairment in accordance with SFAS 142 will often be higher than the level at which it would be tested under IAS 36. Many of the US registrant field visit participants stated that goodwill would be tested for impairment in accordance with IAS 36 at a lower level than under SFAS 142 because of either: (1) the limit SFAS 142 places on how far goodwill can be 'pushed down' for impairment testing (ie one level below an operating segment); or (2) the requirement in SFAS 142 to aggregate components with similar economic characteristics. Nevertheless, these participants unanimously agreed that the IAS 36 approach provides users and management with more useful information. The Board also noted that many of the North American round-table participants stated that they (or, in the case of audit firm participants, their clients) manage and have available information about their investments in goodwill at a level lower than a reporting unit as defined in SFAS 142. Many of these participants expressed a high level of dissatisfaction at being prevented by SFAS 142 from recognising goodwill impairments that they knew existed at these lower levels, but 'disappeared' once the lower level units were aggregated with other units containing sufficient 'cushions' to offset the impairment loss.

BC168 The Board also noted that, unlike SFAS 142, it had as its starting point an impairment model in IAS 36 that integrates the impairment testing of *all* assets within a cash-generating unit, including goodwill. Unlike US generally accepted accounting principles (GAAP), which use an undiscounted cash flow screening mechanism for impairment testing long-lived assets other than goodwill, IAS 36 requires the recoverable amount of an asset or cash-generating unit to be measured whenever there is an indication of possible impairment. Therefore, if at the time of impairment testing a 'larger' unit to which goodwill has been allocated there is an indication of a possible impairment in an asset or 'smaller' cash-generating unit included in that larger unit, an entity is required to test that asset or smaller unit for impairment first. Consequently, the Board concluded that it would be reasonable in an IAS 36 context to presume that an impairment loss for the larger unit would, after all other assets and smaller units are assessed for impairment, be likely to relate to the goodwill in the unit. Such a presumption would not be reasonable if an entity were following US GAAP.

BC169 The Board considered converging fully with the SFAS 142 approach. However, although supporting convergence, the Board was concerned that the SFAS 142 approach would not provide better information than an approach under which goodwill is tested for impairment at a lower level (thereby removing many of the 'cushions' protecting the goodwill from impairment) but with the amount of any impairment loss for goodwill measured in accordance with the one-step approach in the previous version of IAS 36.

BC170 The Board concluded that the complexity and costs of applying the two-step approach proposed in the Exposure Draft would outweigh the benefits of that approach. Therefore, the Board decided to retain the approach to measuring impairments of goodwill included in the previous version of IAS 36. Thus, the Standard requires any excess of the carrying amount of a cash-generating unit (group of units) to which goodwill has been allocated over its recoverable amount to be recognised first as an impairment loss for goodwill. Any excess remaining after the carrying amount of goodwill has been reduced to zero is then recognised by being allocated to the other assets of the unit pro rata with their carrying amounts.

Changes as a result of 2008 revisions to IFRS 3 (Appendix C)

BC170A As a result of the changes to IFRS 3 (as revised in 2008), the requirements in Appendix C of the Standard and the related illustrative examples have been amended to reflect the two ways of measuring non-controlling interests: at fair value and as a proportion of the identifiable net assets of the acquiree. Appendix C has also been modified to clarify the requirements of the Standard.

Timing of impairment tests (paragraphs 96-99)

BC171 To reduce the costs of applying the test, and consistently with the proposals in the Exposure Draft, the Standard permits the annual impairment test for a cash-generating unit (group of units) to which goodwill has been allocated to be performed at any time during an annual period, provided the test is performed at the same time every year. Different cash-generating units (groups of units) may be tested for impairment at different times. However, if some or all of the goodwill allocated to a unit (group of units) was acquired in a business combination during the current annual period, that unit (group of units) must be tested for impairment before the end of the current annual period.

BC172 The Board observed that acquirers can sometimes 'overpay' for an acquiree, resulting in the amount initially recognised for the business combination and the resulting goodwill exceeding the recoverable amount of the investment. The Board concluded that the users of an entity's financial statements are provided with representationally faithful, and therefore useful, information about a business combination if such an impairment loss is recognised by the acquirer in the annual period in which the business combination occurs.

BC173 The Board was concerned that it might be possible for entities to delay recognising such an impairment loss until the annual period after the business combination if the Standard included only a requirement to impairment test cash-generating units (groups of units) to which goodwill has been allocated on an annual basis at any time during a period. Therefore, the Board decided to include in the Standard the added requirement that if some or all of the goodwill allocated to a unit (group of units) was acquired in a business combination during the current annual period, the unit (group of units) should be tested for impairment before the end of that period.

Sequence of impairment tests (paragraph 97)

BC174 The Standard requires that if the assets (cash-generating units) constituting the cash-generating unit (group of units) to which goodwill has been allocated are tested for impairment at the same time as the unit (group of units) containing the goodwill, those other assets (units) should be tested for impairment before the unit (group of units) containing the goodwill.

BC175 The Board observed that assets or cash-generating units making up a unit or group of units to which goodwill has been allocated might need to be tested for impairment at the same time as the unit or group of units containing the goodwill when there is an indication of a possible impairment of the asset or smaller unit. The Board concluded that to assess whether the unit or group of units containing the goodwill, and therefore whether the goodwill, is impaired, the carrying amount of the unit or group of units containing the goodwill would need first to be adjusted by recognising any impairment losses relating to the assets or smaller units within that unit or group of units.

Carrying forward a recoverable amount calculation (paragraph 99)

BC176 Consistently with the impairment test for indefinite-lived intangibles, the Standard permits the most recent detailed calculation of the recoverable amount of a cash-generating unit (group of units) to which goodwill has been allocated to be carried forward from a preceding period for use in the current period's impairment test, provided all of the criteria in paragraph 99 are met.

BC177 Integral to the Board's decision that goodwill should be tested for impairment annually was the view that many entities should be able to conclude that the recoverable amount of a cash-generating unit (group of units) to which goodwill has been allocated is greater than its carrying amount without actually recomputing recoverable amount. However, again consistently with its conclusions about indefinite-lived intangibles, the Board concluded that this would be the case only if the last recoverable amount determination exceeded the carrying amount of the unit (group of units) by a substantial margin, and nothing had happened since that last determination to make the likelihood of an impairment loss other than remote. The Board concluded that in such circumstances, permitting a detailed calculation of the recoverable amount of a cash-generating unit (group of units) to which goodwill has been allocated to be carried forward from the preceding period for use in the current period's impairment test would significantly reduce the costs of applying the impairment test, without compromising its integrity.

Allocating an impairment loss between the assets of a cash-generating unit (paragraphs 104-107)

BCZ178 IAS 36 includes requirements for the allocation of an impairment loss for a cash-generating unit that differ from the proposals in E55. In particular, E55 proposed that an impairment loss should be allocated:

(a) first, to goodwill;

(b) secondly, to intangible assets for which no active market exists;

(b) thirdly, to assets whose net selling price* is less than their carrying amount; and

(d) then, to the other assets of the unit on a pro-rata basis based on the carrying amount of each asset in the unit.

BCZ179 The underlying reasons for making this proposal were that:

(a) an impairment loss for a cash-generating unit should be allocated, in priority, to assets with the most subjective values. Goodwill and intangible assets for which there is no active market were considered to be in that category. Intangible assets for which there is no active market were considered to be similar to goodwill (IASC was thinking of brand names, publishing titles etc).

(b) if the net selling price of an asset is less than its carrying amount, this was considered a reasonable basis for allocating part of the impairment loss to that asset rather than to other assets.

BCZ180 Many commentators on E55 objected to the proposal on the grounds that:

(a) not all intangible assets for which no active market exists are similar to goodwill (for example, licences and franchise rights). They disagreed that the value of intangible assets is always more subjective than the value of tangible assets (for example, specialised plant and equipment).

(b) the concept of cash-generating units implies a global approach for the assets of the units and not an asset-by-asset approach.

In response to these comments, IASC decided to withdraw E55's proposal for the allocation of an impairment loss to intangible assets and assets whose net selling price is less than their carrying amount.

BCZ181 IASC rejected a proposal that an impairment loss for a cash-generating unit should be allocated first to any obviously impaired asset. IASC believed that if the recoverable amount of an obviously impaired asset can be determined for the individual asset, there is no need to estimate the recoverable amount of the asset's cash-generating unit. If the recoverable amount of an individual asset cannot be determined, it cannot be said that the asset is obviously impaired because an impairment loss for a cash-generating unit relates to all of the assets of that unit.

Reversing impairment losses for assets other than goodwill (paragraphs 110-123)

BCZ182 IAS 36 requires that an impairment loss for an asset other than goodwill should be reversed if, and only if, there has been a change in the estimates used to determine an asset's recoverable amount since the last impairment loss was recognised.

* In IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, issued by the IASB in 2004, the term, 'net selling price' was replaced in IAS 36 by 'fair value less costs to sell'.

BCZ183 Opponents of reversals of impairment losses argue that:

(a) reversals of impairment losses are contrary to the historical cost accounting system. When the carrying amount is reduced, recoverable amount becomes the new cost basis for an asset. Consequently, reversing an impairment loss is no different from revaluing an asset upward. Indeed, in many cases, recoverable amount is similar to the measurement basis used for the revaluation of an asset. Hence, reversals of impairment losses should be either prohibited or recognised directly in equity as a revaluation.

(b) reversals of impairment losses introduce volatility in reported earnings. Periodic, short-term income measurements should not be affected by unrealised changes in the measurement of a long-lived asset.

(c) the result of reversals of impairment losses would not be useful to users of financial statements since the amount of a reversal under IAS 36 is limited to an amount that does not increase the carrying amount of an asset above its depreciated historical cost. Neither the amount reversed nor the revised carrying amount have any information content.

(d) in many cases, reversals of impairment losses will result in the implicit recognition of internally generated goodwill.

(e) reversals of impairment losses open the door to abuse and income 'smoothing' in practice.

(f) follow-up to verify whether an impairment loss needs to be reversed is costly.

BCZ184 IASC's reasons for requiring reversals of impairment losses were the following:

(a) it is consistent with the *Framework*[#] and the view that future economic benefits that were not previously expected to flow from an asset have been reassessed as probable.

(b) a reversal of an impairment loss is not a revaluation and is consistent with the historical cost accounting system as long as the reversal does not result in the carrying amount of an asset exceeding its original cost less amortisation/depreciation, had the impairment loss not been recognised. Accordingly, the reversal of an impairment loss should be recognised in the income statement and any amount in excess of the depreciated historical cost should be accounted for as a revaluation.

(c) impairment losses are recognised and measured based on estimates. Any change in the measurement of an impairment loss is similar to a change in estimate. IAS 8 *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies*[*] requires that a change in accounting estimate should be included in the determination of the net profit or loss in (a) the period of the change, if the change affects the period only, or (b) the period of the change and future periods, if the change affects both.

[#] The reference to the *Framework* is to IASC's *Framework for Preparation and Presentation of Financial Statements*, adopted by the IASB in 2001. In September 2010 the IASB replaced the *Framework with the Conceptual Framework for Financial Reporting*.

[*] IAS 8 *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies* was superseded in 2003 by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

(d) reversals of impairment losses provide users with a more useful indication of the potential for future benefits of an asset or group of assets.

(e) results of operations will be more fairly stated in the current period and in future periods because depreciation or amortisation will not reflect a previous impairment loss that is no longer relevant. Prohibition of reversals of impairment losses may lead to abuses such as recording a significant loss one year with the resulting lower amortisation/depreciation charge and higher profits in subsequent years.

BCZ185 The majority of commentators on E55 supported IASC's proposals for reversals of impairment losses.

BCZ186 IAS 36 does not permit an enterprise to recognise a reversal of an impairment loss just because of the unwinding of the discount. IASC supported this requirement for practical reasons only. Otherwise, if an impairment loss is recognised and recoverable amount is based on value in use, a reversal of the impairment loss would be recognised in each subsequent year for the unwinding of the discount. This is because, in most cases, the pattern of depreciation of an asset is different from the pattern of value in use. IASC believed that, when there is no change in the assumptions used to estimate recoverable amount, the benefits from recognising the unwinding of the discount each year after an impairment loss has been recognised do not justify the costs involved. However, if a reversal is recognised because assumptions have changed, the discount unwinding effect is included in the amount of the reversal recognised.

Reversing goodwill impairment losses (paragraph 124)

BC187 Consistently with the proposal in the Exposure Draft, the Standard prohibits the recognition of reversals of impairment losses for goodwill. The previous version of IAS 36 required an impairment loss for goodwill recognised in a previous period to be reversed when the impairment loss was caused by a specific external event of an exceptional nature that was not expected to recur, and subsequent external events had occurred that reversed the effect of that event.

BC188 Most respondents to the Exposure Draft agreed that reversals of impairment losses for goodwill should be prohibited. Those that disagreed argued that reversals of impairment losses for goodwill should be treated in the same way as reversals of impairment losses for other assets, but limited to circumstances in which the impairment loss was caused by specific events beyond the entity's control.

BC189 In revising IAS 36, the Board noted that IAS 38 *Intangible Assets* prohibits the recognition of internally generated goodwill. Therefore, if reversals of impairment losses for goodwill were permitted, an entity would need to establish the extent to which a subsequent increase in the recoverable amount of goodwill is attributable to the recovery of the acquired goodwill within a cash-generating unit, rather than an increase in the internally generated goodwill within the unit. The Board concluded that this will seldom, if ever, be possible. Because the acquired goodwill and internally generated goodwill contribute jointly to the same cash flows, any subsequent increase in the recoverable amount of the acquired goodwill is indistinguishable from an increase in the internally generated goodwill. Even if the specific external event that caused the recognition of the impairment loss is reversed, it will seldom, if ever, be possible to determine that the effect of that reversal is a corresponding increase in the recoverable amount of the acquired goodwill. Therefore, the Board concluded that reversals of impairment losses for goodwill should be prohibited.

BC190 The Board expressed some concern that prohibiting the recognition of reversals of impairment losses for goodwill so as to avoid recognising internally generated goodwill might be viewed by some as inconsistent with the impairment test for goodwill. This is because the impairment test results in the carrying amount of goodwill being shielded from impairment by internally generated goodwill. This has been described by some as 'backdoor' capitalisation of internally generated goodwill.

BC191 However, the Board was not as concerned about goodwill being shielded from the recognition of impairment losses by internally generated goodwill as it was about the direct recognition of internally generated goodwill that might occur if reversals of impairment losses for goodwill were permitted. As discussed in paragraph BC135, the Board is of the view that it is not possible to devise an impairment test for acquired goodwill that removes the cushion against the recognition of impairment losses provided by goodwill generated internally after a business combination.

Disclosures for cash-generating units containing goodwill or indefinite-lived intangibles (paragraphs 134 and 135)

Background to the proposals in the Exposure Draft

BC192 The Exposure Draft proposed requiring an entity to disclose a range of information about cash-generating units whose carrying amounts included goodwill or indefinite-lived intangibles. That information included:

(a) the carrying amount of goodwill and the carrying amount of indefinite-lived intangibles.

(b) the basis on which the unit's recoverable amount had been determined (ie value in use or net selling price).

(c) the amount by which the unit's recoverable amount exceeded its carrying amount.

(d) the key assumptions and estimates used to measure the unit's recoverable amount and information about the sensitivity of that recoverable amount to changes in the key assumptions and estimates.

BC193 If an entity reports segment information in accordance with IAS 14 *Segment Reporting,* the Exposure Draft proposed that this information should be disclosed in aggregate for each segment based on the entity's primary reporting format. However, the Exposure Draft also proposed that the information would be disclosed separately for a cash-generating unit when:

(a) the carrying amount of the goodwill or indefinite-lived intangibles allocated to the unit was significant in relation to the total carrying amount of goodwill or indefinite-lived intangibles; or

(b) the basis for determining the unit's recoverable amount differed from the basis used for the other units within the segment whose carrying amounts include goodwill or indefinite-lived intangibles; or

(c) the nature of, or value assigned to the key assumptions or growth rate on which management based its determination of the unit's recoverable amount differed significantly from that used for the other units within the segment whose carrying amounts include goodwill or indefinite-lived intangibles.

BC194 In deciding to propose these disclosure requirements in the Exposure Draft, the Board observed that non-amortisation of goodwill and indefinite-lived intangibles increases the reliance that must be placed on impairment tests of those assets to ensure that their carrying amounts do not exceed their recoverable amounts. However, the nature of impairment tests means that the carrying amounts of such assets and the related assertion that those carrying amounts are recoverable will normally be supported only by management's projections. Therefore, the Board decided to examine ways in which the reliability of the impairment tests for goodwill and indefinite-lived intangibles could be improved. As a first step, the Board considered including a subsequent cash flow test in the revised Standard, similar to that included in UK Financial Reporting Standard 11 *Impairment of Fixed Assets and Goodwill* (FRS 11).

Subsequent cash flow test

BC195 FRS 11 requires an entity to perform a subsequent cash flow test to confirm, ex post, the cash flow projections used to measure a unit's value in use when testing goodwill for impairment. Under FRS 11, for five years following each impairment test for goodwill in which recoverable amount has been based on value in use, the actual cash flows achieved must be compared with those forecast. If the actual cash flows are so much less than those forecast that use of the actual cash flows in the value in use calculation could have required recognition of an impairment in previous periods, the original impairment calculations must be re-performed using the actual cash flows, but without revising any other cash flows or assumptions (except those that change as a direct consequence of the occurrence of the actual cash flows, for example where a major cash inflow has been delayed for a year). Any impairment identified must then be recognised in the current period, unless the impairment has reversed and the reversal of the loss satisfies the criteria in FRS 11 regarding reversals of impairment losses for goodwill.

BC196 The Board noted the following arguments in support of including a similar test in the revised Standard:

(a) it would enhance the reliability of the goodwill impairment test by preventing the possibility of entities avoiding the recognition of impairment losses by using over-optimistic cash flow projections in the value in use calculations.

(b) it would provide useful information to users of an entity's financial statements because a record of actual cash flows continually less than forecast cash flows tends to cast doubt on the reliability of current estimates.

BC197 However, the subsequent cash flow test is designed only to prevent entities from avoiding goodwill write-downs. The Board observed that, given current trends in 'big bath' restructuring charges, the greater risk to the quality of financial reporting might be from entities trying to write off goodwill without adequate justification in an attempt to 'manage' the balance sheet. The Board also observed that:

(a) the focus of the test on cash flows ignores other elements in the measurement of value in use. As a result, it does not produce representationally faithful results in a present value measurement system. The Board considered incorporating into the recalculation performed under the test corrections of estimates of other elements in the measurement of value in use. However, the Board concluded that specifying which elements to include would be problematic. Moreover, adding corrections of estimates of those other elements to the test would, in effect, transform the test into a requirement to perform a comprehensive recalculation of value in use for each of the five annual reporting periods following an impairment test.

(b) the amount recognised as an impairment loss under the test is the amount of the impairment that would have been recognised, provided changes in estimates of remaining cash flows and changes in discount and growth rates are ignored. Therefore, it is a hypothetical amount that does not provide decision-useful information—it is neither an estimate of a current amount nor a prediction of ultimate cash flows.

(c) the requirement to perform the test for each of the five annual reporting periods following an impairment test could result in an entity having to maintain as many as five sets of 5-year computations for each cash-generating unit to which goodwill has been allocated. Therefore, the test is likely to be extremely burdensome, particularly if an entity has a large number of such units, without producing understandable or decision-useful information.

BC198 Therefore, the Board decided not to propose a subsequent cash flow test in the Exposure Draft. However, the Board remained committed to finding some way of improving the reliability of the impairment tests for goodwill and indefinite-lived intangibles, and decided to explore improving that reliability through disclosure requirements.

Including disclosure requirements in the revised Standard

BC199 In developing the Exposure Draft, the Board observed that the *Framework*[*] identifies reliability as one of the key qualitative characteristics that information must possess to be useful to users in making economic decisions. To be reliable, information must be free from material error and bias and be able to be depended upon to represent faithfully that which it purports to represent. The *Framework* identifies relevance as another key qualitative characteristic that information must possess to be useful to users in making economic decisions. To be relevant, information must help users to evaluate past, present or future events, or confirm or correct their past evaluations.

BC200 The Board observed that information that assists users in evaluating the reliability of other information included in the financial statements is itself relevant, increasing in relevance as the reliability of that other information decreases. For example, information that assists users in evaluating the reliability of the amount recognised for a provision is relevant because it helps users to evaluate the effect of both a past event (ie the economic consequences of the past event giving rise to the present obligation) and a future event (ie the amount of the expected future outflow of economic benefits required to settle the obligation). Accordingly, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* requires an entity to disclose, for each class of provision, information about the uncertainties surrounding the amount and timing of expected outflows of economic benefits, and the major assumptions concerning future events that may affect the amount required to settle the obligation and have been reflected in the amount of the provision.

[*] The references to the *Framework* are to IASC's *Framework for the Preparation and Presentation of Financial Statements*, adopted by the IASB in 2001. In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting*.

BC201 The Board concluded that because information that assists users in evaluating the reliability of other information is itself relevant, an entity should disclose information that assists users in evaluating the reliability of the estimates used by management to support the carrying amounts of goodwill and indefinite-lived intangibles.

BC202 The Board also concluded that such disclosures would provide users with more useful information for evaluating the reliability of the impairment tests for goodwill and indefinite-lived intangibles than the information that would be provided by a subsequent cash flow test.

BC203 The Board then considered how some balance might be achieved between the objective of providing users with useful information for evaluating the reliability of the estimates used by management to support the carrying amounts of goodwill and indefinite-lived intangibles, and the potential magnitude of those disclosures.

BC204 The Board decided that a reasonable balance might be achieved between the objective of the disclosures and their potential magnitude by requiring:

(a) information to be disclosed on an aggregate basis for each segment based on the entity's primary reporting format that includes in its carrying amount goodwill or indefinite-lived intangibles; but

(b) information for a particular cash-generating unit within that segment to be excluded from the aggregate information and disclosed separately when either:

(i) the basis (ie net selling price or value in use), methodology or key assumptions used to measure its recoverable amount differ from those used to measure the recoverable amounts of the other units in the segment; or

(ii) the carrying amount of the goodwill or indefinite-lived intangibles in the unit is significant in relation to the total carrying amount of goodwill or indefinite-lived intangibles.

The Board's redeliberations

BC205 After considering respondents' and field visit participants' comments, the Board confirmed its previous conclusion that information that assists users in evaluating the reliability of other information is itself relevant, increasing in relevance as the reliability of that other information decreases. Therefore, entities should be required to disclose information that assists users in evaluating the reliability of the estimates used by management to support the carrying amounts of goodwill and indefinite-lived intangibles. The Board noted that almost all field visit participants and many respondents expressed explicit support of its conclusion that, because non-amortisation of goodwill and indefinite-lived intangibles increases the reliance that must be placed on impairment tests of those assets, some additional disclosure is necessary to provide users with information for evaluating the reliability of those impairment tests.

BC206 However, it was clear from field visit participants' responses that the proposed disclosures could not be meaningfully aggregated at the segment level to the extent the Board had hoped might be the case. As a result, the proposal to require the information to be disclosed on an aggregate basis for each segment, but with disaggregated disclosures for cash-generating units in the circumstances set out in paragraph BC193 would not result in a reasonable balance between the objective of the disclosures and their potential magnitude.

BC207 The Board was also sympathetic to field visit participants' and respondents' concerns that the proposed disclosures went beyond their intended objective of providing users with relevant information for evaluating the reliability of the impairment tests for goodwill and indefinite-lived intangibles. For example, field visit participants and respondents argued that:

(a) it would be extremely difficult to distil the recoverable amount calculations into concise but meaningful disclosures because those calculations typically are complex and do not normally result in a single point estimate of recoverable amount—a single value for recoverable amount would normally be determined only when the bottom-end of the recoverable amount range is less than a cash-generating unit's carrying amount. These difficulties make it doubtful that the information, particularly the sensitivity analyses, could be produced on a timely basis.

(b) disclosing the proposed information, particularly the values assigned to, and the sensitivity of, each key assumption on which recoverable amount calculations are based, could cause significant commercial harm to an entity. Users of financial statements might, for example, use the quantitative disclosures as the basis for initiating litigation against the entity, its board of directors or management in the highly likely event that those assumptions prove less than accurate. The increased litigation risk would either encourage management to use super-conservative assumptions, thereby resulting in improper asset write-downs, or compel management to engage independent experts to develop all key assumptions and perform the recoverable amount calculations. Additionally, many of the field visit participants expressed concern over the possible impact that disclosing such information might have on their ability to defend themselves in various legal proceedings.

BC208 Therefore, the Board considered the following two interrelated issues:

(a) if the proposed disclosures went beyond their intended objective, what information *should* be disclosed so that users have sufficient information for evaluating the reliability of impairment tests for goodwill and indefinite-lived intangibles?

(b) how should this information be presented so that there is an appropriate balance between providing users with information for evaluating the reliability of the impairment tests, and the potential magnitude of those disclosures?

BC209 As a result of its redeliberations, the Board decided:

(a) not to proceed with the proposal to require information for evaluating the reliability of the impairment tests for goodwill and indefinite-lived intangibles to be disclosed in aggregate for each segment and separately for cash-generating units within a segment in specified circumstances. Instead, the Standard requires this information to be disclosed only for each cash-generating unit (group of units) for which the carrying amount of goodwill or indefinite-lived intangibles allocated to that unit (group of units) is significant in comparison with the entity's total carrying amount of goodwill or indefinite-lived intangibles.

(b) not to proceed with the proposal to require an entity to disclose the amount by which the recoverable amount of a cash-generating unit exceeds its carrying amount. Instead, the Standard requires an entity to disclose this information only if a reasonably possible change in a key assumption on which management has based its determination of the unit's (group of units') recoverable amount would cause the unit's (group of units') carrying amount to exceed its recoverable amount.

(c) not to proceed with the proposal to require an entity to disclose the value assigned to each key assumption on which management based its recoverable amount determination, and the amount by which that value must change, after incorporating any consequential effects of that change on the other variables used to measure recoverable amount, in order for the unit's recoverable amount to be equal to its carrying amount. Instead, the Standard requires an entity to disclose a description of each key assumption on which management has based its recoverable amount determination, management's approach to determining the value(s) assigned to each key assumption, whether those value(s) reflect past experience or, if appropriate, are consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information. However, if a reasonably possible change in a key assumption would cause the unit's (group of units') carrying amount to exceed its recoverable amount, the entity is also required to disclose the value assigned to the key assumption, and the amount by which that value must change, after incorporating any consequential effects of that change on the other variables used to measure recoverable amount, in order for the unit's (group of units') recoverable amount to be equal to its carrying amount.

(d) to require information about key assumptions to be disclosed also for any key assumption that is relevant to the recoverable amount determination of multiple cash-generating units (groups of units) that individually contain insignificant amounts of goodwill or indefinite-lived intangibles, but contain, in aggregate, significant amounts of goodwill or indefinite-lived intangibles.

Changes as a result of *Improvements to IFRSs* (2008)*

BC209A The Board noted that the disclosures that IAS 36 requires when value in use is used to determine recoverable amount differ from those required when fair value less costs to sell is used. These differing requirements appear inconsistent when a similar valuation methodology (discounted cash flows) has been used. Therefore, as part of *Improvements to IFRSs* issued in May 2008, the Board decided to require the same disclosures for fair value less costs to sell and value in use when discounted cash flows are used to estimate recoverable amount.

Changes as a result of IFRS 13 *Fair Value Measurement*

BC209B In developing IFRS 13, issued in May 2011, the Board wa asked by users of financial statements to minimise the differences between the disclosures made about impaired assets in IFRSs and in US GAAP (which requires assets to be tested for impairment by comparing their carrying amount with their fair value). The Board noted that the disclosure requirements in IAS 36 were developed specifically to ensure consistency in the disclosure of information about impaired assets so that the same type of information is provided whether the recoverable amount was determined on the basis of value in use or fair value less costs of disposal. Consequently, the Board did not think it would be appropriate to require an entity to provide information when the recoverable amount is determined on the basis of fair value less costs of disposal (ie those required in IFRS 13) that is significantly different from what the entity would provide when the recoverable amount is determined on the basis of value in use.

BC209C Although IFRSs and US GAAP have different impairment models, the Board concluded that requiring the following information (in addition to what IAS 36 currently requires) about impaired assets measured at fair value less costs of disposal would improve comparability between entities applying IFRSs and those applying US GAAP as well as increase the convergence of IFRSs and US GAAP:

(a) the fair value less costs of disposal;

(b) the level of the fair value hierarchy within which the fair value less costs of disposal is categorised in its entirety (Level 1, 2 or 3);

(c) if applicable, changes to valuation techniques and reasons for those changes; and

(d) quantitative information about significant inputs used when measuring fair value less costs of disposal (along with a conforming amendment to the disclosures about value in use).

BC209D In addition, those disclosures are consistent with the disclosures required for non-recurring fair value measurements in IFRS 13 and in US GAAP.

* This heading and paragraph BC209A were added by *Improvements to IFRSs* issued in May 2008.

Transitional provisions (paragraphs 138-140)

BC210 If an entity elects to apply IFRS 3 from any date before the effective dates outlined in IFRS 3, it is also required to apply IAS 36 from that same date. Paragraphs BC181-BC184 of the Basis for Conclusions on IFRS 3 outline the Board's deliberations on this issue.[†]

BC211 Otherwise, IAS 36 is applied:

(a) to goodwill and intangible assets acquired in business combinations for which the agreement date is on or after 31 March 2004; and

(b) to all other assets prospectively from the beginning of the first annual period beginning on or after 31 March 2004.

BC212 In developing the requirements set out in paragraph BC211, the Board considered whether entities should be required:

(a) to apply retrospectively the revised impairment test for goodwill; and

(b) to apply retrospectively the requirement prohibiting reversals of impairment losses for goodwill and therefore eliminate any reversals recognised before the date the revised Standard was issued.

BC213 The Board concluded that retrospective application of the revised impairment test for goodwill would be problematic for the following reasons:

(a) it was likely to be impossible in many cases because the information needed may not exist or may no longer be obtainable.

(b) it would require the determination of estimates that would have been made at a prior date, and therefore would raise the problem of how the effect of hindsight could be separated from the factors existing at the date of the impairment test.

BC214 The Board also noted that the requirement for goodwill to be tested for impairment annually, irrespective of whether there is any indication that it may be impaired, will ensure that by the end of the first period in which the Standard is effective, all recognised goodwill acquired before its effective date would be tested for impairment.

BC215 In the case of reversals of impairment losses for goodwill, the Board acknowledged that requiring the elimination of reversals recognised before the revised Standard's effective date might seem appropriate, particularly given the Board's reasons for prohibiting reversals of impairment losses for goodwill (see paragraphs BC187-BC191). The Board concluded, however, that the previous amortisation of that goodwill, combined with the requirement for goodwill to be tested for impairment at least annually, ensures that the carrying amount of the goodwill does not exceed its recoverable amount at the end of the reporting period in which the Standard is effective. Therefore, the Board concluded that the Standard should apply on a prospective basis.

[†] The Board issued a revised IFRS 3 in 2008. This paragraph relates to IFRS 3 as issued in 2004.

Transitional impairment test for goodwill

BC216 Given that one of the objectives of the first phase of the Business Combinations project was to seek international convergence on the accounting for goodwill, the Board considered whether IAS 36 should include a transitional goodwill impairment test similar to that included in SFAS 142. SFAS 142 requires goodwill to be tested for impairment annually, and between annual tests if an event occurs or circumstances change and would be more likely than not to reduce the fair value of a reporting unit below its carrying amount. The transitional provisions in SFAS 142 require the impairment test for goodwill to be applied prospectively. However, a transitional goodwill impairment test must be performed as of the *beginning* of the fiscal year in which SFAS 142 is applied in its entirety. An impairment loss recognised as a result of a transitional test is recognised as the effect of a change in accounting principle, rather than as an impairment loss. In addition to the transitional test, SFAS 142 requires an entity to perform the required annual goodwill impairment test in the year that SFAS 142 is initially applied in its entirety. In other words, the transitional goodwill impairment test may not be regarded as the initial year's annual test unless an entity designates the beginning of its fiscal year as the date for its annual goodwill impairment test.

BC217 The FASB concluded that goodwill that was not regarded as impaired under US GAAP before SFAS 142 was issued could be determined to be impaired if the SFAS 142 impairment test was applied to that goodwill at the date an entity initially applied SFAS 142. This is because, under previous US GAAP, entities typically tested goodwill for impairment using undiscounted estimates of future cash flows. The FASB further concluded that:

(a) the preponderance of any transitional impairment losses was likely to result from the change in methods and treating those losses as stemming from changes in accounting principles would therefore be more representationally faithful.

(b) given that a transitional impairment loss should be reported as a change in accounting principle, the transitional goodwill impairment test should ideally apply as of the date SFAS 142 is initially applied.

BC218 The Board observed that under the previous version of IAS 36, goodwill that was amortised over a period exceeding 20 years was required to be tested for impairment at least at each financial year-end. Goodwill that was amortised over a period not exceeding 20 years was required to be tested for impairment at the balance sheet date if there was an indication that it might be impaired. The revised Standard requires goodwill to be tested for impairment annually or more frequently if there is an indication the goodwill might be impaired. It also carries forward from the previous version of IAS 36 (a) the indicators of impairment, (b) the measure of recoverable amount (ie higher of value in use and fair value less costs to sell), and (c) the requirement for an impairment loss for a cash-generating unit to be allocated first to reduce the carrying amount of any goodwill allocated to the unit.

BC219 Therefore, goodwill tested for impairment in accordance with the previous version of the revised Standard immediately before the beginning of the reporting period in which the revised Standard becomes effective (because it was being amortised over a period exceeding 20 years or because there was an indicator of impairment) could not be identified as impaired under IAS 36 at the beginning of the period in which it becomes effective. This is because application of the Standard results in a goodwill impairment loss being identified only if the carrying amount of the cash-generating unit (group of units) to which the goodwill has been allocated exceeds its recoverable amount, and the impairment test in the previous version of IAS 36 ensures that this will not be the case.

BC220 The Board concluded that there would be only one possible situation in which a transitional impairment test might give rise to the recognition of an impairment loss for goodwill. This would be when goodwill being amortised over a period not exceeding 20 years was, immediately before the beginning of the period in which the revised Standard becomes effective, impaired in the absence of any indicator of impairment that ought reasonably to have been considered by the entity. The Board concluded that this is likely to be a rare occurrence.

BC221 The Board observed that any such impairment loss would nonetheless be recognised as a consequence of applying the requirement in IAS 36 to test goodwill for impairment at least annually. Therefore, the only benefit of applying a transitional impairment test would be, in those rare cases, to separate the impairment loss arising before the period in which the revised Standard is effective from any impairment loss arising after the beginning of that period.

BC222 The Board concluded that given the rare circumstances in which this issue would arise, the benefit of applying a transitional goodwill impairment test would be outweighed by the added costs of the test. Therefore, the Board decided that the revised Standard should not require a transitional goodwill impairment test.

Transitional impairment test for indefinite-lived intangibles

BC223 SFAS 142 also requires a transitional impairment test to be applied, as of the beginning of the fiscal year in which that Standard is initially applied, to intangible assets recognised before the effective date of SFAS 142 that are reassessed as having indefinite useful lives. An impairment loss arising from that transitional impairment test is recognised as the effect of a change in accounting principle rather than as an impairment loss. As with goodwill:

(a) intangible assets that cease being amortised upon initial application of SFAS 142 are tested for impairment in accordance with SFAS 142 using a different method from what had previously applied to those assets. Therefore, it is possible that such an intangible asset not previously regarded as impaired might be determined to be impaired under SFAS 142.

(b) the FASB concluded that the preponderance of any transitional impairment losses would be likely to result from the change in impairment testing methods. Treating those losses as stemming from changes in accounting principles is therefore more representationally faithful.

BC224 The Board considered whether IAS 36 should include a transitional impairment test for indefinite-lived intangibles similar to that in SFAS 142.

BC225 The Board observed that the previous version of IAS 38 *Intangible Assets* required an intangible asset being amortised over a period exceeding 20 years to be tested for impairment at least at each financial year-end in accordance with the previous version of IAS 36. An intangible asset being amortised over a period not exceeding 20 years was required, under the previous version of IAS 36, to be tested for impairment at the balance sheet date only if there was an indication the asset might be impaired. The revised Standard requires an indefinite-lived intangible to be tested for impairment at least annually. However, it also requires that the recoverable amount of such an asset should continue to be measured as the higher of the asset's value in use and fair value less costs to sell.

BC226 As with goodwill, the Board concluded that the revised Standard should not require a transitional impairment test for indefinite-lived intangibles because:

(a) the only circumstance in which a transitional impairment test might give rise to the recognition of an impairment loss would be when an indefinite-lived intangible previously being amortised over a period not exceeding 20 years was, immediately before the beginning of the period in which the revised Standard is effective, impaired in the absence of any indicator of impairment that ought reasonably to have been considered by the entity.

(b) any such impairment loss would nonetheless be recognised as a consequence of applying the requirement in the Standard to test such assets for impairment at least annually. Therefore, the only benefit of such a test would be to separate the impairment loss arising before the period in which the revised Standard is effective from any impairment loss arising after the beginning of that period.

(c) given the extremely rare circumstances in which this issue is likely to arise, the benefit of applying a transitional impairment test is outweighed by the added costs of the test.

Early application (paragraph 140)

BC227 The Board noted that the issue of any Standard demonstrates its opinion that application of the Standard will result in more useful information being provided to users about an entity's financial position, performance or cash flows. On that basis, a case exists for permitting, and indeed encouraging, entities to apply IAS 36 before its effective date. However, the Board also considered that permitting a revised Standard to be applied before its effective date potentially diminishes comparability between entities in the period(s) leading up to that effective date, and has the effect of providing entities with an option.

BC228 The Board concluded that the benefit of providing users with more useful information about an entity's financial position, performance and cash flows by permitting early application of IAS 36 outweighs the disadvantages of potentially diminished comparability. Therefore, entities are encouraged to apply the requirements of IAS 36 before its effective date. However, given that the revision of IAS 36 is part of an integrated package, IAS 36 requires IFRS 3 and IAS 38 (as revised in 2004) to be applied at the same time.

Transitional provision for *Improvements to IFRSs* (2009)

BC228A The Board considered the transition provisions and effective date of the amendment to paragraph 80(b). The Board noted that the assessment of goodwill impairment might involve the use of hindsight in determining the fair values of the cash-generating units at the end of a past reporting period. Considering practicability, the Board decided that the effective date should be for annual periods beginning on or after 1 January 2010 although the Board noted that the effective date of IFRS 8 is 1 January 2009. Therefore, the Board decided that an entity should apply the amendment to paragraph 80(b) made by *Improvements to IFRSs* issued in April 2009 prospectively for annual periods beginning on or after 1 January 2010.

Summary of main changes from the Exposure Draft

BC229 The following are the main changes from the Exposure Draft:

(a) the Exposure Draft proposed that an intangible asset with an indefinite useful life should be tested for impairment at the end of each annual period by comparing its carrying amount with its recoverable amount. The Standard requires such an intangible asset to be tested for impairment annually by comparing its carrying amount with its recoverable amount. The impairment test may be performed at any time during an annual period, provided it is performed at the same time every year, and different intangible assets may be tested for impairment at different times. However, if such an intangible asset was initially recognised during the current annual period, the Standard requires that intangible asset to be tested for impairment before the end of the current annual period.

(b) the Exposure Draft proposed that the cash flow projections used to measure value in use should be based on reasonable and supportable assumptions that take into account both past actual cash flows and management's past ability to forecast cash flows accurately. This proposal has not been included in the Standard. Instead, the Standard includes guidance clarifying that management:

   (i) should assess the reasonableness of the assumptions on which its current cash flow projections are based by examining the causes of differences between past cash flow projections and actual cash flows; and

   (ii) should ensure that the assumptions on which its current cash flow projections are based are consistent with past actual outcomes, provided the effects of subsequent events or circumstances that did not exist when those actual cash flows were generated make this appropriate.

(c) the Exposure Draft proposed that if an active market exists for the output produced by an asset or a group of assets, that asset or group of assets should be identified as a cash-generating unit, even if some or all of the output is used internally. In such circumstances, management's best estimate of future market prices for the output should be used in estimating the future cash flows used to determine the unit's value in use. The Exposure Draft also proposed that when estimating future cash flows to determine the value in use of cash-generating units using the output, management's best estimate of future market prices for the output should be used. The Standard similarly requires that if an active market exists for the output produced by an asset or a group of assets, that asset or group of assets should be identified as a cash-generating unit, even if some or all of the output is used internally. However, the Standard clarifies that if the cash inflows generated by *any* asset or cash-generating unit are affected by internal transfer pricing, an entity should use management's best estimate of future price(s) that could be achieved in arm's length transactions in estimating:

(i) the future cash inflows used to determine the asset's or cash-generating unit's value in use; and

(ii) the future cash outflows used to determine the value in use of other assets or cash-generating units affected by the internal transfer pricing.

(d) the Exposure Draft proposed that goodwill acquired in a business combination should be allocated to one or more cash-generating units, with each of those units representing the smallest cash-generating unit to which a portion of the carrying amount of the goodwill could be allocated on a reasonable and consistent basis. The Exposure Draft also proposed that:

(i) a portion of the carrying amount of goodwill should be regarded as capable of being allocated to a cash-generating unit on a reasonable and consistent basis only when that unit represents the lowest level at which management monitors the return on investment in assets that include the goodwill.

(ii) each cash-generating unit should not be larger than a segment based on the entity's primary reporting format determined in accordance with IAS 14 *Segment Reporting*.

The Standard requires goodwill acquired in a business combination to be allocated to each of the acquirer's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units. The Standard also requires each unit or group of units to which the goodwill is so allocated: (1) to represent the lowest level within the entity at which the goodwill is monitored for internal management purposes; and (2) to be not larger than a segment based on either the entity's primary or the entity's secondary reporting format determined in accordance with IAS 14.

(e) the Exposure Draft proposed that when an entity disposes of an operation within a cash-generating unit to which goodwill has been allocated, the goodwill associated with that operation should be:

(i) included in the carrying amount of the operation when determining the gain or loss on disposal; and

(ii) measured on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit retained.

This proposal has been included in the Standard with one modification. The Standard requires the goodwill associated with the operation disposed of to be measured on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit retained, unless the entity can demonstrate that some other method better reflects the goodwill associated with the operation disposed of.

(f) the Exposure Draft proposed that when an entity reorganises its reporting structure in a way that changes the composition of cash-generating units to which goodwill has been allocated, the goodwill should be reallocated to the units affected using a relative value approach similar to that used when an entity disposes of an operation within a cash-generating unit. The Standard similarly requires an entity that reorganises its reporting structure in a way that changes the composition of one or more cash-generating units to which goodwill has been allocated to reallocate the goodwill to the units (groups of units) affected. However, the Standard requires this reallocation to be performed using a relative value approach similar to that used when an entity disposes of an operation within a cash-generating unit, unless the entity can demonstrate that some other method better reflects the goodwill associated with the reorganised units (groups of units).

(g) the Exposure Draft proposed a two-step approach for impairment testing goodwill. The first step involved using a screening mechanism for identifying potential goodwill impairments, whereby goodwill allocated to a cash-generating unit would be identified as potentially impaired only when the carrying amount of the unit exceeded its recoverable amount. If an entity identified the goodwill allocated to a cash-generating unit as potentially impaired, an entity would then determine whether the goodwill allocated to the unit was impaired by comparing its recoverable amount, measured as the implied value of the goodwill, with its carrying amount. The implied value of goodwill would be measured as a residual, being the excess of the recoverable amount of the cash-generating unit to which the goodwill has been allocated, over the net fair value of the identifiable assets, liabilities and contingent liabilities the entity would recognise if it acquired the cash-generating unit in a business combination on the date of the impairment test. The Standard requires any excess of the carrying amount of a cash-generating unit (group of units) to which goodwill has been allocated over its recoverable amount to be recognised first as an impairment loss for goodwill. Any excess remaining after the carrying amount of goodwill has been reduced to zero is then recognised by being allocated to the other assets of the unit pro rata with their carrying amounts.

(h) the Exposure Draft proposed requiring an entity to disclose information about cash-generating units whose carrying amounts included goodwill or indefinite-lived intangibles. That information included the carrying amount of goodwill and the carrying amount of indefinite-lived intangibles, the basis on which the unit's recoverable amount had been determined (ie value in use or net selling price), the amount by which the unit's recoverable amount exceeded its carrying amount, the key assumptions and estimates used to measure the unit's recoverable amount and information about the sensitivity of that recoverable amount to changes in the key assumptions and estimates. If an entity reports segment information in accordance with IAS 14, the Exposure Draft proposed that this information should be disclosed in aggregate for each segment based on the entity's primary reporting format. However, the Exposure Draft also proposed that the information would be disclosed separately for a cash-generating unit if specified criteria were met. The Standard:

(i) does not require information for evaluating the reliability of the impairment tests for goodwill and indefinite-lived intangibles to be disclosed in aggregate for each segment and separately for cash-generating units within a segment when specified criteria are met. Instead, the Standard requires this information to be disclosed for each cash-generating unit (group of units) for which the carrying amount of goodwill or indefinite-lived intangibles allocated to that unit (group of units) is significant in comparison with the entity's total carrying amount of goodwill or indefinite-lived intangibles.

(ii) does not require an entity to disclose the amount by which the recoverable amount of a cash-generating unit exceeds its carrying amount. Instead, the Standard requires an entity to disclose this information only if a reasonably possible change in a key assumption on which management has based its determination of the unit's (group of units') recoverable amount would cause the unit's (group of units') carrying amount to exceed its recoverable amount.

(iii) does not require an entity to disclose the value assigned to each key assumption on which management has based its recoverable amount determination, and the amount by which that value must change, after incorporating any consequential effects of that change on the other variables used to measure recoverable amount, in order for the unit's recoverable amount to be equal to its carrying amount. Instead, the Standard requires an entity to disclose a description of each key assumption on which management has based its recoverable amount determination, management's approach to determining the value(s) assigned to each key assumption, whether those value(s) reflect past experience or, if appropriate, are consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information. However, if a reasonably possible change in a key assumption would cause the unit's (group of units') carrying amount to exceed its recoverable amount, the entity is also required to disclose the value assigned to the key assumption, and the amount by which that value must change, after incorporating any consequential effects of that change on the other variables used to measure recoverable amount, in order for the unit's (group of units') recoverable amount to be equal to its carrying amount.

(iv) requires information about key assumptions to be disclosed for any key assumption that is relevant to the recoverable amount determination of multiple cash-generating units (groups of units) that individually contain insignificant amounts of goodwill or indefinite-lived intangibles, but which contain, in aggregate, significant amounts of goodwill or indefinite-lived intangibles.

History of the development of a standard on impairment of assets

BCZ230 In June 1996, IASC decided to prepare an International Accounting Standard on Impairment of Assets. The reasons for developing a Standard on impairment of assets were:

(a) to combine the requirements for identifying, measuring, recognising and reversing an impairment loss in one Standard to ensure that those requirements are consistent;

(b) the previous requirements and guidance in International Accounting Standards were not detailed enough to ensure that enterprises identified, recognised and measured impairment losses in a similar way, eg there was a need to eliminate certain alternatives for measuring an impairment loss, such as the former option not to use discounting; and

(c) IASC decided in March 1996 to explore whether the amortisation period of intangible assets and goodwill could, in certain rare circumstances, exceed 20 years if those assets were subject to detailed and reliable annual impairment tests.

BCZ231 In April 1997, IASC approved Exposure Draft E55 *Impairment of Assets*. IASC received more than 90 comment letters from over 20 countries. IASC also performed a field test of E55's proposals. More than 20 companies from various business sectors and from 10 different countries participated in the field test. About half of the field test participants prepared their financial statements using International Accounting Standards and the other half reported using other Standards. Field test participants completed a detailed questionnaire and most of them were visited by IASC staff to discuss the results of the application of E55's proposals to some of their assets. A brief summary of the comment letters received on E55 and the results of the field test was published in IASC *Insight* in December 1997.

BCZ232 In October 1997, IASC, together with the Accounting Standards Boards in Australia, Canada, New Zealand, the United Kingdom and the United States, published a discussion paper entitled *International Review of Accounting Standards Specifying a Recoverable Amount Test for Long-Lived Assets* (Jim Paul, from the staff of the Australian Accounting Research Foundation, was the principal author). This discussion paper resulted from the discussions of a 'working group' consisting of some Board members and senior staff members from the standard-setting bodies listed above and IASC. The paper:

(a) noted the key features of the working group members' existing or proposed accounting standards that require an impairment test, and compared those standards; and

(b) proposed the views of the working group on the major issues.

BCZ233 In April 1998, after considering the comments received on E55 and the results of the field test, IASC approved IAS 36 *Impairment of Assets*.

Dissenting opinions

Dissent of Anthony T Cope, James J Leisenring and Geoffrey Whittington

DO1 Messrs Cope and Leisenring and Professor Whittington dissent from the issue of IAS 36.

DO2 Messrs Cope and Leisenring and Professor Whittington dissent because they object to the impairment test that the Standard requires for goodwill.

DO3 Messrs Cope and Leisenring agree with the prohibition, in paragraph 54 of IFRS 3 *Business Combinations,* of amortisation of goodwill.[*] Research and experience have demonstrated that the amortisation of goodwill produces data that is meaningless, and perhaps even misleading. However, if goodwill is not amortised, its special nature mandates that it should be accounted for with caution. The Basis for Conclusions on IAS 36 (paragraph BC131F) states that "if a rigorous and operational impairment test [for goodwill] could be devised, more useful information would be provided to users of an entity's financial statements under an approach in which goodwill is not amortised, but instead tested for impairment annually or more frequently if events or changes in circumstances indicate that the goodwill might be impaired." Messrs Cope and Leisenring agree with that statement. However, they believe that the impairment test to which a majority of the Board has agreed lacks the rigour to satisfy that condition.

DO4 Messrs Cope and Leisenring share the reservations of some Board members, as noted in paragraph BC130 of the Basis for Conclusions on IAS 36, about an impairment test based on measuring the recoverable amount of an asset, and particularly an asset with an indefinite life, as the higher of fair value less costs to sell or value in use. Messrs Cope and Leisenring are content, however, for the time being to defer consideration of that general measurement issue, pending more research and debate on measurement principles. (They note that the use of fair value would achieve significant convergence with US GAAP.) But a much more rigorous effort must be made to determine the recoverable amount of goodwill, however measured, than the Board's revised impairment test. The 'two-step' method originally proposed by the Board in the Exposure Draft of Proposed Amendments to IAS 36 and IAS 38 was a more useful approach to determining the 'implied value' of goodwill. That test should have been retained.

DO5 Messrs Cope and Leisenring recognise that some constituents raised objections to the complexity and potential cost of the requirements proposed in the Exposure Draft. However, they believe that many commentators misunderstood the level at which the Board intended impairment testing to be undertaken. This was demonstrated during the field-testing of the Exposure Draft. Furthermore, the provisions of paragraph 99 of IAS 36, specifying when impairment testing need not be undertaken, provide generous relief from the necessity of making frequent calculations. They would have preferred to meet those objections by specifying that the goodwill impairment test should be at the level set out in US Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 142 *Goodwill and Other Intangible Assets*.

[*] The Board issued a revised IFRS 3 in 2008. The amortisation of goodwill is prohibited, but the paragraph reference no longer exists in IFRS 3 (as revised in 2008).

DO6 Professor Whittington believes that there are two aspects of the proposed impairment test that are particularly unsatisfactory. First, the failure to eliminate the shield from impairment provided by the internally generated goodwill of the acquiring entity at acquisition. This is discussed in paragraph DO7. Second, the lack of a subsequent cash flow test. This is discussed in paragraphs DO8-DO10. The inability to eliminate the shield from impairment provided by internally generated goodwill accruing after the acquisition date is also a problem. However, there is no obvious practical way of dealing with this problem within the framework of conventional impairment tests.

DO7 When an acquired business is merged with an acquirer's existing operations, the impairment test in IAS 36 does not take account of the acquirer's pre-existing internally generated goodwill. Thus, the pre-existing internally generated goodwill of the acquirer provides a shield against impairment additional to that provided by subsequent internally generated goodwill. Professor Whittington believes that the impairment test would be more rigorous if it included a requirement similar to that in UK Financial Reporting Standard 11 *Impairment of Fixed Assets and Goodwill*, which recognises, for purposes of impairment testing, the implied value of the acquirer's goodwill existing at the time of acquisition.

DO8 The subsequent cash flow test is discussed in paragraphs BC195-BC198 of the Basis for Conclusions on IAS 36. A subsequent cash flow test substitutes in past impairment tests the cash flows that actually occurred for those that were estimated at the time of the impairment tests, and requires a write-down if the revised estimates would have created an impairment loss for goodwill. It is thus a correction of an estimate. Such a test is incorporated in FRS 11.

DO9 The Board's reasons for rejecting the subsequent cash flow test are given in paragraph BC197(a)-(c). The preamble to paragraph BC197 claims that the subsequent cash flow test is misdirected because excessive write-downs of goodwill may be a problem that should be prevented. However, the subsequent cash flow test requires only realistic write-downs (based on actual outcomes), not excessive ones. If the statement in paragraph BC197 is correct, this may point to another deficiency in the impairment testing process that requires a different remedy.

DO10 Paragraph BC197(a) asserts that "it does not produce representationally faithful results" because it ignores other elements in the measurement of value in use. As explained above, it merely substitutes the outcome cash flow for the estimate, which should have a clear meaning and provides a safeguard against over-optimism in the estimation of cash flows. If corrections of estimates of other elements, such as variations that have occurred in interest rates, were considered important in this context, they could be incorporated in the calculation. Paragraph BC197(b) seems to raise the same point as paragraph BC197(a), as to the meaning of the impairment loss under the test. Paragraph BC197(c) complains about the excessive burden that a subsequent cash flow test might impose. Professor Whittington notes that the extent of the burden depends, of course, upon the frequency with which the test is applied. He also notes that the extensive disclosure requirements currently associated with the impairment test might be reduced if the subsequent cash flow test were in place.

Amendments to the Basis for Conclusions on IAS 36 - Recoverable Amount Disclosures for Non-Financial Assets

After paragraph BC209D a heading and paragraphs BC209E–BC209Q are added.

Recoverable Amount Disclosures for Non-Financial Assets

BC209E As a consequence of issuing IFRS 13, the IASB amended some of the disclosure requirements in IAS 36 for the recoverable amount of impaired assets. As described in paragraphs BC209B–BC209D, those amendments resulted from the IASB's decision to require the disclosure of the recoverable amount of impaired assets and additional disclosures about the measurement of the recoverable amount of impaired assets when the recoverable amount was based on fair value less costs of disposal. The IASB also intended to retain a balance between the disclosures about fair value less costs of disposal and the disclosures about value in use.

BC209F After issuing IFRS 13, the IASB was made aware that one of the amendments that that Standard had made to IAS 36 resulted in the disclosure requirements being more broadly applicable than the IASB had intended. Instead of requiring the disclosure of the recoverable amount for impaired assets, that amendment required the disclosure of the recoverable amount of each cash-generating unit for which the carrying amount of goodwill or intangible assets with indefinite useful lives allocated to that unit is significant when compared to an entity's total carrying amount of goodwill or intangible assets with indefinite useful lives.

BC209G Consequently, the IASB decided to publish, in January 2013, the Exposure Draft ED/2013/1 *Recoverable Amount Disclosures for Non-Financial Assets* ('Exposure Draft ED/2013/1'), which proposed to amend paragraphs 130 and 134 of IAS 36 to make clear its intention about the scope of the disclosure requirements. For the same reason, the IASB also proposed to amend paragraph 130(f) to require additional information about the fair value measurement when the recoverable amount of impaired assets is based on fair value less costs of disposal, consistently with the disclosure requirements for impaired assets in US GAAP. As mentioned in paragraph BC209C, although IFRS and US GAAP have different impairment models, the IASB had concluded that requiring that additional information about impaired assets measured at fair value less costs of disposal would improve comparability between the disclosures presented in the financial statements of entities applying IFRS and the disclosures presented in the financial statements of those applying US GAAP.

BC209H One of the consequential amendments made by IFRS 13 amended paragraph 134(e) of IAS 36 that relates to fair value less costs of disposal for each cash-generating unit for which the carrying amount of goodwill or intangible assets with indefinite useful lives allocated to that unit is significant in comparison with an entity’s total carrying amount of goodwill or intangible assets with indefinite useful lives. That amendment required the disclosure of the level of the fair value hierarchy in which the measurement is categorised, and whether (and if so why) there has been a change in the valuation technique used to measure fair value less costs of disposal for such cash-generating units. In developing Exposure Draft ED/2013/1, the IASB did not consider it necessary to amend those disclosure requirements because they were consistent with its intention of aligning the disclosures about fair value less costs of disposal in IAS 36 with the fair value disclosures in IFRS 13. Consequently, the IASB decided to retain the disclosure requirements in paragraph 134(e) and to add, as mentioned in paragraph BC209G, requirements for similar disclosures in paragraph 130(f).

BC209I When developing Exposure Draft ED/2013/1, the IASB considered whether there should be consistency between the wording of the disclosure requirements in IAS 36 (which uses the term 'assumptions') with the wording of the measurement requirements in IFRS 13 (which uses the term 'inputs'). The IASB concluded that it was unlikely that those terms could have different meanings because IFRS 13 defines 'inputs' as "the assumptions that market participants would use when pricing the asset or liability…". In addition, the IASB wanted to make clear that the proposed amendments did not change the meaning of the information that is required to be disclosed in accordance with IAS 36. On the basis of that analysis and given that the use of the term 'assumptions' was not questioned by the respondents to Exposure Draft ED/2013/1, the IASB decided to retain that term in the final amendments.

BC209J When developing Exposure Draft ED/2013/1, the IASB also noted that its proposed amendments overlapped with an amendment to paragraph 130(f) of IAS 36 that had been proposed in the Exposure Draft ED/2012/1 *Annual Improvements to IFRSs 2010–2012 Cycle* ('Exposure Draft ED/2012/1') published in May 2012. The intention behind the proposal in Exposure Draft ED/2012/1 was to harmonise the disclosure requirements for fair value less costs of disposal and value in use by adding to paragraph 130(f) the requirement to disclose the discount rates that were used in the current and previous measurements if the recoverable amount of impaired assets, determined on the basis of fair value less costs of disposal, was measured using a present value technique. A total of 64 respondents commented on that proposal, with nearly all of those respondents supporting it. Consequently, the IASB decided to incorporate that proposal into Exposure Draft ED/2013/1, but did not request comments in response to this topic.

BC209K A total of 74 respondents commented on Exposure Draft ED/2013/1. Even though the vast majority of the respondents supported the proposed amendments, a few respondents believed that, when impairment losses were calculated by reference to the recoverable amount determined on the basis of fair value less costs of disposal, the amendments would result in the disclosure requirements being broader than the disclosures that would be required if the same impairment losses were calculated by reference to the recoverable amount determined on the basis of value in use. The IASB noted that it had already taken the decision to require this incremental disclosure when it first amended IAS 36 as a result of issuing IFRS 13. As mentioned in paragraph BC209G, that decision had been taken on the grounds that those amendments would improve comparability between the disclosures presented in the financial statements of entities applying IFRS and the disclosures presented in the financial statements of those applying US GAAP.

BC209L During the development of IFRS 13, the IASB also noted that not all of the additional disclosure requirements for the recoverable amount determined on the basis of fair value less costs of disposal would be applicable for the recoverable amount determined on the basis of value in use. The requirement of disclosing the level of the fair value hierarchy within which the fair value measurement of the impaired asset is categorised would, for example, not be applicable to a measurement based on value in use. In addition, the IASB noted that the amendments to paragraph 130(f) would help to align the disclosure requirements for fair value less costs of disposal for impaired assets with the disclosure requirements in paragraph 134(e) for fair value less costs of disposal for each cash-generating unit for which the carrying amount of goodwill or intangible assets with indefinite useful lives allocated to that unit is significant in comparison with an entity's total carrying amount of goodwill or intangible assets with indefinite useful lives.

BC209M Exposure Draft ED/2013/1 also proposed to remove the term 'material' from paragraph 130. When developing these proposals, the IASB concluded that it was unnecessary to state explicitly that the disclosure requirements in paragraph 130 relate to assets (including goodwill) or cash-generating units, for which a material impairment loss has been recognised or reversed during the period, because all IFRSs are governed by the concept of materiality as described in IAS 1 *Presentation of Financial Statements* (see paragraph 31 of IAS 1) and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Some respondents to Exposure Draft ED/2013/1 were opposed to removing this term because they thought that, by removing it, it would become unclear whether the disclosure requirements in paragraph 130 apply only when a material impairment loss has been recognised or reversed during the period. They were also concerned that the elimination of the term 'material' in paragraph 130 could impact the understanding of the requirements in paragraph 131 that deal with the disclosure of immaterial items on an aggregate basis.

BC209N The IASB had not intended to change the scope of the disclosure requirements in paragraph 130. In addition, the IASB concluded that the removal of the term 'material' in paragraph 130 should not impact the disclosure requirements in paragraph 131. Consequently, the IASB concluded that the rationale for removing the term 'material', as presented in Exposure Draft ED/2013/1, was still valid and, as a result, the IASB confirmed the removal of that term in the final amendments.

BC209O The IASB decided not to retain in the final amendments the last sentence of paragraph 130(f), as proposed in Exposure Draft ED/2013/1. That sentence stated that an "… entity is not required to provide the disclosures required by IFRS 13". The IASB noted that IFRS 13 already excludes from the scope of its disclosure requirements assets for which the recoverable amount is fair value less costs of disposal in accordance with IAS 36. As a result, the IASB concluded that that sentence in paragraph 130(f) was redundant and could cause confusion and therefore decided to remove it from the final amendments.

BC209P Exposure Draft ED/2013/1 proposed to include an illustrative example of the requirements in paragraph 130(b) and the proposed requirements in paragraph 130(f)(ii). Some respondents questioned the usefulness of that illustrative example, which did not illustrate all of the disclosures that are required for the recoverable amount of impaired assets based on fair value less costs of disposal. In their view, such an illustrative example could be misleading rather than helpful, because it might suggest that no other disclosures are required. On the basis of these comments, and because the IASB noted that Illustrative Example 15 to IFRS 13 includes similar disclosures to the ones included in the proposed illustrative example, it decided not to incorporate the proposed example in the final amendments.

BC209Q On the basis of the respondents' comments, the IASB decided to proceed with the final amendments subject to only minor drafting modifications.

After paragraph BC228A a heading and paragraphs BC228B–BC228C are added.

Transition provisions for *Recoverable Amount Disclosures for Non-Financial Assets*

BC228B In Exposure Draft ED/2013/1, the IASB proposed retrospective application and to permit earlier application of the amendments. The vast majority of the respondents supported those proposals.

BC228C The IASB decided to retain in the final amendments the transition requirements proposed in Exposure Draft ED/2013/1 that meant that entities should not provide comparative information for the prior period if they are not also applying IFRS 13 in that period. The objective of such transition requirements is to make these amendments have the same effect as if they had been issued when the IASB issued IFRS 13.

Illustrative Examples
Hong Kong Accounting Standard 36

Impairment of Assets

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Contents

Example 2 - Calculation of value in use and recognition of an impairment loss

In this example, tax effects are ignored.

Background and calculation of value in use

IE23 At the end of 20X0, entity T acquires entity M for CU10,000. M has manufacturing plants in three countries.

Schedule 1. Data at the end of 20X0

End of 20X0	*Allocation of purchase price*	*Fair value of identifiable assets*	*Goodwill*
	CU	CU	CU[(a)]
Activities in Country A	3,000	2,000	1,000
Activities in Country B	2,000	1,500	500
Activities in Country C	5,000	3,500	1,500
Total	10,000	7,000	3,000

(a) Activities in each country represent the lowest level at which the goodwill is monitored for internal management purposes (determined as the difference between the purchase price of the activities in each country, as specified in the purchase agreement, and the fair value of the identifiable assets).

IE23A Because goodwill has been allocated to the activities in each country, each of those activities must be tested for impairment annually or more frequently if there is any indication that it may be impaired (see paragraph 90 of IAS 36).

IE24 The recoverable amounts (ie higher of value in use and fair value less costs ~~to sell~~of disposal) of the cash-generating units are determined on the basis of value in use calculations. At the end of 20X0 and 20X1, the value in use of each cash-generating unit exceeds its carrying amount. Therefore the activities in each country and the goodwill allocated to those activities are regarded as not impaired.

IE25 At the beginning of 20X2, a new government is elected in Country A. It passes legislation significantly restricting exports of T’s main product. As a result, and for the foreseeable future, T’s production in Country A will be cut by 40 per cent.

IE26 The significant export restriction and the resulting production decrease require T also to estimate the recoverable amount of the Country A operations at the beginning of 20X2.

IE27 T uses straight-line depreciation over a 12-year life for the Country A identifiable assets and anticipates no residual value.

Schedule 2. Determination of the depreciated historical cost of the Country A identifiable assets at the end of 20X3

End of 20X3	*Identifiable assets* CU
Historical cost	2,000
Accumulated depreciation *(166.7 × 3 years)*	(500)
Depreciated historical cost	1,500
Carrying amount (Schedule 1)	1,113
Difference	387

Schedule 3. Carrying amount of the Country A assets at the end of 20X3

End of 20X3	*Goodwill* CU	*Identifiable assets* CU	*Total* CU
Gross carrying amount	1,000	2,000	3,000
Accumulated amortisation	-	(414)	(414)
Accumulated impairment loss	(1,000)	(473)	(1,473)
Carrying amount	-	1,113	1,113
Reversal of impairment loss	0	387	387
Carrying amount after reversal of impairment loss	-	1,500	1,500

Example 5 Treatment of a future restructuring

In this example, tax effects are ignored.

Background

IE44 At the end of 20X0, entity K tests a plant for impairment. The plant is a cash-generating unit. The plant's assets are carried at depreciated historical cost. The plant has a carrying amount of CU3,000 and a remaining useful life of 10 years.

IE45 The plant's recoverable amount (ie higher of value in use and fair value less costs ~~to sell~~of disposal) is determined on the basis of a value in use calculation. Value in use is calculated using a pre-tax discount rate of 14 per cent.

IE46 Management approved budgets reflect that:

(a) at the end of 20X3, the plant will be restructured at an estimated cost of CU100. Since K is not yet committed to the restructuring, a provision has not been

IE55 The machine's recoverable amount (ie higher of value in use and fair value less costs ~~to sell~~of disposal) is determined on the basis of a value in use calculation. Value in use is calculated using a pre-tax discount rate of 14 per cent.

IE56 Management approved budgets reflect:

(a) estimated costs necessary to maintain the level of economic benefit expected to arise from the machine in its current condition; and

(b) that in 20X4, costs of CU25,000 will be incurred to enhance the machine's performance by increasing its productive capacity.

IE57 At the end of 20X4, costs to enhance the machine's performance are incurred. The machine's estimated future cash flows reflected in the most recent management approved budgets are given in paragraph IE60 and a current discount rate is the same as at the end of 20X0.

At the end of 20X0

Schedule 1. Calculation of the machine's value in use at the end of 20X0

Year	*Future cash flows CU*	*Discounted at 14% CU*
20X1	22,165[1]	19,443
20X2	21,450[1]	16,505
20X3	20,550[1]	13,871
20X4	24,725[1,2]	14,639
20X5	25,325[1,3]	13,153
20X6	24,825[1,3]	11,310
20X7	24,123[1,3]	9,640
20X8	25,533[1,3]	8,951
20X9	24,234[1,3]	7,452
20X10	22,850[1,3]	6,164
Value in use		121,128

1 Includes estimated costs necessary to maintain the level of economic benefit expected to arise from the machine in its current condition.

2 Excludes estimated costs to enhance the machine's performance reflected in management budgets.

3 Excludes estimated benefits expected from enhancing the machine's performance reflected in management budgets.

IE58 The machine's recoverable amount (value in use) is less than its carrying amount. Therefore, F recognises an impairment loss for the machine.

IE72 The recoverable amount (ie higher of value in use and fair value less costs ~~to sell~~of disposal) of each cash-generating unit is based on its value in use. Value in use is calculated using a pre-tax discount rate of 15 per cent.

Identification of corporate assets

IE73 In accordance with paragraph 102 of IAS 36, M first identifies all the corporate assets that relate to the individual cash-generating units under review. The corporate assets are the headquarters building and the research centre.

IE74 M then decides how to deal with each of the corporate assets:

(a) the carrying amount of the headquarters building can be allocated on a reasonable and consistent basis to the cash-generating units under review; and

(b) the carrying amount of the research centre cannot be allocated on a reasonable and consistent basis to the individual cash-generating units under review.

Allocation of corporate assets

IE75 The carrying amount of the headquarters building is allocated to the carrying amount of each individual cash-generating unit. A weighted allocation basis is used because the estimated remaining useful life of A's cash-generating unit is 10 years, whereas the estimated remaining useful lives of B and C's cash-generating units are 20 years.

Schedule 1. Calculation of a weighted allocation of the carrying amount of the headquarters building

End of 20X0	*A* CU	*B* CU	*C* CU	*Total* CU
Carrying amount	100	150	200	450
Useful life	10 years	20 years	20 years	
Weighting based on useful life	1	2	2	
Carrying amount after weighting	100	300	400	800
Pro-rata allocation of the building	12% *(100/ 800)*	38% *(300/800)*	50% *(400/800)*	100%
Allocation of the carrying amount of the building (based on pro-rata above)	19	56	75	150
Carrying amount (after allocation of the building)	119	206	275	600

IE79 Therefore, no additional impairment loss results from the application of the impairment test to M as a whole. Only an impairment loss of CU46 is recognised as a result of the application of the first step of the test to A, B and C.

Example 9 Disclosures about cash-generating units with goodwill or intangible assets with indefinite useful lives

The purpose of this example is to illustrate the disclosures required by paragraphs 134 and 135 of IAS 36.

Background

IE80 Entity M is a multinational manufacturing firm that uses geographical segments for reporting segment information. M's three reportable segments are Europe, North America and Asia. Goodwill has been allocated for impairment testing purposes to three individual cash-generating units—two in Europe (units A and B) and one in North America (unit C)—and to one group of cash-generating units (comprising operation XYZ) in Asia. Units A, B and C and operation XYZ each represent the lowest level within M at which the goodwill is monitored for internal management purposes.

IE81 M acquired unit C, a manufacturing operation in North America, in December 20X2. Unlike M's other North American operations, C operates in an industry with high margins and high growth rates, and with the benefit of a 10-year patent on its primary product. The patent was granted to C just before M's acquisition of C. As part of accounting for the acquisition of C, M recognised, in addition to the patent, goodwill of CU3,000 and a brand name of CU1,000. M's management has determined that the brand name has an indefinite useful life. M has no other intangible assets with indefinite useful lives.

IE82 The carrying amounts of goodwill and intangible assets with indefinite useful lives allocated to units A, B and C and to operation XYZ are as follows:

	Goodwill	*Intangible assets with indefinite useful lives*
	CU	CU
A	350	
B	450	
C	3,000	1,000
XYZ	1,200	
Total	5,000	1,000

IE83 During the year ending 31 December 20X3, M determines that there is no impairment of any of its cash-generating units or group of cash-generating units containing goodwill or intangible assets with indefinite useful lives. The recoverable amounts (ie higher of value in use and fair value less costs ~~to sell~~of disposal) of those units and group of units are determined on the basis of value in use calculations. M has determined that the recoverable amount calculations are most sensitive to changes in the following assumptions:

HKAS 40
Revised ~~July 2012~~June 2014

Hong Kong Accounting Standard 40

Investment Property

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CONTENTS

Hong Kong Accounting Standard 40 *Investment Property* (HKAS 40) is set out in paragraphs 1-86. All the paragraphs have equal authority. HKAS 40 should be read in the context of its objective and the IASB's Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting~~the Preparation and Presentation of Financial Standards~~*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

IN1 Hong Kong Accounting Standard 40 *Investment Property* (HKAS 40) replaces SSAP 13 *Accounting for Investment Property* (revised in 2000), and should be applied for annual periods beginning on or after 1 January 2005. Earlier application is encouraged.

Reasons for issuing HKAS 40

IN2 The objectives of the HKICPA in issuing HKAS 40 were to reduce or eliminate alternatives, redundancies and conflicts within the HKFRSs, to deal with some convergence issues and to make other improvements.

IN3 The HKICPA did not reconsider the fundamental approach to the accounting for investment property.

The main features

IN4 The main features of HKAS 40 are described below.

IN5 A property interest that is held by a lessee under an operating lease may be classified and accounted for as investment property provided that:

(a) the rest of the definition of investment property is met;

(b) the operating lease is accounted for as if it were a finance lease in accordance with HKAS 17 *Leases*; and

(c) the lessee uses the fair value model set out in this Standard for the asset recognised.

IN6 The classification alternative described in paragraph IN5 is available on a property-by-property basis. However, because it is a general requirement of the Standard that all investment property should be consistently accounted for using the fair value or cost model, once this alternative is selected for one such property, all property classified as investment property is to be accounted for consistently on a fair value basis.

IN7 The Standard requires an entity to disclose:

(a) whether it applies the fair value model or the cost model; and

(b) if it applies the fair value model, whether, and in what circumstances, property interests held under operating leases are classified and accounted for as investment property.

IN8 When a valuation obtained for investment property is adjusted significantly for the purpose of the financial statements, a reconciliation is required between the valuation obtained and the valuation included in the financial statements.

IN9 The Standard clarifies that if a property interest held under a lease is classified as investment property, the item accounted for at fair value is that interest and not the underlying property.

IN10 Comparative information is required for all disclosures.

IN11 The following have been incorporated into the Standard:

(a) to specify what costs are included in the cost of investment property and when replaced items should be derecognised;

(b) to specify when exchange transactions (ie transactions in which investment property is acquired in exchange for non-monetary assets, in whole or in part) have commercial substance and how such transactions, with or without commercial substance, are accounted for; and

(c) to specify the accounting for compensation from third parties for investment property that was impaired, lost or given up.

Summary of the approach required by the Standard

IN12 The Standard permits entities to choose either:

(a) a fair value model, under which an investment property is measured, after initial measurement, at fair value with changes in fair value recognised in profit or loss; or

(b) a cost model. The cost model is specified in HKAS 16 and requires an investment property to be measured after initial measurement at depreciated cost (less any accumulated impairment losses). An entity that chooses the cost model discloses the fair value of its investment property.

IN13 The choice between the cost and fair value models is not available to a lessee accounting for a property interest held under an operating lease that it has elected to classify and account for as investment property. The Standard requires such investment property to be measured using the fair value model.

IN14 The fair value model differs from the revaluation model that is permitted for some non-financial assets. Under the revaluation model, increases in carrying amount above a cost-based measure are recognised as revaluation surplus. However, under the fair value model, all changes in fair value are recognised in profit or loss.

IN15 The Standard requires an entity to apply its chosen model to all of its investment property. However, this does not mean that all eligible operating leases must be classified as investment properties.

IN16 In exceptional cases, when an entity has adopted the fair value model, there may be clear evidence when an entity first acquires an investment property (or when an existing property first becomes investment property following the completion of construction or development, or after a change in use) that its fair value will not be reliably ~~determinable~~ measurable on a continuing basis. In such cases, the Standard requires the entity to measure that investment property using the cost model in HKAS 16 until disposal of the investment property. The residual value of the investment property is assumed to be zero.

IN17 A change from one model to the other is made only if the change results in a more relevant presentation. The Standard states that this is highly unlikely to be the case for a change from the fair value model to the cost model.

IN18 HKAS 40 depends upon HKAS 17 for requirements for the classification of leases, the accounting for finance and operating leases and for some of the disclosures relevant to leased investment properties. When a property interest held under an operating lease is classified and accounted for as an investment property, HKAS 40 overrides HKAS 17 by requiring that the lease is accounted for as if it were a finance lease. Paragraphs 14–18 of HKAS 17 apply to the classification of leases of land and buildings. In particular, paragraph 18 specifies when it is not necessary to measure separately the land and building elements of such a lease.

Hong Kong Accounting Standard 40
Investment Property

Objective

1 The objective of this Standard is to prescribe the accounting treatment for investment property and related disclosure requirements.

Scope

2 This Standard shall be applied in the recognition, measurement and disclosure of investment property.

3 Among other things, this Standard applies to the measurement in a lessee's financial statements of investment property interests held under a lease accounted for as a finance lease and to the measurement in a lessor's financial statements of investment property provided to a lessee under an operating lease. This Standard does not deal with matters covered in HKAS 17 *Leases*, including:

(a) classification of leases as finance leases or operating leases;

(b) recognition of lease income from investment property (see also HKAS 18 *Revenue*);

(c) measurement in a lessee's financial statements of property interests held under a lease accounted for as an operating lease;

(d) measurement in a lessor's financial statements of its net investment in a finance lease;

(e) accounting for sale and leaseback transactions; and

(f) disclosure about finance leases and operating leases.

4 This Standard does not apply to:

(a) biological assets related to agricultural activity (see HKAS 41 *Agriculture*); and

(b) mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources.

Definitions

5 The following terms are used in this Standard with the meanings specified:

Carrying amount **is the amount at which an asset is recognised in the statement of financial position.**

Cost **is the amount of cash or cash equivalents paid or the fair value of other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other HKFRSs, eg HKFRS 2 *Share-based Payment*.**

Fair value **~~is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.~~ 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. (See HKFRS 13 *Fair Value Measurement*).**

Investment property **is property (land or a building—or part of a building—or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for:**

(a) use in the production or supply of goods or services or for administrative purposes; or

(b) sale in the ordinary course of business.

Owner-occupied property **is property held (by the owner or by the lessee under a finance lease) for use in the production or supply of goods or services or for administrative purposes.**

6 A property interest that is held by a lessee under an operating lease may be classified and accounted for as investment property if, and only if, the property would otherwise meet the definition of an investment property and the lessee uses the fair value model set out in paragraphs 33-55 for the asset recognised. This classification alternative is available on a property-by-property basis. However, once this classification alternative is selected for one such property interest held under an operating lease, all property classified as investment property shall be accounted for using the fair value model. When this classification alternative is selected, any interest so classified is included in the disclosures required by paragraphs 74-78.

7 Investment property is held to earn rentals or for capital appreciation or both. Therefore, an investment property generates cash flows largely independently of the other assets held by an entity. This distinguishes investment property from owner-occupied property. The production or supply of goods or services (or the use of property for administrative purposes) generates cash flows that are attributable not only to property, but also to other assets used in the production or supply process. HKAS 16 *Property, Plant and Equipment* applies to owner-occupied property.

8 The following are examples of investment property:

(a) land held for long-term capital appreciation rather than for short-term sale in the ordinary course of business.

(b) land held for a currently undetermined future use. (If an entity has not determined that it will use the land as owner-occupied property or for short-term sale in the ordinary course of business, the land is regarded as held for capital appreciation.)

(c) a building owned by the entity (or held by the entity under a finance lease) and leased out under one or more operating leases.

(d) a building that is vacant but is held to be leased out under one or more operating leases.

(e) property that is being constructed or developed for future use as investment property.

9 The following are examples of items that are not investment property and are therefore outside the scope of this Standard:

(a) property intended for sale in the ordinary course of business or in the process of construction or development for such sale (see HKAS 2 *Inventories*), for example, property acquired exclusively with a view to subsequent disposal in the near future or for development and resale.

(b) property being constructed or developed on behalf of third parties (see HKAS 11 *Construction Contracts*).

(c) owner-occupied property (see HKAS 16), including (among other things) property held for future use as owner-occupied property, property held for future development and subsequent use as owner-occupied property, property occupied by employees (whether or not the employees pay rent at market rates) and owner-occupied property awaiting disposal.

(d) [deleted]

(e) property that is leased to another entity under a finance lease.

10 Some properties comprise a portion that is held to earn rentals or for capital appreciation and another portion that is held for use in the production or supply of goods or services or for administrative purposes. If these portions could be sold separately (or leased out separately under a finance lease), an entity accounts for the portions separately. If the portions could not be sold separately, the property is investment property only if an insignificant portion is held for use in the production or supply of goods or services or for administrative purposes.

11 In some cases, an entity provides ancillary services to the occupants of a property it holds. An entity treats such a property as investment property if the services are insignificant to the arrangement as a whole. An example is when the owner of an office building provides security and maintenance services to the lessees who occupy the building.

12 In other cases, the services provided are significant. For example, if an entity owns and manages a hotel, services provided to guests are significant to the arrangement as a whole. Therefore, an owner-managed hotel is owner-occupied property, rather than investment property.

13 It may be difficult to determine whether ancillary services are so significant that a property does not qualify as investment property. For example, the owner of a hotel sometimes transfers some responsibilities to third parties under a management contract. The terms of such contracts vary widely. At one end of the spectrum, the owner's position may, in substance, be that of a passive investor. At the other end of the spectrum, the owner may simply have outsourced day-to-day functions while retaining significant exposure to variation in the cash flows generated by the operations of the hotel.

14 Judgement is needed to determine whether a property qualifies as investment property. An entity develops criteria so that it can exercise that judgement consistently in accordance with the definition of investment property and with the related guidance in paragraphs 7-13. Paragraph 75(c) requires an entity to disclose these criteria when classification is difficult.

15 In some cases, an entity owns property that is leased to, and occupied by, its parent or another subsidiary. The property does not qualify as investment property in the consolidated financial statements, because the property is owner-occupied from the perspective of the group. However, from the perspective of the entity that owns it, the property is investment property if it meets the definition in paragraph 5. Therefore, the lessor treats the property as investment property in its individual financial statements.

Recognition

16 Investment property shall be recognised as an asset when, and only when:

(a) it is probable that the future economic benefits that are associated with the investment property will flow to the entity; and

(b) the cost of the investment property can be measured reliably.

17 An entity evaluates under this recognition principle all its investment property costs at the time they are incurred. These costs include costs incurred initially to acquire an investment property and costs incurred subsequently to add to, replace part of, or service a property.

18 Under the recognition principle in paragraph 16, an entity does not recognise in the carrying amount of an investment property the costs of the day-to-day servicing of such a property. Rather, these costs are recognised in profit or loss as incurred. Costs of day-to-day servicing are primarily the cost of labour and consumables, and may include the cost of minor parts. The purpose of these expenditures is often described as for the 'repairs and maintenance' of the property.

19 Parts of investment properties may have been acquired through replacement. For example, the interior walls may be replacements of original walls. Under the recognition principle, an entity recognises in the carrying amount of an investment property the cost of replacing part of an existing investment property at the time that cost is incurred if the recognition criteria are met. The carrying amount of those parts that are replaced is derecognised in accordance with the derecognition provisions of this Standard.

Measurement at recognition

20 **An investment property shall be measured initially at its cost. Transaction costs shall be included in the initial measurement.**

21 The cost of a purchased investment property comprises its purchase price and any directly attributable expenditure. Directly attributable expenditure includes, for example, professional fees for legal services, property transfer taxes and other transaction costs.

22 [Deleted]

23 The cost of an investment property is not increased by:

(a) start-up costs (unless they are necessary to bring the property to the condition necessary for it to be capable of operating in the manner intended by management),

(b) operating losses incurred before the investment property achieves the planned level of occupancy, or

(c) abnormal amounts of wasted material, labour or other resources incurred in constructing or developing the property.

24 If payment for an investment property is deferred, its cost is the cash price equivalent. The difference between this amount and the total payments is recognised as interest expense over the period of credit.

25 **The initial cost of a property interest held under a lease and classified as an investment property shall be as prescribed for a finance lease by paragraph 20 of HKAS 17, ie the asset shall be recognised at the lower of the fair value of the property and the present value of the minimum lease payments. An equivalent amount shall be recognised as a liability in accordance with that same paragraph.**

26 Any premium paid for a lease is treated as part of the minimum lease payments for this purpose, and is therefore included in the cost of the asset, but is excluded from the liability. If a property interest held under a lease is classified as investment property, the item accounted for at fair value is that interest and not the underlying property. Guidance on ~~determining~~ measuring the fair value of a property interest is set out for the fair value model in paragraphs 33-35, 40, 41, 48, 50 and 52 and in HKFRS 13. That guidance is also relevant to the ~~determination~~ measurement of fair value when that value is used as cost for initial recognition purposes.

27 One or more investment properties may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. The following discussion refers to an exchange of one non-monetary asset for another, but it also applies to all exchanges described in the preceding sentence. The cost of such an investment property is measured at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. The acquired asset is measured in this way even if an entity cannot immediately derecognise the asset given up. If the acquired asset is not measured at fair value, its cost is measured at the carrying amount of the asset given up.

28 An entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction has commercial substance if:

(a) the configuration (risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred, or

(b) the entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange, and

(c) the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

For the purpose of determining whether an exchange transaction has commercial substance, the entity-specific value of the portion of the entity's operations affected by the transaction shall reflect post-tax cash flows. The result of these analyses may be clear without an entity having to perform detailed calculations.

29 The fair value of an asset ~~for which comparable market transactions do not exist~~ is reliably measurable if (a) the variability in the range of reasonable fair value estimates is not significant for that asset or (b) the probabilities of the various estimates within the range can be reasonably assessed and used ~~in estimating~~when measuring fair value. If the entity is able to ~~determine~~ measure reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure cost unless the fair value of the asset received is more clearly evident.

Measurement after recognition

Accounting policy

30 With the exception noted in paragraphs 32A and 34, an entity shall choose as its accounting policy either the fair value model in paragraphs 33-55 or the cost model in paragraph 56 and shall apply that policy to all of its investment property.

31 HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* states that a voluntary change in accounting policy shall be made only if the change results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows. It is highly unlikely that a change from the fair value model to the cost model will result in a more relevant presentation.

32 This Standard requires all entities to ~~determine~~ measure the fair value of investment property, for the purpose of either measurement (if the entity uses the fair value model) or disclosure (if it uses the cost model). An entity is encouraged, but not required, to ~~determine~~ measure the fair value of investment property on the basis of a valuation by a valuer who holds a recognised and relevant professional qualification and has recent experience in the location and category of the investment property being valued.

32A An entity may:

(a) choose either the fair value model or the cost model for all investment property backing liabilities that pay a return linked directly to the fair value of, or returns from, specified assets including that investment property; and

(b) choose either the fair value model or the cost model for all other investment property, regardless of the choice made in (a).

32B Some insurers and other entities operate an internal property fund that issues notional units, with some units held by investors in linked contracts and others held by the entity. Paragraph 32A does not permit an entity to measure the property held by the fund partly at cost and partly at fair value.

32C If an entity chooses different models for the two categories described in paragraph 32A, sales of investment property between pools of assets measured using different models shall be recognised at fair value and the cumulative change in fair value shall be recognised in profit or loss. Accordingly, if an investment property is sold from a pool in which the fair value model is used into a pool in which the cost model is used, the property's fair value at the date of the sale becomes its deemed cost.

Fair value model

33 After initial recognition, an entity that chooses the fair value model shall measure all of its investment property at fair value, except in the cases described in paragraph 53.

34 When a property interest held by a lessee under an operating lease is classified as an investment property under paragraph 6, paragraph 30 is not elective; the fair value model shall be applied.

35 A gain or loss arising from a change in the fair value of investment property shall be recognised in profit or loss for the period in which it arises.

36 - 39 [Deleted]~~The fair value of investment property is the price at which the property could be exchanged between knowledgeable, willing parties in an arm's length transaction (see paragraph 5). Fair value specifically excludes an estimated price inflated or deflated by special terms or circumstances such as atypical financing, sale and leaseback arrangements, special considerations or concessions granted by anyone associated with the sale.~~

~~37 An entity determines fair value without any deduction for transaction costs it may incur on sale or other disposal.~~

~~**38 The fair value of investment property shall reflect market conditions at the end of the reporting period.**~~

~~39 Fair value is time-specific as of a given date. Because market conditions may change, the amount reported as fair value may be incorrect or inappropriate if estimated as of another time. The definition of fair value also assumes simultaneous exchange and completion of the contract for sale without any variation in price that might be made in an arm's length transaction between knowledgeable, willing parties if exchange and completion are not simultaneous.~~

40 ~~The~~ When measuring the fair value of investment property in accordance with HKFRS 13, an entity shall ensure that the fair value reflects, among other things, rental income from current leases and ~~reasonable and supportable~~ other assumptions that market participants ~~represent what knowledgeable, willing parties~~ would use when pricing investment property ~~assume about rental income from future leases in the light of~~ under current market conditions. ~~It also reflects, on a similar basis, any cash outflows (including rental payments and other outflows) that could be expected in respect of the property. Some of those outflows are reflected in the liability whereas others relate to outflows that are not recognised in the financial statements until a later date (eg periodic payments such as contingent rents).~~

41 Paragraph 25 specifies the basis for initial recognition of the cost of an interest in a leased property. Paragraph 33 requires the interest in the leased property to be remeasured, if necessary, to fair value. In a lease negotiated at market rates, the fair value of an interest in a leased property at acquisition, net of all expected lease payments (including those relating to recognised liabilities), should be zero. This fair value does not change regardless of whether, for accounting purposes, a leased asset and liability are recognised at fair value or at the present value of minimum lease payments, in accordance with paragraph 20 of HKAS 17. Thus, remeasuring a leased asset from cost in accordance with paragraph 25 to fair value in accordance with paragraph 33 should not give rise to any initial gain or loss, unless fair value is measured at different times. This could occur when an election to apply the fair value model is made after initial recognition.

42 - 47 [Deleted] ~~The definition of fair value refers to "knowledgeable, willing parties". In this context, "knowledgeable" means that both the willing buyer and the willing seller are reasonably informed about the nature and characteristics of the investment property, its actual and potential uses, and market conditions at the end of the reporting period. A willing buyer is motivated, but not compelled, to buy. This buyer is neither over-eager nor determined to buy at any price. The assumed buyer would not pay a higher price than a market comprising knowledgeable, willing buyers and sellers would require.~~

~~43 A willing seller is neither an over-eager nor a forced seller, prepared to sell at any price, nor one prepared to hold out for a price not considered reasonable in current market conditions. The willing seller is motivated to sell the investment property at market terms for the best price obtainable. The factual circumstances of the actual investment property owner are not a part of this consideration because the willing seller is a hypothetical owner (eg a willing seller would not take into account the particular tax circumstances of the actual investment property owner).~~

~~44 The definition of fair value refers to an arm's length transaction. An arm's length transaction is one between parties that do not have a particular or special relationship that makes prices of transactions uncharacteristic of market conditions. The transaction is presumed to be between unrelated parties, each acting independently.~~

~~45 The best evidence of fair value is given by current prices in an active market for similar property in the same location and condition and subject to similar lease and other contracts. An entity takes care to identify any differences in the nature, location or condition of the property, or in the contractual terms of the leases and other contracts relating to the property.~~

~~46 In the absence of current prices in an active market of the kind described in paragraph 45, an entity considers information from a variety of sources, including:~~

~~(a) current prices in an active market for properties of different nature, condition or location (or subject to different lease or other contracts), adjusted to reflect those differences;~~

~~(b) recent prices of similar properties on less active markets, with adjustments to reflect any changes in economic conditions since the date of the transactions that occurred at those prices; and~~

~~(c) discounted cash flow projections based on reliable estimates of future cash flows, supported by the terms of any existing lease and other contracts and (when possible) by external evidence such as current market rents for similar properties in the same location and condition, and using discount rates that reflect current market assessments of the uncertainty in the amount and timing of the cash flows.~~

~~47 In some cases, the various sources listed in the previous paragraph may suggest different conclusions about the fair value of an investment property. An entity considers the reasons for those differences, in order to arrive at the most reliable estimate of fair value within a range of reasonable fair value estimates.~~

48 In exceptional cases, there is clear evidence when an entity first acquires an investment property (or when an existing property first becomes investment property after a change in use) that the variability in the range of reasonable fair value ~~estimates~~ measurements will be so great, and the probabilities of the various outcomes so difficult to assess, that the usefulness of a single ~~estimate~~ measure of fair value is negated. This may indicate that the fair value of the property will not be reliably ~~determinable~~ measurable on a continuing basis (see paragraph 53).

49 [Deleted]~~Fair value differs from value in use, as defined in HKAS 36 *Impairment of Assets*. Fair value reflects the knowledge and estimates of knowledgeable, willing buyers and sellers. In contrast, value in use reflects the entity's estimates, including the effects of factors that may be specific to the entity and not applicable to entities in general. For example, fair value does not reflect any of the following factors to the extent that they would not be generally available to knowledgeable, willing buyers and sellers:~~

~~(a) additional value derived from the creation of a portfolio of properties in different locations;~~

~~(b) synergies between investment property and other assets;~~

~~(c) legal rights or legal restrictions that are specific only to the current owner; and~~

~~(d) tax benefits or tax burdens that are specific to the current owner.~~

50 In determining the carrying amount of investment property under the fair value model , an entity does not double-count assets or liabilities that are recognised as separate assets or liabilities. For example:

(a) equipment such as lifts or air-conditioning is often an integral part of a building and is generally included in the fair value of the investment property, rather than recognised separately as property, plant and equipment.

(b) if an office is leased on a furnished basis, the fair value of the office generally includes the fair value of the furniture, because the rental income relates to the furnished office. When furniture is included in the fair value of investment property, an entity does not recognise that furniture as a separate asset.

(c) the fair value of investment property excludes prepaid or accrued operating lease income, because the entity recognises it as a separate liability or asset.

(d) the fair value of investment property held under a lease reflects expected cash flows (including contingent rent that is expected to become payable). Accordingly, if a valuation obtained for a property is net of all payments expected to be made, it will be necessary to add back any recognised lease liability, to arrive at the carrying amount of the investment property using the fair value model.

51 [Deleted]~~The fair value of investment property does not reflect future capital expenditure that will improve or enhance the property and does not reflect the related future benefits from this future expenditure.~~

52 In some cases, an entity expects that the present value of its payments relating to an investment property (other than payments relating to recognised liabilities) will exceed the present value of the related cash receipts. An entity applies HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets* to determine whether to recognise a liability and, if so, how to measure it.

Inability to ~~determine~~ measure fair value reliably

53 There is a rebuttable presumption that an entity can reliably ~~determine~~ measure the fair value of an investment property on a continuing basis. However, in exceptional cases, there is clear evidence when an entity first acquires an investment property (or when an existing property first becomes investment property after a change in use) that the fair value of the investment property is not reliably ~~determinable~~ measurable on a continuing basis. This arises when, and only when, the market for comparable ~~market~~ properties is inactive (eg there are few recent transactions, price quotations are not current or observed transaction prices indicate that the seller was forced to sell) ~~are infrequent~~ and alternative reliable ~~estimates~~ measurements of fair value (for example, based on discounted cash flow projections) are not available. If an entity determines that the fair value of an investment property under construction is not reliably ~~determinable~~ measurable but expects the fair value of the property to be reliably ~~determinable~~ measurable when construction is complete, it shall measure that investment property under construction at cost until either its fair value becomes reliably ~~determinable~~ measurable or construction is completed (whichever is earlier). If an entity determines that the fair value of an investment property (other than an investment property under construction) is not reliably ~~determinable~~ measurable on a continuing basis, the entity shall measure that investment property using the cost model in HKAS 16. The residual value of the investment property shall be assumed to be zero. The entity shall apply HKAS 16 until disposal of the investment property.

53A Once an entity becomes able to measure reliably the fair value of an investment property under construction that has previously been measured at cost, it shall measure that property at its fair value. Once construction of that property is complete, it is presumed that fair value can be measured reliably. If this is not the case, in accordance with paragraph 53, the property shall be accounted for using the cost model in accordance with HKAS 16.

53B The presumption that the fair value of investment property under construction can be measured reliably can be rebutted only on initial recognition. An entity that has measured an item of investment property under construction at fair value may not conclude that the fair value of the completed investment property cannot be ~~determined~~ measured reliably.

54 In the exceptional cases when an entity is compelled, for the reason given in paragraph 53, to measure an investment property using the cost model in accordance with HKAS 16, it measures at fair value all its other investment property, including investment property under construction. In these cases, although an entity may use the cost model for one investment property, the entity shall continue to account for each of the remaining properties using the fair value model.

55 If an entity has previously measured an investment property at fair value, it shall continue to measure the property at fair value until disposal (or until the property becomes owner-occupied property or the entity begins to develop the property for subsequent sale in the ordinary course of business) even if comparable market transactions become less frequent or market prices become less readily available.

Cost model

56 After initial recognition, an entity that chooses the cost model shall measure all of its investment properties in accordance with HKAS 16's requirements for that model other than those that meet the criteria to be classified as held for sale (or are included in a disposal group that is classified as held for sale) in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. Investment properties that meet the criteria to be classified as held for sale (or are included in a disposal group that is classified as held for sale) shall be measured in accordance with HKFRS 5.

Transfers

57 Transfers to, or from, investment property shall be made when, and only when, there is a change in use, evidenced by:

(a) commencement of owner-occupation, for a transfer from investment property to owner-occupied property;

(b) commencement of development with a view to sale, for a transfer from investment property to inventories;

(c) end of owner-occupation, for a transfer from owner-occupied property to investment property; or

(d) commencement of an operating lease to another party, for a transfer from inventories to investment property.

(e) [deleted]

58 Paragraph 57(b) requires an entity to transfer a property from investment property to inventories when, and only when, there is a change in use, evidenced by commencement of development with a view to sale. When an entity decides to dispose of an investment property without development, it continues to treat the property as an investment property until it is derecognised (eliminated from the statement of financial position) and does not treat it as inventory. Similarly, if an entity begins to redevelop an existing investment property for continued future use as investment property, the property remains an investment property and is not reclassified as owner-occupied property during the redevelopment.

59 Paragraphs 60-65 apply to recognition and measurement issues that arise when an entity uses the fair value model for investment property. When an entity uses the cost model, transfers between investment property, owner-occupied property and inventories do not change the carrying amount of the property transferred and they do not change the cost of that property for measurement or disclosure purposes.

60 For a transfer from investment property carried at fair value to owner-occupied property or inventories, the property's deemed cost for subsequent accounting in accordance with HKAS 16 or HKAS 2 shall be its fair value at the date of change in use.

61 If an owner-occupied property becomes an investment property that will be carried at fair value, an entity shall apply HKAS 16 up to the date of change in use. The entity shall treat any difference at that date between the carrying amount of the property in accordance with HKAS 16 and its fair value in the same way as a revaluation in accordance with HKAS 16.

62 Up to the date when an owner-occupied property becomes an investment property carried at fair value, an entity depreciates the property and recognises any impairment losses that have occurred. The entity treats any difference at that date between the carrying amount of the property in accordance with HKAS 16 and its fair value in the same way as a revaluation in accordance with HKAS 16. In other words:

(a) any resulting decrease in the carrying amount of the property is recognised in profit or loss. However, to the extent that an amount is included in revaluation surplus for that property, the decrease is recognised in other comprehensive income and reduces the revaluation surplus within equity.

(b) any resulting increase in the carrying amount is treated as follows:

(i) to the extent that the increase reverses a previous impairment loss for that property, the increase is recognised in profit or loss. The amount recognised in profit or loss does not exceed the amount needed to restore the carrying amount to the carrying amount that would have been determined (net of depreciation) had no impairment loss been recognised.

(ii) any remaining part of the increase is recognised in other comprehensive income and increases the revaluation surplus within equity. On subsequent disposal of the investment property, the revaluation surplus included in equity may be transferred to retained earnings. The transfer from revaluation surplus to retained earnings is not made through profit or loss.

63 For a transfer from inventories to investment property that will be carried at fair value, any difference between the fair value of the property at that date and its previous carrying amount shall be recognised in profit or loss.

64 The treatment of transfers from inventories to investment property that will be carried at fair value is consistent with the treatment of sales of inventories.

65 When an entity completes the construction or development of a self-constructed investment property that will be carried at fair value, any difference between the fair value of the property at that date and its previous carrying amount shall be recognised in profit or loss.

Disposals

66 An investment property shall be derecognised (eliminated from the statement of financial position) on disposal or when the investment property is permanently withdrawn from use and no future economic benefits are expected from its disposal.

67 The disposal of an investment property may be achieved by sale or by entering into a finance lease. In determining the date of disposal for investment property, an entity applies the criteria in HKAS 18 for recognising revenue from the sale of goods and considers the related guidance in the Appendix to HKAS 18. HKAS 17 applies to a disposal effected by entering into a finance lease and to a sale and leaseback.

68 If, in accordance with the recognition principle in paragraph 16, an entity recognises in the carrying amount of an asset the cost of a replacement for part of an investment property, it derecognises the carrying amount of the replaced part. For investment property accounted for using the cost model, a replaced part may not be a part that was depreciated separately. If it is not practicable for an entity to determine the carrying amount of the replaced part, it may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or constructed. Under the fair value model, the fair value of the investment property may already reflect that the part to be replaced has lost its value. In other cases it may be difficult to discern how much fair value should be reduced for the part being replaced. An alternative to reducing fair value for the replaced part, when it is not practical to do so, is to include the cost of the replacement in the carrying amount of the asset and then to reassess the fair value, as would be required for additions not involving replacement.

69 Gains or losses arising from the retirement or disposal of investment property shall be determined as the difference between the net disposal proceeds and the carrying amount of the asset and shall be recognised in profit or loss (unless HKAS 17 requires otherwise on a sale and leaseback) in the period of the retirement or disposal.

70 The consideration receivable on disposal of an investment property is recognised initially at fair value. In particular, if payment for an investment property is deferred, the consideration received is recognised initially at the cash price equivalent. The difference between the nominal amount of the consideration and the cash price equivalent is recognised as interest revenue in accordance with HKAS 18 using the effective interest method.

71 An entity applies HKAS 37 or other Standards, as appropriate, to any liabilities that it retains after disposal of an investment property.

72 Compensation from third parties for investment property that was impaired, lost or given up shall be recognised in profit or loss when the compensation becomes receivable.

73 Impairments or losses of investment property, related claims for or payments of compensation from third parties and any subsequent purchase or construction of replacement assets are separate economic events and are accounted for separately as follows:

(a) impairments of investment property are recognised in accordance with HKAS 36;

(b) retirements or disposals of investment property are recognised in accordance with paragraphs 66-71 of this Standard;

(c) compensation from third parties for investment property that was impaired, lost or given up is recognised in profit or loss when it becomes receivable; and

(d) the cost of assets restored, purchased or constructed as replacements is determined in accordance with paragraphs 20-29 of this Standard.

Disclosure

Fair value model and cost model

74 The disclosures below apply in addition to those in HKAS 17. In accordance with HKAS 17, the owner of an investment property provides lessors' disclosures about leases into which it has entered. An entity that holds an investment property under a finance or operating lease provides lessees' disclosures for finance leases and lessors' disclosures for any operating leases into which it has entered.

75 An entity shall disclose:

(a) whether it applies the fair value model or the cost model.

(b) if it applies the fair value model, whether, and in what circumstances, property interests held under operating leases are classified and accounted for as investment property.

(c) when classification is difficult (see paragraph 14), the criteria it uses to distinguish investment property from owner-occupied property and from property held for sale in the ordinary course of business.

(d) [deleted]~~the methods and significant assumptions applied in determining the fair value of investment property, including a statement whether the determination of fair value was supported by market evidence or was more heavily based on other factors (which the entity shall disclose) because of the nature of the property and lack of comparable market data.~~

(e) the extent to which the fair value of investment property (as measured or disclosed in the financial statements) is based on a valuation by an independent valuer who holds a recognised and relevant professional qualification and has recent experience in the location and category of the investment property being valued. If there has been no such valuation, that fact shall be disclosed.

(f) the amounts recognised in profit or loss for:

(i) rental income from investment property;

(ii) direct operating expenses (including repairs and maintenance) arising from investment property that generated rental income during the period;

(iii) direct operating expenses (including repairs and maintenance) arising from investment property that did not generate rental income during the period; and

(iv) the cumulative change in fair value recognised in profit or loss on a sale of investment property from a pool of assets in which the cost model is used into a pool in which the fair value model is used (see paragraph 32C).

(g) the existence and amounts of restrictions on the realisability of investment property or the remittance of income and proceeds of disposal.

(h) contractual obligations to purchase, construct or develop investment property or for repairs, maintenance or enhancements.

Fair value model

76 In addition to the disclosures required by paragraph 75, an entity that applies the fair value model in paragraphs 33-55 shall disclose a reconciliation between the carrying amounts of investment property at the beginning and end of the period, showing the following:

(a) additions, disclosing separately those additions resulting from acquisitions and those resulting from subsequent expenditure recognised in the carrying amount of an asset;

(b) additions resulting from acquisitions through business combinations;

(c) assets classified as held for sale or included in a disposal group classified as held for sale in accordance with HKFRS 5 and other disposals;

(d) net gains or losses from fair value adjustments;

(e) the net exchange differences arising on the translation of the financial statements into a different presentation currency, and on translation of a foreign operation into the presentation currency of the reporting entity;

(f) transfers to and from inventories and owner-occupied property; and

(g) other changes.

77 When a valuation obtained for investment property is adjusted significantly for the purpose of the financial statements, for example to avoid double-counting of assets or liabilities that are recognised as separate assets and liabilities as described in paragraph 50, the entity shall disclose a reconciliation between the valuation obtained and the adjusted valuation included in the financial statements, showing separately the aggregate amount of any recognised lease obligations that have been added back, and any other significant adjustments.

78 In the exceptional cases referred to in paragraph 53, when an entity measures investment property using the cost model in HKAS 16, the reconciliation required by paragraph 76 shall disclose amounts relating to that investment property separately from amounts relating to other investment property. In addition, an entity shall disclose:

(a) a description of the investment property;

(b) an explanation of why fair value cannot be ~~determined~~ measured reliably;

(c) if possible, the range of estimates within which fair value is highly likely to lie; and

(d) on disposal of investment property not carried at fair value:

(i) the fact that the entity has disposed of investment property not carried at fair value;

(ii) the carrying amount of that investment property at the time of sale; and

(iii) the amount of gain or loss recognised.

Cost model

79 **In addition to the disclosures required by paragraph 75, an entity that applies the cost model in paragraph 56 shall disclose:**

(a) the depreciation methods used;

(b) the useful lives or the depreciation rates used;

(c) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period;

(d) a reconciliation of the carrying amount of investment property at the beginning and end of the period, showing the following:

(i) additions, disclosing separately those additions resulting from acquisitions and those resulting from subsequent expenditure recognised as an asset;

(ii) additions resulting from acquisitions through business combinations;

(iii) assets classified as held for sale or included in a disposal group classified as held for sale in accordance with HKFRS 5 and other disposals;

(iv) depreciation;

(v) the amount of impairment losses recognised, and the amount of impairment losses reversed, during the period in accordance with HKAS 36;

(vi) the net exchange differences arising on the translation of the financial statements into a different presentation currency, and on translation of a foreign operation into the presentation currency of the reporting entity;

(vii) transfers to and from inventories and owner-occupied property; and

(viii) other changes~~; and~~.

(e) the fair value of investment property. In the exceptional cases described in paragraph 53, when an entity cannot ~~determine~~ measure the fair value of the investment property reliably, it shall disclose:

(i) a description of the investment property;

(ii) an explanation of why fair value cannot be ~~determined~~ measured reliably; and

(iii) if possible, the range of estimates within which fair value is highly likely to lie.

Transitional provisions

Fair value model

80 **An entity that has previously applied SSAP 13 (2000) and elects for the first time to classify and account for some or all eligible property interests held under operating leases as investment property shall recognise the effect of that election as an adjustment to the opening balance of retained earnings for the period in which the election is first made. In addition:**

(a) if the entity has previously disclosed publicly (in financial statements or otherwise) the fair value of those property interests in earlier periods (~~determined~~ measured on a basis that satisfies the definition of fair value in ~~paragraph 5 and the guidance in paragraphs 36-52~~HKFRS 13), the entity is encouraged, but not required:

(i) to adjust the opening balance of retained earnings for the earliest period presented for which such fair value was disclosed publicly; and

(ii) to restate comparative information for those periods; and

(b) if the entity has not previously disclosed publicly the information described in (a), it shall not restate comparative information and shall disclose that fact.

80A An entity that has previously applied SSAP 13 (2000) for investment properties other than those dealt with under paragraph 80 and chooses to use the fair value model under this Standard shall report the effect of applying this Standard on its effective date (or earlier) as an adjustment to the opening balance of retained earnings for the period in which this Standard is first applied. In addition:

(a) if the entity has previously disclosed publicly (in financial statements or otherwise) the fair value of those property interests in earlier periods (determined on a basis that satisfies the definition of fair value in paragraph 5 and the guidance in paragraphs 36-52), the entity is encouraged, but not required:

(i) to adjust the opening balance of retained earnings for the earliest period presented for which such fair value was disclosed publicly; and

(ii) to restate comparative information for those periods; and

(b) if the entity has not previously disclosed publicly the information described in (a), it shall not restate comparative information and shall disclose that fact.

81 This Standard requires a treatment different from that required by HKAS 8. HKAS 8 requires comparative information to be restated unless such restatement is impracticable.

82 When an entity first applies this Standard, the adjustment to the opening balance of retained earnings includes the reclassification of any amount held in revaluation surplus for investment property.

Cost model

83 Except as provided in paragraph 83A, HKAS 8 applies to any change in accounting policies that is made when an entity first applies this Standard and chooses to use the cost model. The effect of the change in accounting policies includes the reclassification of any amount held in revaluation surplus for investment property.

83A An entity that has previously applied SSAP 13 (2000) or has previously taken advantage of the exemption under SSAP 13 (2000) from compliance with its requirements and chooses to use the cost model under this Standard is permitted to deem the carrying amount of an investment property immediately before applying this Standard on its effective date (or earlier) as the cost of that property. Any adjustments, including the reclassification of any amount previously held in revaluation reserve for investment property, shall be made to the opening balance of retained earnings for the period in which this Standard is first applied. Depreciation on deemed cost commences from the time at which this Standard is first applied.

83B Paragraph 83A may apply in cases where an entity had previously applied the transitional provisions set out in SSAP 13 (2000) to state investment property at pre September 1994 carrying amount.

84 The requirements of paragraphs 27-29 regarding the initial measurement of an investment property acquired in an exchange of assets transaction shall be applied prospectively only to future transactions.

Effective date

85 An entity shall apply this Standard for annual periods beginning on or after 1 January 2005. Earlier application is encouraged. If an entity applies this Standard for a period beginning before 1 January 2005, it shall disclose that fact.

85a If an entity decides to apply this Standard for an earlier period, it is not required to apply all the HKASs with the effective date for that same period. However, it is required to apply the amendments set out in the appendix on amendments to other pronouncements for that earlier period(s).

85A HKAS 1 *Presentation of Financial Statements* (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraph 62. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

85B Paragraphs 8, 9, 48, 53, 54 and 57 were amended, paragraph 22 was deleted and paragraphs 53A and 53B were added by *Improvements to HKFRSs* issued in October 2008. An entity shall apply those amendments prospectively for annual periods beginning on or after 1 January 2009. An entity is permitted to apply the amendments to investment property under construction from any date before 1 January 2009 provided that the fair values of investment properties under construction were ~~determined~~ measured at those dates. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact and at the same time apply the amendments to paragraphs 5 and 81E of HKAS 16 *Property, Plant and Equipment*.

85C HKFRS 13, issued in June 2011, amended the definition of fair value in paragraph 5, amended paragraphs 26, 29, 32, 40, 48, 53, 53B, 78-80 and 85B and deleted paragraphs 36-39, 42-47, 49, 51 and 75(d). An entity shall apply those amendments when it applies HKFRS 13.

Withdrawal of SSAP 13

86 This Standard supersedes SSAP 13 Accounting for Investment Properties (revised in 2000).

CONTENTS

from paragraph

BASIS FOR CONCLUSIONS ON IAS 40 *INVESTMENT PROPERTY* (2000)

B35 Some commentators suggested that the definition of investment property should exclude property held for rentals, but not for capital appreciation. In their view, a fair value model may be appropriate for dealing activities, but is inappropriate where an entity has historically held rental property for many years and has no intention of selling it in the foreseeable future. They consider that holding property for long-term rental is a service activity and the assets used in that activity should be treated in the same way as assets used to support other service activities. In their view, holding an investment in property in such cases is similar to holding "held-to-maturity investments", which are measured at amortised cost under IAS 39.

B36 In the Board's view, the fair value model provides useful information about property held for rental, even if there is no immediate intention to sell the property. The economic performance of a property can be regarded as being made up of both rental income earned during the period (net of expenses) and changes in the value of future net rental income. The fair value of an investment property can be regarded as a market-based representation of the value of the future net rental income, regardless of whether the entity is likely to sell the property in the near future. Also, the Standard notes that fair value is determined without deducting costs of disposal—in other words, the use of the fair value model is not intended as a representation that a sale could, or should, be made in the near future.[#]

B37 The classification of hotels and similar property was controversial throughout the project and commentators on E64 had mixed views on this subject. Some see hotels essentially as investments, while others see them essentially as operating properties. Some requested a detailed rule to specify whether hotels (and, perhaps, other categories of property, such as restaurants, bars and nursing homes) should be classified as investment property or as owner-occupied property.

B38 The Board concluded that it is preferable to distinguish investment property from owner-occupied property on the basis of general principles, rather than have arbitrary rules for specific classes of property. Also, it would inevitably be difficult to establish rigorous definitions of specific classes of property to be covered by such rules. Paragraphs ~~9-11~~11-13 of the Standard discuss cases such as hotels in the context of the general principles that apply when an entity provides ancillary services.

B39 Some commentators requested quantitative guidance (such as a percentage) to clarify whether an "insignificant portion" is owner-occupied (paragraph~~8~~10) and whether ancillary services are "significant" (paragraphs ~~9-11~~11-13 of the Standard). As for similar cases in other Standards, the Board concluded that quantitative guidance would create arbitrary distinctions.

Subsequent Expenditure

B40 Some believe that there is no need to capitalise subsequent expenditure in a fair value model and that all subsequent expenditure should be recognised as an expense. However, others believe – and the Board agreed – that the failure to capitalise subsequent expenditure would lead to a distortion of the reported components of financial performance. Therefore, the Standard requires that an entity should determine whether subsequent expenditure should be capitalised using a test similar to the test used for owner-occupied property in IAS 16.

B41 Some commentators suggested that the test for capitalising subsequent expenditure should not refer to the originally assessed standard of performance. They felt that it is impractical and irrelevant to judge against the originally assessed standard of performance, which may relate to many years in the past. Instead, they suggested that subsequent expenditure should be capitalised if it enhances the previously assessed standard of performance – for example, if it increases the current market value of the property or is intended to maintain its competitiveness in the market. The Board saw some merit in this suggestion.

B42 Nevertheless, the Board believes that a reference to the previously assessed standard of performance would require substantial additional guidance, might not change the way the Standard is applied in practice and might cause confusion. The Board also concluded that it was important to retain the existing reference to the originally assessed standard of performance[*] to be consistent with IAS 16 and IAS 38.

[#] IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

[*] IAS 16 *Property, Plant and Equipment* as revised by the IASB in 2003 requires all subsequent costs to be covered by its general recognition principle and eliminated the requirement to reference the originally assessed standard of performance. IAS 40 was amended as a consequence of the change to IAS 16

lease—refer to the IASB's Basis for Conclusions on the amendments made in 2003.] The fair value model is the model proposed in E64: investment property should be measured at fair value and changes in fair value should be recognised in the income statement. The cost model is the benchmark treatment* in IAS 16 *Property, Plant and Equipment*: investment property should be measured at depreciated cost (less any accumulated impairment losses). An entity that chooses the cost model should disclose the fair value of its investment property.

B50 Under IAS 8 *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies,*† a change in accounting policies from one model to the other model should be made only if the change will result in a more appropriate presentation of events or transactions.‡ The Board concluded that this is highly unlikely to be the case for a change from the fair value model to the cost model and paragraph ~~25~~31 of the Standard reflects this conclusion.

B51 The Board believes that it is undesirable to permit three different accounting treatments for investment property. Accordingly, if an entity does not adopt the fair value model, the Standard requires the entity to use the benchmark treatment in IAS 16 and does not permit the use of the allowed alternative treatment. However, an entity may still use the allowed alternative for other properties covered by IAS 16.⌖

Guidance on Fair Value#

B52 The valuation profession will have an important role in implementing the Standard. Accordingly, in developing its guidance on the fair value of investment property, the Board considered not only similar guidance in other IASC literature, but also International Valuation Standards (IVS) issued by the International Valuation Standards Committee (IVSC). The Board understands that IVSC intends to review, and perhaps revise, its Standards in the near future.

B53 The Board believes that IASC's concept of fair value is similar to the IVSC concept of market value. IVSC defines market value as "the estimated amount for which an asset should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion." The Board believes that the guidance in paragraphs ~~29-30~~36, 37 and ~~32-38~~39-44 of the Standard is, in substance (and largely in wording as well), identical with guidance in IVS 1.β

B54 Paragraphs ~~31~~38 and ~~39-46~~45-52 of IAS 40 have no direct counterpart in the IVSC literature. The Board developed much of this material in response to commentators on E64, who asked for more detailed guidance on determining the fair value of investment property. In developing this material, the Board considered guidance on fair value in other IASC Standards and Exposure Drafts, particularly those on financial instruments (IAS 32 and IAS 39), intangible assets (IAS 38) and agriculture (E65).Ω

Independent Valuation

B55 Some commentators believe that fair values should be determined on the basis of an independent valuation, to enhance the reliability of the fair values reported. Others believe, on cost-benefit grounds, that IASC should not require (and perhaps not even encourage) an independent valuation. They believe that it is for preparers to decide, in consultation with auditors, whether an entity has sufficient internal resources to determine reliable fair values. Some also believe that independent valuers with appropriate expertise are not available in some markets.

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* IAS 16 *Property, Plant and Equipment* as revised by the IASB in 2003 eliminated all references to 'benchmark' treatment and 'allowed alternative' treatments.

† revised by the IASB in 2003 as IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

‡ The IASB conformed the terminology used in paragraph 31 to the terminology used in IAS 8 by *Improvements to IFRSs* issued in May 2008.

⌖ IAS 16 *Property, Plant and Equipment* as revised by the IASB in 2003 eliminated all references to 'benchmark' treatment and 'allowed alternative' treatments.

\# IFRS 13, issued in May 2011, contains the requirements for measuring fair value.

β The requirements for measuring fair value in IFRS 13, issued in May 2011, differ in some respects from the guidance for measuring market value in accordance with IVS 1. IFRS 13 deleted paragraphs 36, 37 and 42-44 of IAS 40.

Ω IFRS 13, issued in May 2011, defines fair value and contains the requirements for measuring fair value. As a consequence paragraphs 38, 45-47, 49 and 51 of IAS 40 have been deleted.

B56 The Board concluded that an independent valuation is not always necessary. Therefore, as proposed in E64, the Standard encourages, but does not require, an entity to determine the fair value of all investment property on the basis of a valuation by an independent valuer who holds a recognised and relevant professional qualification and who has recent experience in the location and category of the investment property being valued. This approach is consistent with the approach to actuarial valuations in IAS 19 *Employee Benefits* (see IAS 19, paragraph 57).[#]

Inability to Measure Fair Value Reliably

B57 E64 included a rebuttable presumption that an entity will be able to determine reliably the fair value of property held to earn rentals or for capital appreciation. E64 also proposed a reliability exception: IAS 16 should be applied if evidence indicates clearly, when an entity acquires or constructs a property, that fair value will not be determinable reliably on a continuing basis.

B58 Some commentators opposed various aspects of this proposal, on one or more of the following grounds:

(a) the rebuttable presumption underestimates the difficulties of determining fair value reliably. This will often be impossible, particularly where markets are thin or where there is not a well-established valuation profession;

(b) the accounting model under IAS 16 includes an impairment test under IAS 36. However, it is illogical to rely on an impairment test when fair value cannot be determined using cash flow projections, because an impairment test under IAS 36 is also difficult in such cases;

(c) where fair value cannot be determined reliably, this fact does not justify charging depreciation. Instead, the property in question should be measured at cost less impairment losses; and

(d) to avoid the danger of manipulation, all efforts should be made to determine fair values, even in a relatively inactive market. Even without an active market, a range of projected cash flows is available. If there are problems in determining fair value, an entity should measure the property at the best estimate of fair value and disclose limitations on the reliability of the estimate. If it is completely impossible to determine fair value, fair value should be deemed to be zero.

B59 The Board concluded that the rebuttable presumption and the reliability exception should be retained, but decided to implement them in a different way. In E64, they were implemented by excluding a property from the definition of investment property if the rebuttable presumption was overcome. Some commentators felt that it was confusing to include such a reliability exception in a definition. Accordingly, the Board moved the reliability exception from the definition to the section on subsequent measurement (paragraphs ~~47-49~~53-55).

B60 Under E64, an entity should not stop using the fair value model if comparable market transactions become less frequent or market prices become less readily available. Some commentators disagreed with this proposal. They argued that there may be cases when reliable estimates are no longer available and that it would be misleading to continue fair value accounting in such cases. The Board decided that it is important to keep the E64 approach, because otherwise entities might use a reliability exception as an excuse to discontinue fair value accounting in a falling market.[†]

B61 In cases where the reliability exception applies, E64 proposed that an entity should continue to apply IAS 16 until disposal of the property. Some commentators proposed that an entity should start applying the fair value model once the fair value becomes measurable reliably. The Board rejected this proposal because it would inevitably be a subjective decision to determine when fair value has become measurable reliably and this subjectivity could lead to inconsistent application.

B62 E64 proposed no specific disclosure where the reliability exception applies. Some commentators felt that disclosure would be important in such cases. The Board agreed and decided to include disclosures consistent with paragraph 170(b) of IAS 39[*] (see paragraphs ~~68 and 69(e)~~78 and 79(e) of IAS 40). Paragraph 170(b) of IAS 39 requires disclosures for financial assets whose fair value cannot be reliably measured.

[#] Paragraph 57 was renumbered as paragraph 59 when IAS 19 was amended in 2011.

[†] IFRS 13. Issued in May 2011, discusses the measurement of fair value when the volume or level of activity for an asset has significantly decreased.

[*] In August 2005, the IASB relocated all disclosures relating to financial instruments to IFRS 7 *Financial Instruments: Disclosures*.

Gains and Losses on Remeasurement to Fair Value

B63 Some commentators argued that there should be either a requirement or an option to recognise changes in the fair value of investment property in equity, on the grounds that:

(a) the market for property is not liquid enough and market values are uncertain and variable. Investment property is not as liquid as financial instruments and IAS 39 allows an option for available-for-sale investments;

(b) until performance reporting issues are resolved more generally, it is premature to require recognition of fair value changes in the income statement;

(c) recognition of unrealised gains and losses in the income statement increases volatility and does not enhance transparency, because revaluation changes will blur the assessment of an entity's operating performance. It may also cause a presumption that the unrealised gains are available for distribution as dividends;

(d) recognition in equity is more consistent with the historical cost and modified historical cost conventions that are a basis for much of today's accounting. For example, it is consistent with IASC's treatment of revaluations of property, plant and equipment under IAS 16 and with the option available for certain financial instruments under IAS 39;

(e) for properties financed by debt, changes in the fair value of the properties resulting from interest rate changes should not be recognised in the income statement, since the corresponding changes in the fair value of the debt are not recognised under IAS 39;

(f) under paragraphs 92 and 93 of the *Framework*,[#] income should be recognised only when it can be measured with sufficient certainty. For example, IAS 11 *Construction Contracts* requires certain conditions before an entity can use the percentage-of-completion method. These conditions are not normally met for investment property; and

(g) results from operations should be distinguished from changes in values. For example, under IAS 21, unrealised exchange differences on a foreign entity[*] are recognised in equity.

B64 Some commentators suggested that increases should be recognised in equity and decreases should be recognised in net profit or loss. This is similar to the revaluation model that forms the allowed alternative treatment[†]in IAS 16 (except for the lack of depreciation).

B65 As proposed in E64, the Board concluded that, in a fair value model, changes in the fair value of investment property should be recognised in the income statement as part of profit or loss for the period. The arguments for this approach include the following:

(a) the conceptual case for the fair value model is built largely on the view that this provides the most relevant and transparent view of the financial performance of investment property. Given this, it would be inconsistent to permit or require recognition in equity;

(b) recognition of fair value changes in equity would create a mismatch because net rental income would be recognised in the income statement, whereas the related consumption of the service potential (recognised as depreciation under IAS 16) would be recognised in equity. Similarly, maintenance expenditure would be recognised as an expense while related increases in fair value would be recognised in equity;

(c) using this approach, there is no need to resolve some difficult and controversial issues that would arise if changes in the fair value of investment property were recognised in equity. These issues include the following:

[#] The reference to the *Framework* is to IASC's *Framework for the Preparation and Presentation of Financial Statements*, adopted by the IASB in 2001. In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting*. Paragraphs 92 and 93 are now paragraphs 4.47 and 4.48 of the *Conceptual Framework*.

[*] In IAS 21 *The Effects of Changes in Foreign Exchange Rates*, as revised by the IASB in 2003, the term 'foreign entity' was replaced by 'foreign operation'.

[†] IAS 16 *Property, Plant and Equipment* as revised by the IASB in 2003 eliminated all references to 'benchmark' treatment and 'allowed alternative' treatments.

(i) should fair value changes previously recognised in equity be transferred ("recycled") to profit or loss on disposal of investment property; and

(ii) should fair value changes previously recognised in equity be transferred ("recycled") to profit or loss when investment property is impaired? If so, how should such impairment be identified and measured; and

(d) given the difficulty in defining investment property rigorously, entities will sometimes have the option of applying the investment property standard or either of the two treatments in IAS 16. It would be undesirable to include two choices in the investment property standard, as this would give entities a choice (at least occasionally) between four different treatments.

Transfers

B66 When an owner-occupied property carried under the benchmark treatment under IAS 16 becomes an investment property, the measurement basis for the property changes from depreciated cost to fair value. The Board concluded that the effect of this change in measurement basis should be treated as a revaluation under IAS 16 at the date of change in use. The result is that:

(a) the income statement excludes cumulative net increases in fair value that arose before the property became investment property. The portion of this change that arose before the beginning of the current period does not represent financial performance of the current period; and

(b) this treatment creates comparability between entities that had previously revalued the property under the allowed alternative treatment in IAS 16 and those entities that had previously used the IAS 16 benchmark treatment.[*]

Summary of Changes to E64

B67 The most important change between E64 and the final Standard was the introduction of the cost model as an alternative to the fair value model. The other main changes are listed below.

(a) The guidance on determining fair value was expanded, to clarify the following:[#]

(i) the fair value of investment property is not reduced by transaction costs that may be incurred on sale or other disposal (paragraph ~~30~~37 of the Standard). This is consistent with the measurement of financial assets under paragraph 69 of IAS 39.[ϕ] E64 was silent on the treatment of such costs;

(ii) measurement is based on valuation at the balance sheet date (paragraph~~31~~38);

(iii) the best evidence of fair value is normally given by current prices on an active market for similar property in the same location and condition and subject to similar lease and other contracts (paragraph~~39~~45). In the absence of such evidence, fair value reflects information from a variety of sources and an entity needs to investigate reasons for any differences between the information from different sources (paragraphs ~~40-41~~46 and 47);

(iv) market value differs from value in use as defined in IAS 36 *Impairment of Assets* (paragraph ~~43~~49);

(v) there is a need to avoid double counting of investment property and separately recognised assets and liabilities. Integral equipment (such as elevators or air-conditioning) is generally included in the investment property, rather than recognised separately (paragraph ~~44~~50);

(vi) the fair value of investment property does not reflect future capital expenditure that will improve or enhance the asset and does not reflect the related future benefits from this future expenditure (paragraph ~~45~~51);

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* IAS 16 *Property, Plant and Equipment* as revised by the IASB in 2003 eliminated all references to 'benchmark' treatment and 'allowed alternative' treatments.

\# IFRS 13, issued in May 2011, contains the requirements for measuring fair value and for disclosing information about fair value measurements. As a consequence paragraphs 37, 38, 45-47, 49, 51 and 75(d) of IAS 40 have been deleted.

ϕ Paragraph 69 was replaced by paragraph 46 when the IASB revised IAS 39 in 2003.

(f) New disclosure requirements include[#]:

(i) extension of the required disclosure on methods and significant assumptions, which are now to include disclosure of whether fair value was supported by market evidence, or whether the estimate is based on other data (which the entity should disclose) because of the nature of the property and the lack of comparable market data (paragraph ~~66(b)~~75(d));

(ii) disclosures of rental income and direct operating expenses (paragraph ~~66(d)~~75(f)); and

(iii) disclosures in the exceptional cases when fair value is not reliably determinable (paragraphs ~~68 and 69(e)~~78 and 79(e)).

(g) E64 proposed a requirement to disclose the carrying amount of unlet or vacant investment property. Some commentators argued that this disclosure was impracticable, particularly for property that is partly vacant. Some also felt that this is a matter for disclosure in a financial review by management, rather than in the financial statements. The Board deleted this disclosure requirement. It should be noted that some indication of vacancy levels may be available from the required disclosure of rental income and from the IAS 17 requirement to disclose cash flows from non-cancellable operating leases (split into less than one year, one to five years and more than five years).

(h) E64 included no specific transitional provisions, which means that IAS 8 would apply. There is a risk that restatement of prior periods might allow entities to manipulate their reported profit or loss for the period by selective use of hindsight in determining fair values in prior periods. Accordingly, the Board decided to prohibit restatement in the fair value model, except where an entity has already publicly disclosed fair values for prior periods (paragraph ~~70~~80).

[#] IFRS 13, issued in May 2011, contains the requirements for measuring fair value and for disclosing information about fair value measurements. As a consequence paragraphs 37, 38, 45-47, 49, 51 and 75(d) of IAS 40 have been deleted.

HKAS 41
Revised ~~June 2010~~June 2014

Hong Kong Accounting Standard 41

Agriculture

Hong Kong Institute of
Certified Public Accountants
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CONTENTS

Hong Kong Accounting Standard 41 *Agriculture* (HKAS 41) is set out in paragraphs 1-~~60~~61. All the paragraphs have equal authority. HKAS 41 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting ~~the Preparation and Presentation of Financial Statements~~*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

IN1 Hong Kong Accounting Standard 41 *Agriculture* (HKAS 41) prescribes the accounting treatment, financial statement presentation, and disclosures related to agricultural activity, a matter not covered in other Standards. Agricultural activity is the management by an entity of the biological transformation of living animals or plants (biological assets) for sale, into agricultural produce, or into additional biological assets.

IN2 HKAS 41 prescribes, among other things, the accounting treatment for biological assets during the period of growth, degeneration, production, and procreation, and for the initial measurement of agricultural produce at the point of harvest. It requires measurement at fair value less costs to sell from initial recognition of biological assets up to the point of harvest, other than when fair value cannot be measured reliably on initial recognition. However, HKAS 41 does not deal with processing of agricultural produce after harvest; for example, processing grapes into wine and wool into yarn.

IN3 There is a presumption that fair value can be measured reliably for a biological asset. However, that presumption can be rebutted only on initial recognition for a biological asset for which quoted market~~-determined~~ prices ~~or values~~ are not available and for which alternative ~~estimates of~~ fair value measurements are determined to be clearly unreliable. In such a case, HKAS 41 requires an entity to measure that biological asset at its cost less any accumulated depreciation and any accumulated impairment losses. Once the fair value of such a biological asset becomes reliably measurable, an entity should measure it at its fair value less costs to sell. In all cases, an entity should measure agricultural produce at the point of harvest at its fair value less costs to sell.

IN4 HKAS 41 requires that a change in fair value less costs to sell of a biological asset be included in profit or loss for the period in which it arises. In agricultural activity, a change in physical attributes of a living animal or plant directly enhances or diminishes economic benefits to the entity. Under a transaction-based, historical cost accounting model, a plantation forestry entity might report no income until first harvest and sale, perhaps 30 years after planting. On the other hand, an accounting model that recognises and measures biological growth using current fair values reports changes in fair value throughout the period between planting and harvest.

IN5 HKAS 41 does not establish any new principles for land related to agricultural activity. Instead, an entity follows HKAS 16 *Property, Plant and Equipment* or HKAS 40 *Investment Property*, depending on which standard is appropriate in the circumstances. HKAS 16 requires land to be measured either at its cost less any accumulated impairment losses, or at a revalued amount. HKAS 40 requires land that is investment property to be measured at its fair value, or cost less any accumulated impairment losses. Biological assets that are physically attached to land (for example, trees in a plantation forest) are measured at their fair value less costs to sell separately from the land.

IN6 HKAS 41 requires an unconditional government grant related to a biological asset measured at its fair value less costs to sell to be recognised in profit or loss when, and only when, the government grant becomes receivable. If a government grant is conditional, including when a government grant requires an entity not to engage in specified agricultural activity, an entity should recognise the government grant in profit or loss when, and only when, the conditions attaching to the government grant are met. If a government grant relates to a biological asset measured at its cost less any accumulated depreciation and any accumulated impairment losses, the entity applies HKAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*.

IN7 HKAS 41 is effective for annual financial statements covering periods beginning on or after 1 January 2005. Earlier application is encouraged.

IN8 HKAS 41 does not establish any specific transitional provisions. The adoption of HKAS 41 is accounted for in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

IN9 The Appendix provides illustrative examples of the application of HKAS 41. The Basis for Conclusions summarises the International Accounting Standards Board's reasons for adopting the requirements set out in HKAS 41.

Hong Kong Accounting Standard 41
Agriculture

Objective

The objective of this Standard is to prescribe the accounting treatment and disclosures related to agricultural activity.

Scope

1 **This Standard shall be applied to account for the following when they relate to agricultural activity:**

(a) biological assets;

(b) agricultural produce at the point of harvest; and

(c) government grants covered by paragraphs 34 and 35.

2 This Standard does not apply to:

(a) land related to agricultural activity (see HKAS 16 *Property, Plant and Equipment* and HKAS 40 *Investment Property*); and

(b) intangible assets related to agricultural activity (see HKAS 38 *Intangible Assets*).

3 This Standard is applied to agricultural produce, which is the harvested product of the entity's biological assets, only at the point of harvest. Thereafter, HKAS 2 *Inventories*, or another applicable Standard is applied. Accordingly, this Standard does not deal with the processing of agricultural produce after harvest; for example, the processing of grapes into wine by a vintner who has grown the grapes. While such processing may be a logical and natural extension of agricultural activity, and the events taking place may bear some similarity to biological transformation, such processing is not included within the definition of agricultural activity in this Standard.

4 The table below provides examples of biological assets, agricultural produce, and products that are the result of processing after harvest:

Biological assets	**Agricultural produce**	**Products that are the result of processing after harvest**
Sheep	Wool	Yarn, carpet
Trees in a plantation forest	Felled trees	Logs, lumber
Plants	Cotton	Thread, clothing
	Harvested cane	Sugar
Dairy cattle	Milk	Cheese
Pigs	Carcass	Sausages, cured hams
Bushes	Leaf	Tea, cured tobacco
Vines	Grapes	Wine
Fruit trees	Picked fruit	Processed fruit

Definitions

Agriculture-related definitions

5 **The following terms are used in this Standard with the meanings specified:**

Agricultural activity **is the management by an entity of the biological transformation and harvest of biological assets for sale or for conversion into agricultural produce or into additional biological assets.**

Agricultural produce **is the harvested product of the entity's biological assets.**

A *biological asset* **is a living animal or plant.**

Biological transformation **comprises the processes of growth, degeneration, production, and procreation that cause qualitative or quantitative changes in a biological asset.**

Costs to sell **are the incremental costs directly attributable to the disposal of an asset, excluding finance costs and income taxes.**

A *group of biological assets* **is an aggregation of similar living animals or plants.**

Harvest **is the detachment of produce from a biological asset or the cessation of a biological asset's life processes.**

6 Agricultural activity covers a diverse range of activities; for example, raising livestock, forestry, annual or perennial cropping, cultivating orchards and plantations, floriculture, and aquaculture (including fish farming). Certain common features exist within this diversity:

(a) *Capability to change*. Living animals and plants are capable of biological transformation;

(b) *Management of change*. Management facilitates biological transformation by enhancing, or at least stabilising, conditions necessary for the process to take place (for example, nutrient levels, moisture, temperature, fertility, and light). Such management distinguishes agricultural activity from other activities. For example, harvesting from unmanaged sources (such as ocean fishing and deforestation) is not agricultural activity; and

(c) *Measurement of change*. The change in quality (for example, genetic merit, density, ripeness, fat cover, protein content, and fibre strength) or quantity (for example, progeny, weight, cubic metres, fibre length or diameter, and number of buds) brought about by biological transformation or harvest is measured and monitored as a routine management function.

7 Biological transformation results in the following types of outcomes:

(a) asset changes through (i) growth (an increase in quantity or improvement in quality of an animal or plant), (ii) degeneration (a decrease in the quantity or deterioration in quality of an animal or plant); or (iii) procreation (creation of additional living animals or plants); or

(b) production of agricultural produce such as latex, tea leaf, wool, and milk.

General definitions

8 **The following terms are used in this Standard with the meanings specified:**

~~**An** *active market* **is a market where all the following conditions exist:**~~

~~**(a) the items traded within the market are homogeneous;**~~

~~**(b) willing buyers and sellers can normally be found at any time; and**~~

~~**(c) prices are available to the public.**~~

Carrying amount **is the amount at which an asset is recognised in the statement of financial position.**

Fair value **is the ~~amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.~~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. (See HKFRS 13 *Fair Value Measurement.)***

Government grants **are as defined in HKAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*.**

9 [Deleted]~~The fair value of an asset is based on its present location and condition. As a result, for example, the fair value of cattle at a farm is the price for the cattle in the relevant market less the transport and other costs of getting the cattle to that market.~~

Recognition and measurement

10 An entity shall recognise a biological asset or agricultural produce when, and only when:

(a) the entity controls the asset as a result of past events;

(b) it is probable that future economic benefits associated with the asset will flow to the entity; and

(c) the fair value or cost of the asset can be measured reliably.

11 In agricultural activity, control may be evidenced by, for example, legal ownership of cattle and the branding or otherwise marking of the cattle on acquisition, birth, or weaning. The future benefits are normally assessed by measuring the significant physical attributes.

12 A biological asset shall be measured on initial recognition and at the end of each reporting period at its fair value less costs to sell, except for the case described in paragraph 30 where the fair value cannot be measured reliably.

13 Agricultural produce harvested from an entity's biological assets shall be measured at its fair value less costs to sell at the point of harvest. Such measurement is the cost at that date when applying HKAS 2 *Inventories* or another applicable Standard.

14 [Deleted]

15 The ~~determination of~~ fair value measurement of ~~for~~ a biological asset or agricultural produce may be facilitated by grouping biological assets or agricultural produce according to significant attributes; for example, by age or quality. An entity selects the attributes corresponding to the attributes used in the market as a basis for pricing.

16 Entities often enter into contracts to sell their biological assets or agricultural produce at a future date. Contract prices are not necessarily relevant in ~~determining~~ measuring fair value, because fair value reflects the current market conditions in which ~~a willing buyer and seller~~ market participant buyers and sellers would enter into a transaction. As a result, the fair value of a biological asset or agricultural produce is not adjusted because of the existence of a contract. In some cases, a contract for the sale of a biological asset or agricultural produce may be an onerous contract, as defined in HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. HKAS 37 applies to onerous contracts.

17 - 21 [Deleted]~~If an active market exists for a biological asset or agricultural produce in its present location and condition, the quoted price in that market is the appropriate basis for determining the fair value of that asset. If an entity has access to different active markets, the entity uses the most relevant one. For example, if an entity has access to two active markets, it would use the price existing in the market expected to be used.~~

~~18 If an active market does not exist, an entity uses one or more of the following, when available, in determining fair value:~~

~~(a) the most recent market transaction price, provided that there has not been a significant change in economic circumstances between the date of that transaction and the end of the reporting period;~~

~~(b) market prices for similar assets with adjustment to reflect differences; and~~

~~(c) sector benchmarks such as the value of an orchard expressed per export tray, bushel, or hectare, and the value of cattle expressed per kilogram of meat.~~

~~19 In some cases, the information sources listed in paragraph 18 may suggest different conclusions as to the fair value of a biological asset or agricultural produce. An entity considers the reasons for those differences, in order to arrive at the most reliable estimate of fair value within a relatively narrow range of reasonable estimates.~~

~~20 In some circumstances, market-determined prices or values may not be available for a biological asset in its present condition. In these circumstances, an entity uses the present value of expected net cash flows from the asset discounted at a current market-determined rate in determining fair value.~~

~~21 The objective of a calculation of the present value of expected net cash flows is to determine the fair value of a biological asset in its present location and condition. An entity considers this in determining an appropriate discount rate to be used and in estimating expected net cash flows. In determining the present value of expected net cash flows, an entity includes the net cash flows that market participants would expect the asset to generate in its most relevant market.~~

22 An entity does not include any cash flows for financing the assets, taxation, or re-establishing biological assets after harvest (for example, the cost of replanting trees in a plantation forest after harvest).

23 [Deleted]~~In agreeing an arm's length transaction price, knowledgeable, willing buyers and sellers consider the possibility of variations in cash flows. It follows that fair value reflects the possibility of such variations. Accordingly, an entity incorporates expectations about possible variations in cash flows into either the expected cash flows, or the discount rate, or some combination of the two. In determining a discount rate, an entity uses assumptions consistent with those used in estimating the expected cash flows, to avoid the effect of some assumptions being double-counted or ignored.~~

24 Cost may sometimes approximate fair value, particularly when

(a) little biological transformation has taken place since initial cost incurrence (for example, for fruit tree seedlings planted immediately prior to the end of a reporting period); or

(b) the impact of the biological transformation on price is not expected to be material (for example, for the initial growth in a 30-year pine plantation production cycle).

25 Biological assets are often physically attached to land (for example, trees in a plantation forest). There may be no separate market for biological assets that are attached to the land but an active market may exist for the combined assets, that is, for the biological assets, raw land, and land improvements, as a package. An entity may use information regarding the combined assets to ~~determine~~ measure the fair value ~~for~~ of the biological assets. For example, the fair value of raw land and land improvements may be deducted from the fair value of the combined assets to arrive at the fair value of biological assets.

Gains and losses

26 A gain or loss arising on initial recognition of a biological asset at fair value less costs to sell and from a change in fair value less costs to sell of a biological asset shall be included in profit or loss for the period in which it arises.

27 A loss may arise on initial recognition of a biological asset, because costs to sell are deducted in determining fair value less costs to sell of a biological asset. A gain may arise on initial recognition of a biological asset, such as when a calf is born.

28 A gain or loss arising on initial recognition of agricultural produce at fair value less costs to sell shall be included in profit or loss for the period in which it arises.

29 A gain or loss may arise on initial recognition of agricultural produce as a result of harvesting.

Inability to measure fair value reliably

30 There is a presumption that fair value can be measured reliably for a biological asset. However, that presumption can be rebutted only on initial recognition for a biological asset for which quoted market~~-determined~~ prices ~~or values~~ are not available and for which alternative ~~estimates of~~ fair value measurements are determined to be clearly unreliable. In such a case, that biological asset shall be measured at its cost less any accumulated depreciation and any accumulated impairment losses. Once the fair value of such a biological asset becomes reliably measurable, an entity shall measure it at its fair value less costs to sell. Once a non-current biological 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) in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, it is presumed that fair value can be measured reliably.

31 The presumption in paragraph 30 can be rebutted only on initial recognition. An entity that has previously measured a biological asset at its fair value less costs to sell continues to measure the biological asset at its fair value less costs to sell until disposal.

32 In all cases, an entity measures agricultural produce at the point of harvest at its fair value less costs to sell. This Standard reflects the view that the fair value of agricultural produce at the point of harvest can always be measured reliably.

33 In determining cost, accumulated depreciation and accumulated impairment losses, an entity considers HKAS 2, HKAS 16 and HKAS 36 *Impairment of Assets*.

Government grants

34 An unconditional government grant related to a biological asset measured at its fair value less costs to sell shall be recognised in profit or loss when, and only when, the government grant becomes receivable.

35 If a government grant related to a biological asset measured at its fair value less costs to sell is conditional, including when a government grant requires an entity not to engage in specified agricultural activity, an entity shall recognise the government grant in profit or loss when, and only when, the conditions attaching to the government grant are met.

36 Terms and conditions of government grants vary. For example, a grant may require an entity to farm in a particular location for five years and require the entity to return all of the grant if it farms for a period shorter than five years. In this case, the grant is not recognised in profit or loss until the five years have passed. However, if the terms of the grant allow part of it to be retained according to the time that has elapsed, the entity recognises that part in profit or loss as time passes.

37 If a government grant relates to a biological asset measured at its cost less any accumulated depreciation and any accumulated impairment losses (see paragraph 30), HKAS 20 is applied.

38 This Standard requires a different treatment from HKAS 20, if a government grant relates to a biological asset measured at its fair value less costs to sell or a government grant requires an entity not to engage in specified agricultural activity. HKAS 20 is applied only to a government grant related to a biological asset measured at its cost less any accumulated depreciation and any accumulated impairment losses.

Disclosure

39 [Deleted]

General

40 An entity shall disclose the aggregate gain or loss arising during the current period on initial recognition of biological assets and agricultural produce and from the change in fair value less costs to sell of biological assets.

41 An entity shall provide a description of each group of biological assets.

42 The disclosure required by paragraph 41 may take the form of a narrative or quantified description.

43 An entity is encouraged to provide a quantified description of each group of biological assets, distinguishing between consumable and bearer biological assets or between mature and immature biological assets, as appropriate. For example, an entity may disclose the carrying amounts of consumable biological assets and bearer biological assets by group. An entity may further divide those carrying amounts between mature and immature assets. These distinctions provide information that may be helpful in assessing the timing of future cash flows. An entity discloses the basis for making any such distinctions.

44 Consumable biological assets are those that are to be harvested as agricultural produce or sold as biological assets. Examples of consumable biological assets are livestock intended for the production of meat, livestock held for sale, fish in farms, crops such as maize and wheat, and trees being grown for lumber. Bearer biological assets are those other than consumable biological assets; for example, livestock from which milk is produced, grape vines, fruit trees, and trees from which firewood is harvested while the tree remains. Bearer biological assets are not agricultural produce but, rather, are self-regenerating.

45 Biological assets may be classified either as mature biological assets or immature biological assets. Mature biological assets are those that have attained harvestable specifications (for consumable biological assets) or are able to sustain regular harvests (for bearer biological assets).

46 If not disclosed elsewhere in information published with the financial statements, an entity shall describe:

(a) the nature of its activities involving each group of biological assets; and

(b) non-financial measures or estimates of the physical quantities of:

(i) each group of the entity's biological assets at the end of the period; and

(ii) output of agricultural produce during the period.

47 - 48 [Deleted]~~**An entity shall disclose the methods and significant assumptions applied in determining the fair value of each group of agricultural produce at the point of harvest and each group of biological assets.**~~

~~**48 An entity shall disclose the fair value less costs to sell of agricultural produce harvested during the period, determined at the point of harvest.**~~

49 An entity shall disclose:

(a) the existence and carrying amounts of biological assets whose title is restricted, and the carrying amounts of biological assets pledged as security for liabilities;

(b) the amount of commitments for the development or acquisition of biological assets; and

(c) financial risk management strategies related to agricultural activity.

50 An entity shall present a reconciliation of changes in the carrying amount of biological assets between the beginning and the end of the current period. The reconciliation shall include:

(a) the gain or loss arising from changes in fair value less costs to sell;

(b) increases due to purchases;

(c) decreases attributable to sales and biological assets classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5;

(d) decreases due to harvest;

(e) increases resulting from business combinations;

(f) net exchange differences arising on the translation of financial statements into a different presentation currency, and on the translation of a foreign operation into the presentation currency of the reporting entity; and

(g) other changes.

51 The fair value less costs to sell of a biological asset can change due to both physical changes and price changes in the market. Separate disclosure of physical and price changes is useful in appraising current period performance and future prospects, particularly when there is a production cycle of more than one year. In such cases, an entity is encouraged to disclose, by group or otherwise, the amount of change in fair value less costs to sell included in profit or loss due to physical changes and due to price changes. This information is generally less useful when the production cycle is less than one year (for example, when raising chickens or growing cereal crops).

52 Biological transformation results in a number of types of physical change - growth, degeneration, production, and procreation, each of which is observable and measurable. Each of those physical changes has a direct relationship to future economic benefits. A change in fair value of a biological asset due to harvesting is also a physical change.

53 Agricultural activity is often exposed to climatic, disease and other natural risks. If an event occurs that gives rise to a material item of income or expense, the nature and amount of that item are disclosed in accordance with HKAS 1 *Presentation of Financial Statements*. Examples of such an event include an outbreak of a virulent disease, a flood, a severe drought or frost, and a plague of insects.

Additional disclosures for biological assets where fair value cannot be measured reliably

54 If an entity measures biological assets at their cost less any accumulated depreciation and any accumulated impairment losses (see paragraph 30) at the end of the period, the entity shall disclose for such biological assets:

(a) a description of the biological assets;

(b) an explanation of why fair value cannot be measured reliably;

(c) if possible, the range of estimates within which fair value is highly likely to lie;

(d) the depreciation method used;

(e) the useful lives or the depreciation rates used; and

(f) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period.

55 If, during the current period, an entity measures biological assets at their cost less any accumulated depreciation and any accumulated impairment losses (see paragraph 30), an entity shall disclose any gain or loss recognised on disposal of such biological assets and the reconciliation required by paragraph 50 shall disclose amounts related to such biological assets separately. In addition, the reconciliation shall include the following amounts included in profit or loss related to those biological assets:

(a) impairment losses;

(b) reversals of impairment losses; and

(c) depreciation.

56 If the fair value of biological assets previously measured at their cost less any accumulated depreciation and any accumulated impairment losses becomes reliably measurable during the current period, an entity shall disclose for those biological assets:

(a) a description of the biological assets;

(b) an explanation of why fair value has become reliably measurable; and

(c) the effect of the change.

Government grants

57 An entity shall disclose the following related to agricultural activity covered by this Standard:

(a) the nature and extent of government grants recognised in the financial statements;

(b) unfulfilled conditions and other contingencies attaching to government grants; and

(c) significant decreases expected in the level of government grants.

Effective date and transition

58 This Standard becomes operative for annual financial statements covering periods beginning on or after 1 January 2005. Earlier application is encouraged. If an entity applies this Standard for periods beginning before 1 January 2005, it shall disclose that fact.

59 This Standard does not establish any specific transitional provisions. The adoption of this Standard is accounted for in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

59A This Standard supersedes SSAP 36 *Agriculture* (issued in November 2002).

60 Paragraphs 5, 6, 17, 20 and 21 were amended and paragraph 14 deleted by *Improvements to HKFRSs* issued in October 2008. An entity shall apply those amendments prospectively for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact.

61 HKFRS 13, issued in June 2011, amended paragraphs 8, 15, 16, 25 and 30 and deleted paragraphs 9, 17-21, 23, 47 and 48. An entity shall apply those amendments when it applies HKFRS 13.

Appendix

Illustrative examples

This appendix, accompanies, but is not part of, IAS 41. It has been updated to take account of the changes made by IAS 1 Presentation of Financial Statements *(as revised in 2007) and* Improvements to IFRSs *issued in 2008.*

A1 Example 1 illustrates how the disclosure requirements of this Standard might be put into practice for a dairy farming entity. This Standard encourages the separation of the change in fair value less costs to sell of an entity's biological assets into physical change and price change. That separation is reflected in Example 1. Example 2 illustrates how to separate physical change and price change.

A2 The financial statements in Example 1 do not conform to all of the disclosure and presentation requirements of other Standards. Other approaches to presentation and disclosure may also be appropriate.

Example 1 XYZ Dairy Ltd

Statement of financial position

XYZ Dairy Ltd Statement of financial position	Notes	31 December 20X1	31 December 20X0
ASSETS			
Non-current assets			
Dairy livestock - immature[1]		52,060	47,730
Dairy livestock - mature[1]		372,990	411,840
Subtotal - biological assets	3	425,050	459,570
Property, plant and equipment		1,462,650	1,409,800
Total non-current assets		**1,887,700**	**1,869,370**
Current assets			
Inventories		82,950	70,650
Trade and other receivables		88,000	65,000
Cash		10,000	10,000
Total current assets		**180,950**	**145,650**
Total assets		**2,068,650**	**2,015,020**
EQUITY AND LIABILITIES			
Equity			
Issued capital		1,000,000	1,000,000
Retained earnings		902,828	865,000
Total equity		**1,902,828**	**1,865,000**
Current liabilities			
Trade and other payables		165,822	150,020
Total current liabilities		**165,822**	**150,020**
Total equity and liabilities		**2,068,650**	**2,015,020**

[1] An entity is encouraged, but not required, to provide a quantified description of each group of biological assets, distinguishing between consumable and bearer biological assets or between mature and immature biological assets, as appropriate. An entity discloses the basis for making any such distinctions.

Statement of comprehensive income[2]

XYZ Dairy Ltd **Statement of comprehensive income**	**Notes**	**Year Ended 31 December 20X1**
Fair value of milk produced		518,240
Gains arising from changes in fair value less costs to sell of dairy livestock	3	39,930
		558,170
Inventories used		(137,523)
Staff costs		(127,283)
Depreciation expense		(15,250)
Other operating expenses		(197,092)
		(477,148)
Profit from operations		**81,022**
Income tax expense		(43,194)
Profit/comprehensive income for the year		**37,828** =====

Statement of changes in equity

XYZ Dairy Ltd **Statement of Changes in Equity**			**Year Ended 31 December 20X1**
	Share capital	**Retained earnings**	**Total**
Balance at 1 January 20X1	1,000,000	865,000	**1,865,000**
Profit/comprehensive income for the year		37,828	**37,828**
Balance at 31 December 20X1	**1,000,000** =======	**902,828** ======	**1,902,828** =======

2 This statement of comprehensive income presents an analysis of expenses using a classification based on the nature of expenses. IAS 1 *Presentation of Financial Statements* requires that an entity present, either in the statement of comprehensive income or in the notes, an analysis of expenses using a classification based on either the nature of expenses or their function within the entity. IAS 1 encourages presentation of an analysis of expenses in the statement of comprehensive income.

Statement of cash flows[3]

XYZ Dairy Ltd **Statement of cash flows**	**Notes**	**Year Ended 31 December 20X1**
Cash flows from operating activities		
Cash receipts from sales of milk		498,027
Cash receipts from sales of livestock		97,913
Cash paid for supplies and to employees		(460,831)
Cash paid for purchases of livestock		(23,815)
		111,294
Income taxes paid		(43,194)
Net cash from operating activities		**68,100**
Cash flows from investing activities		
Purchase of property, plant and equipment		(68,100)
Net cash used in investing activities		**(68,100)**
Net increase in cash		**0**
Cash at beginning of the year		**10,000**
Cash at end of the year		**10,000** **======**

Notes

1 Operations and principal activities

XYZ Dairy Ltd ('the Company') is engaged in milk production for supply to various customers. At 31 December 20X1, the Company held 419 cows able to produce milk (mature assets) and 137 heifers being raised to produce milk in the future (immature assets). The Company produced 157,584kg of milk with a fair value less costs to sell of 518,240 (~~that is determined~~ at the time of milking) in the year ended 31 December 20X1.

[3] This statement of cash flows reports cash flows from operating activities using the direct method. IAS 7 *Statement of Cash Flows* requires that an entity report cash flows from operating activities using either the direct method or the indirect method. IAS 7 encourages use of the direct method.

2 Accounting policies

Livestock and milk

Livestock are measured at their fair value less costs to sell. The fair value of livestock is ~~determined~~ based on ~~market~~ quoted prices of livestock of similar age, breed, and genetic merit in the principal (or most advantageous) market for the livestock. Milk is initially measured at its fair value less costs to sell at the time of milking. The fair value of milk is ~~determined~~ based on quoted ~~market~~ prices in the local area in the principal (or most advantageous) market for the milk.

3 Biological assets

Reconciliation of carrying amounts of dairy livestock	**20X1**
Carrying amount at 1 January 20X1	**459,570**
Increases due to purchases	26,250
Gain arising from changes in fair value less costs to sell attributable to physical changes [4]	15,350
Gain arising from changes in fair value less costs to sell attributable to price changes [4]	24,580
Decreases due to sales	(100,700)
Carrying amount at 31 December 20X1	**425,050**
	=======

4 Financial risk management strategies

The Company is exposed to financial risks arising from changes in milk prices. The Company does not anticipate that milk prices will decline significantly in the foreseeable future and, therefore, has not entered into derivative or other contracts to manage the risk of a decline in milk prices. The Company reviews its outlook for milk prices regularly in considering the need for active financial risk management.

[4] Separating the increase in fair value less costs to sell between the portion attributable to physical changes and the portion attributable to price changes is encouraged but not required by this Standard.

Example 2 Physical change and price change

The following example illustrates how to separate physical change and price change. Separating the change in fair value less costs to sell between the portion attributable to physical changes and the portion attributable to price changes is encouraged but not required by this Standard.

A herd of 10 2 year old animals was held at 1 January 20X1. One animal aged 2.5 years was purchased on 1 July 20X1 for 108, and one animal was born on 1 July 20X1. No animals were sold or disposed of during the period. Per-unit fair values less costs to sell were as follows:

2 year old animal at 1 January 20X1	100	
Newborn animal at 1 July 20X1	70	
2.5 year old animal at 1 July 20X1	108	
Newborn animal at 31 December 20X1	72	
0.5 year old animal at 31 December 20X1	80	
2 year old animal at 31 December 20X1	105	
2.5 year old animal at 31 December 20X1	111	
3 year old animal at 31 December 20X1	120	
Fair value less costs to sell of herd at 1 January 20X1 (10 x 100)		1,000
Purchase on 1 July 20X1 (1 x 108)		108
Increase in fair value less costs to sell due to price change:		
10 x (105 - 100)	50	
1 x (111 - 108)	3	
1 x (72 - 70)	2	55
Increase in fair value less costs to sell due to physical change:		
10 x (120 - 105)	150	
1 x (120 - 111)	9	
1 x (80 - 72)	8	
1 x 70	70	237
Fair value less costs to sell of herd at 31 December 20X1		
11 x 120	1,320	
1 x 80	80	1,400

HKAS 41 BC
Revised ~~July 2012~~June 2014

Basis for Conclusions
Hong Kong Accounting Standard 41

Agriculture

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Basis for Conclusions on IAS 41 *Agriculture*

This Basis for Conclusions accompanies, but is not part of, IAS 41.

HKAS 41 is based on IAS 41 Agriculture. In approving HKAS 41, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IAS 41. Accordingly, there are no significant differences between HKAS 41 and IAS 41. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IAS 41 referred to below generally correspond with those in HKAS 41.

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching its conclusions on amending IAS 41 *Agriculture* by *Improvements to IFRSs* in May 2008. Individual Board members gave greater weight to some factors than to others.

BC2 Because the Board's intention was not to reconsider the fundamental approach to the accounting for agriculture established by IAS 41, this Basis for Conclusions does not discuss requirements in IAS 41 that the Board has not reconsidered. The IASC Basis for Conclusions on IAS 41 follows this Basis.

Scope

Costs to sell (paragraph 5)

BC3 Before the *Improvements to IFRSs* issued in May 2008, IAS 41 used the term 'point-of-sale costs'. This term was not used elsewhere in IFRSs. The term 'costs to sell' is used in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and IAS 36 *Impairment of Assets*. The Board decided that 'point-of-sale costs' and 'costs to sell' meant the same thing in the context of IAS 41. The word 'incremental' in the definition of 'costs to sell' excludes costs that are included in the fair value measurement of a biological asset, such as transport costs. It includes costs that are necessary for a sale to occur but that would not otherwise arise, such as commissions to brokers and dealers, levies by regulatory agencies and commodity exchanges, and transfer taxes and duties. Both terms relate to transaction costs arising at the point of sale.

BC4 Therefore, the Board decided to replace the terms 'point-of-sale costs' and 'estimated point-of-sale costs' with 'costs to sell' to make IAS 41 consistent with IFRS 5 and IAS 36.

Recognition and measurement

Discount rate (paragraph 20)

BC5 As part of the annual improvements project begun in 2007, the Board reconsidered whether it is appropriate to require a pre-tax discount rate in paragraph 20 when measuring fair value.[*] The Board noted that a fair value measurement should take into account the attributes, including tax attributes, that a market participant would consider when pricing an asset or liability.

BC6 The Board noted that a willing buyer would factor into the amount that it would be willing to pay the seller to acquire an asset (or would receive to assume a liability) all incremental cash flows that would benefit that buyer. Those incremental cash flows would be reduced by expected income tax payments using appropriate tax rates (ie the tax rate of a market participant buyer). Accordingly, fair value takes into account future income taxes that a market participant purchasing the asset (or assuming the liability) would be expected to pay (or to receive), without regard to an entity's specific tax situation.[#]

[*] IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

[#] IFRS 13, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

BC7 Therefore, the Board decided to keep the requirement to use a current market-based discount rate but in *Improvements to IFRSs* issued in May 2008 removed the reference to a pre-tax discount rate in paragraph 20.

Additional biological transformation (paragraph 21)

BC8 Sometimes the fair value of an asset in its current location and condition is estimated using discounted cash flows. Paragraph 21 could be read to exclude from such calculations increases in cash flows arising from ‘additional biological transformation’. Diversity in practice had developed from different interpretations of this requirement. The Board decided that not including these cash flows resulted in a carrying amount that is not representative of the asset’s fair value. The Board noted that an entity should consider the risks associated with cash flows from ‘additional biological transformation’ in determining the expected cash flows, the discount rate, or some combination of the two. Therefore, the Board decided to amend IAS 41 to remove the prohibition on an entity taking into account the cash flows resulting from ‘additional biological transformation’ when estimating the fair value of a biological asset.[*]

BC9 In its exposure draft of proposed *Improvements to International Financial Reporting Standards* published in 2007, the Board proposed changing the definition of biological transformation to include harvest. This was because the Board wished to make clear that harvest altered the condition of a biological asset. Some commentators objected to this change on the basis that harvest is a human activity rather than a biological transformation. The Board agreed with this argument and decided not to include the harvest in the definition of biological transformation. Instead, the Board amended the Standard to refer to biological transformation or harvest when applicable to make clear that harvest changes the condition of an asset.

BC10 Because applying the changes discussed in paragraphs BC8 and BC9 retrospectively might require some entities to remeasure the fair value of biological assets at a past date, the Board decided that these amendments should be applied prospectively.

[*] IFRS 13, issued in May 2011, contains the requirements for measuring fair value. As a consequence, paragraph 21 of IAS 41 has been deleted.

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(c) relatively long and continuous production cycles, with volatility in both the production and market environment, mean that the accounting period often does not depict a full cycle. Therefore, period-end measurement (as opposed to time of transaction) assumes greater significance in deriving a measure of current period financial performance or position. The less significant current year harvest is in relation to total biological transformation, the greater the significance of period-end measures of asset change (growth and degeneration). In relatively high turnover, short production cycle, highly controlled agricultural systems (for example, broiler chicken or mushroom production) in which the majority of biological transformation and harvesting occurs within a year, the relationship between cost and future economic benefits appears more stable. This apparent stability does not alter the relationship between current market value and future economic benefits, but it makes the difference in measurement method less significant; and

(d) different sources of replacement animals and plants (home-grown or purchased) give rise to different costs in a historical cost approach. Similar assets should give rise to similar expectations with regard to future benefits. Considerably enhanced comparability and understandability result when similar assets are measured and reported using the same basis.

B17 Those who oppose measuring biological assets at fair value believe there is superior reliability in cost measurement because historical cost is the result of arm's length transactions, and therefore provides evidence of an open-market value at that point in time, and is independently verifiable. More importantly, they believe fair value is sometimes not reliably measurable and that users of financial statements may be misled by presentation of numbers that are indicated as being fair value but are based on subjective and unverifiable assumptions. Information regarding fair value can be provided other than in a single number in the financial statements. They believe the scope of the Standard is too broad. They also argue that:

(a) market prices are often volatile and cyclical and not appropriate as a basis of measurement;

(b) it may be onerous to require fair valuation at each balance sheet date, especially if interim reports are required;

(c) the historical cost convention is well established and commonly used. The use of any other basis should be accompanied by a change in the IASC *Framework for the Preparation and Presentation of Financial Statements*[*] (the '*Framework*'). For consistency with other International Accounting Standards and other activities, biological assets should be measured at their cost;

(d) cost measurement provides more objective and consistent measurement;

(e) active markets may not exist for some biological assets in some countries. In such cases, fair value cannot be measured reliably, especially during the period of growth in the case of a biological asset that has a long growth period (for example, trees in a plantation forest);

(f) fair value measurement results in recognition of unrealised gains and losses and contradicts principles in International Accounting Standards on recognition of revenue; and

(g) market prices at a balance sheet date may not bear a close relationship to the prices at which assets will be sold, and many biological assets are not held for sale.

B18 The *Framework* is neutral with respect to the choice of measurement basis, identifying that a number of different bases are employed to different degrees and in varying combinations, though noting that historical cost is most commonly adopted. The alternatives specifically identified are historical cost, current cost, realisable value, and present value. Precedents for fair value measurement exist in other International Accounting Standards.

B19 The Board concluded that the Standard should require a fair value model for biological assets related to agricultural activity because of the unique nature and characteristics of agricultural activity. However, the Board also concluded that, in some cases, fair value cannot be measured reliably. Some respondents to the questionnaire, as well as some commentators on

[*] References to the *Framework* are to IASC's *Framework for the Preparation and Presentation of Financial Statements*, which was adopted by the IASB in 2001. In September 2010 the IASB replaced the *Framework with the Conceptual Framework for Financial Reporting*.

E65, expressed significant concern about the reliability of fair value measurement for some biological assets, arguing that:

(a) active markets do not exist for some biological assets, in particular for those with a long growth period;

(b) present value of expected net cash flows is often an unreliable measure of fair value due to the need for, and use of, subjective assumptions (for example, about weather); and

(c) fair value cannot be measured reliably prior to harvest.

Some commentators on E65 suggested that the Standard should include a reliability exception for cases where no active market exists.

B20 The Board decided there was a need to include a reliability exception for cases where market-determined prices or values are not available and alternative estimates of fair value are determined to be clearly unreliable. In those cases, biological assets should be measured at their cost less any accumulated depreciation and any accumulated impairment losses. In determining cost, accumulated depreciation and accumulated impairment losses, an entity considers IAS 2 *Inventories*, IAS 16 *Property, Plant and Equipment* and IAS 36 *Impairment of Assets*.

B21 The Board rejected a benchmark treatment of fair value and an allowed alternative treatment of historical cost because of the greater comparability and understandability achieved by a mandatory fair value approach in the presence of active markets. The Board is also uncomfortable with options in International Accounting Standards.

Treatment of point-of-sale costs

B22 The Standard requires that a biological asset should be measured at its fair value less estimated point-of-sale costs. Point-of-sale costs include commissions to brokers and dealers, levies by regulatory agencies and commodity exchanges, and transfer taxes and duties. Point-of-sale costs exclude transport and other costs necessary to get assets to a market. Such transport and other costs are deducted in determining fair value (that is, fair value is a market price less transport and other costs necessary to get an asset to a market).[*]

B23 E65 proposed that pre-sale disposal costs that will be incurred to place an asset on the market (such as transport costs) should be deducted in determining fair value, if a biological asset will be sold in an active market in another location. However, E65 did not specify the treatment of point-of-sale costs. Some commentators suggested that the Standard should clarify the treatment of point-of-sale costs, as well as pre-sale disposal costs.

B24 Some argue that point-of-sale costs should not be deducted in a fair value model. They argue that fair value less estimated point-of-sale costs would be a biased estimate of markets' estimate of future cash flows, because point-of-sale costs would in effect be recognised as an expense twice if the acquirer pays point-of-sale costs on acquisition; once related to the initial acquisition of biological assets and once related to the immediate measurement at fair value less estimated point-of-sale costs. This would occur even when point-of-sale costs would not be incurred until a future period or would not be paid at all for a bearer biological asset that will not be sold.

B25 On the other hand, some believe that point-of-sale costs should be deducted in a fair value model. They believe that the carrying amount of an asset should represent the economic benefits that are expected to flow from the asset. They argue that fair value less estimated point-of-sale costs would represent the markets' estimate of the economic benefits that are expected to flow to the entity from that asset at the balance sheet date. They also argue that failure to deduct estimated point-of-sale costs could result in a loss being deferred until a sale occurs.

B26 The Board concluded that fair value less estimated point-of-sale costs is a more relevant measurement of biological assets, acknowledging that, in particular, failure to deduct estimated point-of-sale costs could result in a loss being deferred.

[*] IFRS 13, issued in May 2011, describes how transport costs are factored into a fair value measurement.

Hierarchy in fair value measurement[#]

B27 The Standard requires that, if an active market exists for a biological asset, the quoted price in that market is the appropriate basis for determining the fair value of that asset. If an active market does not exist, an entity uses market-determined prices or values (such as the most recent market transaction price) when available. However, in some circumstances, market-determined prices or values may not be available for a biological asset in its present condition. In these circumstances, the Standard indicates that an entity uses the present value of expected net cash flows[*] from the asset.

B28 E65 proposed that, if an active market exists for a biological asset, an entity should use the market price in the active market. If an active market does not exist, E65 proposed that an entity should consider other measurement bases such as the price of the most recent transaction for the same type of asset, sector benchmarks, and present value of expected net cash flows. E65 did not set a hierarchy in cases where no active market exists; that is, E65 did not indicate which basis is preferable to the other bases.

B29 The Board considered setting an explicit hierarchy in cases where no active market exists. Some believe that using market-determined prices or values; for example, the most recent market transaction price, would always be preferable to present value of expected net cash flows. On the other hand, some believe that market-determined prices or values would not necessarily be preferable to present value of expected net cash flows, especially when an entity uses market prices for similar assets with adjustment to reflect differences.

B30 The Board concluded that a detailed hierarchy would not provide sufficient flexibility to appropriately deal with all the circumstances that may arise and decided not to set a detailed hierarchy in cases where no active market exists. However, the Board decided to indicate that an entity uses all available market-determined prices or values since otherwise there is a possibility that entities may opt to use present value of expected net cash flows from the asset even when useful market-determined prices or values are available. Of the 20 companies that responded to the questionnaire, six companies used present value of expected net cash flows as a basis of fair value measurement and, in addition, two companies indicated that it was impossible to measure their biological assets reliably since the present value of expected net cash flows would not be reliable (as they would need to use present value as a basis).

B31 When an entity has access to different markets, the Standard indicates that the entity uses the most relevant one. For example, if an entity has access to two active markets, it uses the price existing in the market expected to be used. Some believe that the most advantageous price in the accessible markets should be used. The Standard reflects the view that the most relevant measurement results from using the market expected to be used.

Frequency of fair value measurement

B32 Some argue that less frequent measurement of fair value should be permitted because of concerns about burdens on entities. The Board rejected this approach because of the:

(a) continuous nature of biological transformation;

(b) lack of direct relationships between financial transactions and the outcomes of biological transformation; and

(c) general availability of reliable measures of fair value at reasonable cost.

[#] IFRS 13, issued in May 2011, defines an active market and contains a three-level fair value hierarchy for the inputs used in the valuation techniques used to measure fair value.

[*] Paragraph 20 of the previous version of IAS 41 required entities to use a pre-tax discount rate when measuring fair value. The IASB decided to maintain the requirement to use a current market-based discount rate but removed the reference to a pre-tax discount rate by *Improvements to IFRSs* issued in May 2008.

Sales contracts

B47 Entities often enter into contracts to sell at a future date their biological assets or agricultural produce. The Standard indicates that contract prices are not necessarily relevant in determining fair value and that the fair value of a biological asset or agricultural produce is not adjusted because of the existence of a contract.

B48 E65 did not propose how to account for a contract for the sale of a biological asset or agricultural produce. Some commentators suggested prescribing the treatment of sales contracts since such sales contracts are common in certain agricultural activity. Some commentators also pointed out that certain sales contracts are not within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* and that no other International Accounting Standards deal with those contracts.

B49 Some argue that contract prices should be used in measuring the related biological assets when an entity expects to settle the contract by delivery and believe this would result in the most relevant carrying amount for the biological asset. Others argue that contract prices are not necessarily relevant in measuring the biological assets at fair value since fair value reflects the current market in which a willing buyer and seller would enter into a transaction.[*]

B50 The Board concluded that contract prices should not be used in measuring related biological assets, because contract prices do not necessarily reflect the current market in which a willing buyer and seller would enter into a transaction and therefore do not necessarily represent the fair value of assets. The Board wished to maintain a consistent approach to the measurement of assets. The Board instead considered whether it might require that sales contracts be measured at fair value. It is logical to measure a sales contract at fair value to the extent that a related biological asset is also measured at fair value.

B51 However, the Board noted that to achieve symmetry between the measurement of a biological asset and a related sales contract the Standard would have to carefully restrict the sales contracts to be measured at fair value. An entity may enter into a contract to sell agricultural produce to be harvested from the entity's biological assets. The Board concluded that it would not be appropriate to require fair value measurement for a contract to sell agricultural produce that does not yet exist (for example, milk to be harvested from a cow), since no related asset has yet been recognised or measured at fair value and to do so would be beyond the scope of the project on agriculture.

B52 Thus, the Board considered restricting the sales contracts to be measured at fair value to those for the sale of an entity's existing biological assets and agricultural produce. However, the Board noted that it is difficult to differentiate existing agricultural produce from agricultural produce that does not exist. For example:

(a) if an entity enters into a contract to sell fully-grown wheat at a future date and has half-grown wheat at a balance sheet date, it seems clear that the wheat to be delivered under the contract does not yet exist at the balance sheet date; but

(b) on the other hand, if an entity enters into a contract to sell mature cattle at a future date and has mature cattle at a balance sheet date, it could be argued that the cattle exist in the form in which they will be sold at the balance sheet date. However, it could also be argued that the cattle do not yet exist in the form in which they will be sold at the balance sheet date since further biological transformation will occur between the balance sheet date and the date of delivery.

B53 The Board also noted that the Standard would have to require an entity to stop fair value measurement for sales contracts once agricultural produce to be sold under the contract is harvested from an entity's biological assets, since accounting for agricultural produce is not dealt with in the Standard except for initial measurement and IAS 2 *Inventories* or another applicable International Accounting Standard applies after harvest. It would be illogical to continue fair value measurement when the agricultural produce is measured at historical cost. The Board noted that it would be anomalous to require an entity to start measuring a contract at fair value once the related asset exists and to stop doing that at a later date.

[*] IFRS 13, issued in May 2011, contains the requirements for measure+ing fair value.

HKFRS 2
Revised ~~February 2010~~June 2014

Effective for annual periods
beginning on or after 1 January 2005

Hong Kong Financial Reporting Standard 2

Share-based Payment

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Contents

Hong Kong Financial Reporting Standard 2 *Share-based Payment* (HKFRS 2) is set out in paragraphs 1-64 and Appendices A-C. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the Standard. HKFRS 2 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting~~the Preparation and Presentation of Financial Statements~~*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

(b) has an obligation to settle a share-based payment transaction when another entity in the same group receives the goods or services

unless the transaction is clearly for a purpose other than payment for goods or services supplied to the entity receiving them.

4 For the purposes of this HKFRS, a transaction with an employee (or other party) in his/her capacity as a holder of equity instruments of the entity is not a share-based payment transaction. For example, if an entity grants all holders of a particular class of its equity instruments the right to acquire additional equity instruments of the entity at a price that is less than the fair value of those equity instruments, and an employee receives such a right because he/she is a holder of equity instruments of that particular class, the granting or exercise of that right is not subject to the requirements of this HKFRS.

5 As noted in paragraph 2, this HKFRS applies to share-based payment transactions in which an entity acquires or receives goods or services. Goods includes inventories, consumables, property, plant and equipment, intangible assets and other non-financial assets. However, an entity shall not apply this HKFRS to transactions in which the entity acquires goods as part of the net assets acquired in a business combination as defined by HKFRS 3 *Business Combinations* (as revised in 2008), in a combination of entities or businesses under common control as described in paragraphs B1–B4 of HKFRS 3, or the contribution of a business on the formation of a joint venture as defined by ~~HKAS 31 *Interests in Joint Ventures*~~ HKFRS 11 *Joint Arrangements*. Hence, equity instruments issued in a business combination in exchange for control of the acquiree are not within the scope of this HKFRS. However, equity instruments granted to employees of the acquiree in their capacity as employees (e.g. in return for continued service) are within the scope of this HKFRS. Similarly, the cancellation, replacement or other modification of *share-based payment arrangements* because of a business combination or other equity restructuring shall be accounted for in accordance with this HKFRS. HKFRS 3 provides guidance on determining whether equity instruments issued in a business combination are part of the consideration transferred in exchange for control of the acquiree (and therefore within the scope of HKFRS 3) or are in return for continued service to be recognised in the post-combination period (and therefore within the scope of this HKFRS).

6 This HKFRS does not apply to share-based payment transactions in which the entity receives or acquires goods or services under a contract within the scope of paragraphs 8-10 of HKAS 32 *Financial Instruments: Presentation*[*] or paragraphs 5-7 of HKAS 39 *Financial Instruments: Recognition and Measurement*.

6A This HKFRS uses the term 'fair value' in a way that differs in some respects from the definition of fair value in HKFRS 13 *Fair Value Measurement*. Therefore, when applying HKFRS 2 an entity measures fair value in accordance with this HKFRS, not HKFRS 13.

Recognition

7 An entity shall recognise the goods or services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received. The entity shall recognise a corresponding increase in equity if the goods or services were received in an equity-settled share-based payment transaction, or a liability if the goods or services were acquired in a cash-settled share-based payment transaction.

[*] The title of HKAS 32 was amended in 2005.

(b) the revised definitions of 'vest' and 'vesting conditions' in Appendix A;

(c) the amendments in paragraphs 28 and 28A in respect of cancellations.

Earlier application is permitted. If an entity applies these amendments for a period beginning before 1 January 2009, it shall disclose that fact.

63 An entity shall apply the following amendments made by *Group Cash-settled Share-based Payment Transactions* issued in July 2009 retrospectively, subject to the transitional provisions in paragraphs 53–59, in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* for annual periods beginning on or after 1 January 2010:

(a) the amendment of paragraph 2, the deletion of paragraph 3 and the addition of paragraphs 3A and 43A–43D and of paragraphs B45, B47, B50, B54, B56–B58 and B60 in Appendix B in respect of the accounting for transactions among group entities.

(b) the revised definitions in Appendix A of the following terms:

- cash-settled share-based payment transaction,
- equity-settled share-based payment transaction,
- share-based payment arrangement, and
- share-based payment transaction.

If the information necessary for retrospective application is not available, an entity shall reflect in its separate or individual financial statements the amounts previously recognised in the group's consolidated financial statements. Earlier application is permitted. If an entity applies the amendments for a period beginning before 1 January 2010, it shall disclose that fact.

63A HKFRS 10 *Consolidated Financial Statements* and HKFRS 11, issued in June 2011, amended paragraph 5 and Appendix A. An entity shall apply those amendments when it applies HKFRS 10 and HKFRS 11.

Withdrawal of Interpretations

64 *Group Cash-settled Share-based Payment Transactions* issued in July 2009 supersedes HK(IFRIC)-Int 8 *Scope of HKFRS 2* and HK(IFRIC)-Int 11 *HKFRS 2—Group and Treasury Share Transactions*. The amendments made by that document incorporated the previous requirements set out in HK(IFRIC)-Int 8 and HK(IFRIC)-Int 11 as follows:

(a) amended paragraph 2 and added paragraph 13A in respect of the accounting for transactions in which the entity cannot identify specifically some or all of the goods or services received. Those requirements were effective for annual periods beginning on or after 1 May 2006.

(b) added paragraphs B46, B48, B49, B51–B53, B55, B59 and B61 in Appendix B in respect of the accounting for transactions among group entities. Those requirements were effective for annual periods beginning on or after 1 March 2007.

Those requirements were applied retrospectively in accordance with the requirements of HKAS 8, subject to the transitional provisions of HKFRS 2.

share-based payment arrangement An agreement between the entity (or another group[a] entity or any shareholder of any group entity) and another party (including an employee) that entitles the other party to receive

(a) cash or other assets of the entity for amounts that are based on the price (or value) of **equity instruments** (including shares or **share options**) of the entity or another group entity, or

(b) equity instruments (including shares or share options) of the entity or another group entity,

provided the specified **vesting conditions**, if any, are met.

share-based payment transaction A transaction in which the entity

(a) receives goods or services from the supplier of those goods or services (including an employee) in a **share-based payment arrangement**, or

(b) incurs an obligation to settle the transaction with the supplier in a share-based payment arrangement when another group entity receives those goods or services.

share option A contract that gives the holder the right, but not the obligation, to subscribe to the entity's shares at a fixed or determinable price for a specified period of time.

vest To become an entitlement. Under a **share-based payment arrangement**, a counterparty's right to receive cash, other assets or **equity instruments** of the entity vests when the counterparty's entitlement is no longer conditional on the satisfaction of any **vesting conditions**.

[a] A 'group' is defined in ~~paragraph 4~~ Appendix A of ~~HKAS 27~~ HKFRS 10 *Consolidated ~~and Separate~~ Financial Statements* as 'a parent and its subsidiaries' from the perspective of the reporting entity's ultimate parent.

Basis for Conclusions on
Hong Kong Financial Reporting Standard 2

Share-based Payment

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Basis for Conclusions
IFRS 2 *Share-based Payment*

HKFRS 2 is based on IFRS 2 *Share-based Payment*. In approving HKFRS 2, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IFRS 2. Accordingly, there are no significant differences between HKFRS 2 and IFRS 2. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IFRS 2 referred to below generally correspond with those in HKFRS 2.

CONTENTS *from paragraph*

BC22E During its redeliberations of the proposed amendments, the Board agreed with respondents' comments that, as proposed, the scope of IFRS 2 remained unclear and inconsistent between the standard and related Interpretations. For example, the terms 'shareholder' and 'parent' have different meanings: a shareholder is not necessarily a parent, and a parent does not have to be a shareholder. The Board noted that share-based payment transactions among group entities are often directed by the parent, indicating a level of control. Therefore, the Board clarified the boundaries of a 'group' by adopting the same definition as in paragraph 4 of IAS 27 *Consolidated and Separate Financial Statements*, which includes only a parent and its subsidiaries.[*]

BC22F Some respondents to the exposure draft questioned whether the proposals should apply to joint ventures. Before the Board's amendments, the guidance in paragraph 3 (now superseded by paragraph 3A) stated that when a shareholder transferred equity instruments of the entity (or another group entity), the transaction would be within the scope of IFRS 2 for the entity receiving the goods or services. However, that guidance did not specify the accounting by a shareholder transferor. The Board noted that the defined terms in Appendix A, as amended, would clearly state that any entity (including a joint venture) that receives goods or services in a share-based payment transaction should account for the transaction in accordance with the IFRS, regardless of whether that entity also settles the transaction.

BC22G Furthermore, the Board noted that the exposure draft and related discussions focused on clarifying guidance for transactions involving group entities in the separate or individual financial statements of the entity receiving the goods or services. Addressing transactions involving related parties outside a group structure in their separate or individual financial statements would significantly expand the scope of the project and change the scope of IFRS 2. Therefore, the Board decided not to address transactions between entities not in the same group that are similar to share-based payment transactions but outside the definitions as amended. This carries forward the existing guidance of IFRS 2 for entities not in the same group and the Board does not intend to change that guidance.

Transactions within the scope of IFRS 3 *Business Combinations*

BC23 An entity might acquire goods (or other non-financial assets) as part of the net assets acquired in a business combination for which the consideration paid included shares or other equity instruments issued by the entity. Because IFRS 3 applies to the acquisition of assets and issue of shares in connection with a business combination, that is the more specific standard that should be applied to that transaction.

BC24 Therefore, equity instruments issued in a business combination in exchange for control of the acquiree are not within the scope of IFRS 2. However, equity instruments granted to employees of the acquiree in their capacity as employees, e.g. in return for continued service, are within the scope of IFRS 2. Also, the cancellation, replacement, or other modifications to share-based payment arrangements because of a business combination or other equity restructuring should be accounted for in accordance with IFRS 2.

BC24A IFRS 3 (as revised in 2008) changed the definition of a business combination. The previous definition of a business combination was 'the bringing together of separate entities or businesses into one reporting entity'. The revised definition of a business combination is 'a transaction or other event in which an acquirer obtains control of one or more businesses'.

[*] The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The definition of control changed but the definition of a group was not substantially changed.

(c) there is no cost to the entity, because no cash or other assets are given up; the shareholders bear the cost, in the form of dilution of their ownership interests, not the entity.

(d) the recognition of an expense is inconsistent with the definition of an expense in the conceptual frameworks used by accounting standard-setters, including the IASB's *Framework for the Preparation and Presentation of Financial Statements.*[*]

(e) the cost borne by the shareholders is recognised in the dilution of earnings per share (EPS); if the transaction is recognised in the entity's accounts, the resulting charge to the income statement would mean that EPS is 'hit twice'.

(f) requiring the recognition of a charge would have adverse economic consequences, because it would discourage entities from introducing or continuing employee share plans.

'The entity is not a party to the transaction'

BC34 Some argue that the effect of employee share plans is that the existing shareholders transfer some of their ownership interests to the employees and that the entity is not a party to this transaction.

BC35 The Board did not accept this argument. Entities, not shareholders, set up employee share plans and entities, not shareholders, issue share options to their employees. Even if that were not the case, e.g. if shareholders transferred shares or share options direct to the employees, this would not mean that the entity is not a party to the transaction. The equity instruments are issued in return for services rendered by the employees and the entity, not the shareholders, receives those services. Therefore, the Board concluded that the entity should account for the services received in return for the equity instruments issued. The Board noted that this is no different from other situations in which equity instruments are issued. For example, if an entity issues warrants for cash, the entity recognises the cash received in return for the warrants issued. Although the effect of an issue, and subsequent exercise, of warrants might be described as a transfer of ownership interests from the existing shareholders to the warrant holders, the entity nevertheless is a party to the transaction because it receives resources (cash) for the issue of warrants and further resources (cash) for the issue of shares upon exercise of the warrants. Similarly, with employee share options, the entity receives resources (employee services) for the issue of the options and further resources (cash) for the issue of shares on the exercise of options.

'The employees do not provide services'

BC36 Some who argue that the entity is not a party to the transaction counter the points made above with the argument that employees do not provide services for the options, because the employees are paid in cash (or other assets) for their services.

BC37 Again, the Board was not convinced by this argument. If it were true that employees do not provide services for their share options, this would mean that entities are issuing valuable share options and getting nothing in return. Employees do not pay cash for the share options they receive. Hence, if they do not provide services for the options, the employees are providing nothing in return. If this were true, by issuing such options the entity's directors would be in breach of their fiduciary duties to their shareholders.

[*] *References* to the Framework *are to IASC's* Framework for the Preparation and Presentation of Financial Statements, *adopted by the IASB in 2001. In September 2010 the IASB replaced the* Framework *with the* Conceptual Framework for Financial Reporting.

BC44 The only difference in the case of employee services (or other services) received as consideration for the issue of shares or share options is that usually the resources received are consumed immediately upon receipt. This means that an expense for the consumption of resources is recognised immediately, rather than over a period of time. The Board concluded that the timing of consumption does not change the principle; the financial statements should recognise the receipt and consumption of resources, even when consumption occurs at the same time as, or soon after, receipt. This point is discussed further in paragraphs BC45-BC53.

'Expense recognition is inconsistent with the definition of an expense'

BC45 Some have questioned whether recognition of an expense arising from particular share-based payment transactions is consistent with accounting standard-setters' conceptual frameworks, in particular, the *Framework*, which states:

> Expenses are decreases in economic benefits during the accounting period in the form of outflows or *depletions of assets* or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants. (paragraph 70,[#] emphasis added)

BC46 Some argue that if services are received in a share-based payment transaction, there is no transaction or event that meets the definition of an expense. They contend that there is no outflow of assets and that no liability is incurred. Furthermore, because services usually do not meet the criteria for recognition as an asset, it is argued that the consumption of those services does not represent a depletion of assets.

BC47 The *Framework* defines an asset and explains that the term 'asset' is not limited to resources that can be recognised as assets in the balance sheet (*Framework*, paragraphs 49 and 50).[✧] Although services to be received in the future might not meet the definition of an asset,[*] services are assets when received. These assets are usually consumed immediately. This is explained in FASB Statement of Financial Accounting Concepts No. 6 *Elements of Financial Statements*:

> Services provided by other entities, including personal services, cannot be stored and are received and used simultaneously. They can be assets of an entity only momentarily – as the entity receives and uses them - although their use may create or add value to other assets of the entity… (paragraph 31)

BC48 This applies to all types of services, e.g. employee services, legal services and telephone services. It also applies irrespective of the form of payment. For example, if an entity purchases services for cash, the accounting entry is:

Dr Services received
 Cr Cash paid

BC49 Sometimes, those services are consumed in the creation of a recognisable asset, such as inventories, in which case the debit for services received is capitalised as part of a recognised asset. But often the services do not create or form part of a recognisable asset, in which case the debit for services received is charged immediately to the income statement as an expense. The debit entry above (and the resulting expense) does not represent the cash outflow - that is what the credit entry was for. Nor does it represent some sort of balancing item, to make the accounts balance. The debit entry above represents the resources received, and the resulting expense represents the consumption of those resources.

[#] now paragraph 4.25 of the *Conceptual Framework*

[✧] now paragraph 4.4 and 4.5 of the *Conceptual Framework*

[*] For example, the entity might not have control over future services.

BC57 In summary, the Board concluded that the dual effect on diluted EPS is not double-counting the effects of a share or share option grant—the same effect is not counted twice. Rather, two different effects are each counted once.

'Adverse economic consequences'

BC58 Some argue that to require recognition (or greater recognition) of employee share-based payment would have adverse economic consequences, in that it might discourage entities from introducing or continuing employee share plans.

BC59 Others argue that if the introduction of accounting changes did lead to a reduction in the use of employee share plans, it might be because the requirement for entities to account properly for employee share plans had revealed the economic consequences of such plans. They argue that this would correct the present economic distortion, whereby entities obtain and consume resources by issuing valuable shares or share options without accounting for those transactions.

BC60 In any event, the Board noted that the role of accounting is to report transactions and events in a neutral manner, not to give 'favourable' treatment to particular transactions to encourage entities to engage in those transactions. To do so would impair the quality of financial reporting. The omission of expenses from the financial statements does not change the fact that those expenses have been incurred. Hence, if expenses are omitted from the income statement, reported profits are overstated. The financial statements are not neutral, are less transparent and are potentially misleading to users. Comparability is impaired, given that expenses arising from employee share-based payment transactions vary from entity to entity, from sector to sector, and from year to year. More fundamentally, accountability is impaired, because the entities are not accounting for transactions they have entered into and the consequences of those transactions.

Measurement of equity-settled share-based payment transactions

BC61 To recognise equity-settled share-based payment transactions, it is necessary to decide how the transactions should be measured. The Board began by considering how to measure share-based payment transactions in principle. Later, it considered practical issues arising from the application of its preferred measurement approach. In terms of accounting principles, there are two basic questions:

(a) which measurement basis should be applied?

(b) when should that measurement basis be applied?

BC62 To answer these questions, the Board considered the accounting principles applying to equity transactions. The *Framework* states:

> Equity is the residual interest in the assets of the enterprise after deducting all of its liabilities…The amount at which equity is shown in the balance sheet is dependent upon the measurement of assets and liabilities. Normally, the aggregate amount of equity only by coincidence corresponds with the aggregate market value of the shares of the enterprise… (paragraphs 49 and 67)*

* now paragraphs 4.4 and 4.22 of the *Conceptual Framework*

BC242 Because cash-settled SARs involve an outflow of cash (rather than the issue of equity instruments) cash SARs should be accounted for in accordance with the usual accounting for similar liabilities. That sounds straightforward, but there are some questions to consider:

(a) should a liability be recognised before vesting date, i.e. before the employees have fulfilled the conditions to become unconditionally entitled to the cash payment?

(b) if so, how should that liability be measured?

(c) how should the expense be presented in the income statement?

Is there a liability before vesting date?

BC243 It could be argued that the entity does not have a liability until vesting date, because the entity does not have a present obligation to pay cash to the employees until the employees fulfil the conditions to become unconditionally entitled to the cash; between grant date and vesting date there is only a contingent liability.

BC244 The Board noted that this argument applies to all sorts of employee benefits settled in cash, not just SARs. For example, it could be argued that an entity has no liability for pension payments to employees until the employees have met the specified vesting conditions. This argument was considered by IASC in IAS 19 *Employee Benefits*. The Basis for Conclusions states:

> Paragraph 54 of the new IAS 19 summarises the recognition and measurement of liabilities arising from defined benefit plans…Paragraph 54 of the new IAS 19 is based on the definition of, and recognition criteria for, a liability in IASC's *Framework*…The Board believes that an enterprise has an obligation under a defined benefit plan when an employee has rendered service in return for the benefits promised under the plan…The Board believes that an obligation exists even if a benefit is not vested, in other words if the employee's right to receive the benefit is conditional upon future employment. For example, consider an enterprise that provides a benefit of 100 to employees who remain in service for two years. At the end of the first year, the employee and the enterprise are not in the same position as at the beginning of the first year, because the employee will only need to work for one year, instead of two, before becoming entitled to the benefit. Although there is a possibility that the benefit may not vest, that difference is an obligation and, in the Board's view, should result in the recognition of a liability at the end of the first year. The measurement of that obligation at its present value reflects the enterprise's best estimate of the probability that the benefit may not vest. (IAS 19, Basis for Conclusions, paragraphs BC11-BC14)[*]

BC245 Therefore, the Board concluded that, to be consistent with IAS 19, which covers other cash-settled employee benefits, a liability should be recognised in respect of cash-settled SARs during the vesting period, as services are rendered by the employees. Thus, no matter how the liability is measured, the Board concluded that it should be accrued over the vesting period, to the extent that the employees have performed their side of the arrangement. For example, if the terms of the arrangement require the employees to perform services over a three-year period, the liability would be accrued over that three-year period, consistently with the treatment of other cash-settled employee benefits.

[*] IAS 19 *Employee Benefits* (as amended in June 2011) renumbered and amended paragraphs BC11–BC14 as paragraphs BC52–BC55. The amendments changed the terminology for consistency with IAS 19.

> received numerous requests from individual and institutional investors, financial analysts and many others urging the Board to mandate the expensing of the compensation cost relating to employee stock options…While a number of major companies have voluntarily opted to reflect these costs as an expense in reporting their earnings, other companies continue to show these costs in the footnotes to their financial statements. In addition, a move to require an expense treatment would be consistent with the FASB's commitment to work toward convergence between U.S. and international accounting standards. In taking all of these factors into consideration, the Board concluded that it was critical that it now revisit this important subject. (FASB News Release, 12 March 2003)

BC285 During the Board's redeliberations of the proposals in ED 2, the Board worked with the FASB to achieve convergence of international and US standards, to the extent possible, bearing in mind that the FASB was at an earlier stage in its project—the FASB was developing an Exposure Draft to revise SFAS 123 whereas the IASB was finalising its IFRS. The Board concluded that, although convergence is an important objective, it would not be appropriate to delay the issue of the IFRS, because of the pressing need for a standard on share-based payment, as explained in paragraphs BC2-BC5. In any event, at the time the IASB concluded its deliberations, a substantial amount of convergence had been achieved. For example, the FASB agreed with the IASB that all share-based payment transactions should be recognised in the financial statements, measured on a fair value measurement basis, including transactions in which share options are granted to employees. Hence, the FASB agreed that the disclosure alternative in SFAS 123 should be eliminated.

BC286 The IASB and FASB also agreed that, once both boards have issued final standards on share-based payment, the two boards will consider undertaking a convergence project, with the objective of eliminating any remaining areas of divergence between international and US standards on this topic.

Recognition versus disclosure

BC287 A basic accounting concept is that disclosure of financial information is not an adequate substitute for recognition in the financial statements. For example, the *Framework* states:

> Items that meet the recognition criteria should be recognised in the balance sheet or income statement. The failure to recognise such items is not rectified by disclosure of the accounting policies used nor by notes or explanatory material. (paragraph 82)[*]

BC288 A key aspect of the recognition criteria is that the item can be measured with reliability. This issue is discussed further below. Therefore, this discussion focuses on the 'recognition versus disclosure' issue in principle, not on measurement reliability. Once it has been determined that an item meets the criteria for recognition in the financial statements, failing to recognise it is inconsistent with the basic concept that disclosure is not an adequate substitute for recognition.

BC289 Some disagree with this concept, arguing that it makes no difference whether information is recognised in the financial statements or disclosed in the notes. Either way, users of financial statements have the information they require to make economic decisions. Hence, they believe that note disclosure of expenses arising from particular employee share-based payment transactions (i.e. those involving awards of share options to employees), rather than recognition in the income statement, is acceptable.

[*] now paragraph 4.37 of the *Conceptual Framework*

HKFRS 4
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Hong Kong Financial Reporting Standard 4

Insurance Contracts

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Hong Kong Financial Reporting Standard 4 *Insurance Contracts* (HKFRS 4) is set out in paragraphs 1-45 and Appendices A-C and E. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the Standard. Definitions of other terms are given in the Glossary for Hong Kong Financial Reporting Standards. HKFRS 4 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting* ~~*the Preparation and Presentation of Financial Statements*~~. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Effective date and transition

40 The transitional provisions in paragraphs 41-45 apply both to an entity that is already applying HKFRSs when it first applies this HKFRS and to an entity that applies HKFRSs for the first-time (a first-time adopter).

41. **An entity shall apply this HKFRS for annual periods beginning on or after 1 January 2005. Earlier application is encouraged. If an entity applies this HKFRS for an earlier period, it shall disclose that fact.**

41A *Financial Guarantee Contracts* (Amendments to HKAS 39 and HKFRS 4), issued in September 2005, amended paragraphs 4(d), B18(g) and B19(f). An entity shall apply those amendments for annual periods beginning on or after 1 January 2006. Earlier application is encouraged. If an entity applies those amendments for an earlier period, it shall disclose that fact and apply the related amendments to HKAS 39 and HKAS 32* at the same time.

41B HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraph 30. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

41C *[This paragraph refers to amendments that are not yet effective, and is therefore not included in this edition.]*

41D *[This paragraph refers to amendments that are not yet effective, and is therefore not included in this edition.]*

41E *HKFRS 13 Fair Value Measurement, issued in June 2011, amended the definition of fair value in Appendix A. An entity shall apply that amendment when it applies HKFRS 13.*

Disclosure

42 An entity need not apply the disclosure requirements in this HKFRS to comparative information that relates to annual periods beginning before 1 January 2005, except for the disclosures required by paragraph 37(a) and (b) about accounting policies, and recognised assets, liabilities, income and expense (and cash flows if the direct method is used).

43 If it is impracticable to apply a particular requirement of paragraphs 10-35 to comparative information that relates to annual periods beginning before 1 January 2005, an entity shall disclose that fact. Applying the liability adequacy test (paragraphs 15-19) to such comparative information might sometimes be impracticable, but it is highly unlikely to be impracticable to apply other requirements of paragraphs 10-35 to such comparative information. HKAS 8 explains the term 'impracticable'.

44 In applying paragraph 39(c)(iii), an entity need not disclose information about claims development that occurred earlier than five years before the end of the first financial year in which it applies this HKFRS. Furthermore, if it is impracticable, when an entity first applies this HKFRS, to prepare information about claims development that occurred before the beginning of the earliest period for which an entity presents full comparative information that complies with this HKFRS, the entity shall disclose that fact.

* When an entity applies HKFRS 7, the reference to HKAS 32 is replaced by reference to HKFRS 7.

Appendix A
Defined terms

This appendix is an integral part of the HKFRS.

cedant	The **policyholder** under a **reinsurance contract**.
deposit component	A contractual component that is not accounted for as a derivative under HKAS 39 and would be within the scope of HKAS 39 if it were a separate instrument.
direct insurance contract	An **insurance contract** that is not a **reinsurance contract**.
discretionary participation feature	A contractual right to receive, as a supplement to **guaranteed benefits**, additional benefits: (a) that are likely to be a significant portion of the total contractual benefits; (b) whose amount or timing is contractually at the discretion of the issuer; and (c) that are contractually based on: (i) the performance of a specified pool of contracts or a specified type of contract; (ii) realised and/or unrealised investment returns on a specified pool of assets held by the issuer; or (iii) the profit or loss of the company, fund or other entity that issues the contract.
fair value	~~The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.~~ *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. (See HKFRS 13.)
financial guarantee contract	A contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.
financial risk	The risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract.
guaranteed benefits	Payments or other benefits to which a particular **policyholder** or investor has an unconditional right that is not subject to the contractual discretion of the issuer.

Basis for Conclusions on
Hong Kong Financial Reporting Standards 4

Insurance Contracts

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HKFRS 4 is based on IFRS 4 *Insurance Contracts*. In approving HKFRS 4, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IFRS 4. Accordingly, there are no significant differences between HKFRS 4 and IFRS 4. The IASB's Basis for Conclusions is reproduced below for reference. The paragraph numbers of IFRS 4 referred to below generally correspond with those in HKFRS 4.

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from paragraph

BASIS FOR CONCLUSIONS ON IFRS 4 *INSURANCE CONTRACTS*

Tentative conclusions for phase II

BC6 The Board sees phase I as a stepping stone to phase II and is committed to completing phase II without delay once it has investigated all relevant conceptual and practical questions and completed its due process. In January 2003, the Board reached the following tentative conclusions for phase II:

(a) The approach should be an asset-and-liability approach that would require an entity to identify and measure directly the contractual rights and obligations arising from insurance contracts, rather than create deferrals of inflows and outflows.

(b) Assets and liabilities arising from insurance contracts should be measured at their fair value, with the following two caveats:

(i) Recognising the lack of market transactions, an entity may use entity-specific assumptions and information when market-based information is not available without undue cost and effort.

(ii) In the absence of market evidence to the contrary, the estimated fair value of an insurance liability shall not be less, but may be more, than the entity would charge to accept new contracts with identical contractual terms and remaining maturity from new policyholders. It follows that an insurer would not recognise a net gain at inception of an insurance contract, unless such market evidence is available.

(c) As implied by the definition of fair value:[*]

(i) an undiscounted measure is inconsistent with fair value.

(ii) expectations about the performance of assets should not be incorporated into the measurement of an insurance contract, directly or indirectly (unless the amounts payable to a policyholder depend on the performance of specific assets).

(iii) the measurement of fair value should include an adjustment for the premium that marketplace participants would demand for risks and mark-up in addition to the expected cash flows.

(iv) fair value measurement of an insurance contract should reflect the credit characteristics of that contract, including the effect of policyholder protections and insurance provided by governmental bodies or other guarantors.

(d) The measurement of contractual rights and obligations associated with the closed book of insurance contracts should include future premiums specified in the contracts (and claims, benefits, expenses, and other additional cash flows resulting from those premiums) if, and only if:

(i) policyholders hold non-cancellable continuation or renewal rights that significantly constrain the insurer's ability to reprice the contract to rates that would apply for new policyholders whose characteristics are similar to those of the existing policyholders; and

[*] IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

(ii) those rights will lapse if the policyholders stop paying premiums.

(e) Acquisition costs should be recognised as an expense when incurred.

(f) The Board will consider two more questions later in phase II:

(i) Should the measurement model unbundle the individual elements of an insurance contract and measure them individually?

(ii) How should an insurer measure its liability to holders of participating contracts?

BC7 In two areas, those tentative conclusions differ from the IASC Steering Committee's recommendations in the DSOP:

(a) the use of a fair value measurement objective rather than entity-specific value. However, that change is not as significant as it might seem because entity-specific value as described in the DSOP is indistinguishable in most respects from estimates of fair value determined using measurement guidance that the Board has tentatively adopted in phase II of its project on business combinations.*

(b) the criteria used to determine whether measurement should reflect future premiums and related cash flows (paragraph BC6(d)).

BC8 Since January 2003, constraints on Board and staff resources have prevented the Board from continuing work to determine whether its tentative conclusions for phase II can be developed into a standard that is consistent with the IASB *Framework* and workable in practice. The Board intends to return to phase II of the project in the second quarter of 2004. It plans to focus at that time on both conceptual and practical issues, as in any project. Only after completing its deliberations will the Board proceed with an Exposure Draft of a proposed IFRS. The Board's deliberations in all projects include a consideration of alternatives and whether those alternatives represent conceptually superior approaches to financial reporting issues. Consequently, the Board will examine existing practices throughout the world to ascertain whether any could be deemed to be a superior answer suitable for international adoption.

BC9 As discussed in paragraph BC84, ED 5 proposed a 'sunset clause', which the Board deleted in finalising the IFRS. Although respondents generally opposed the sunset clause, many applauded the Board's signal of its commitment to complete phase II without delay.

Scope

BC10 Some argued that the IFRS should deal with all aspects of financial reporting by insurers, to ensure that the financial reporting for insurers is internally consistent. They noted that regulatory requirements, and some national accounting requirements, often cover all aspects of an insurer's business. However, for the following reasons, the IFRS deals with insurance contracts of all entities and does not address other aspects of accounting by insurers:

* The Board completed the second phase of its project on business combinations in 2008 by issuing a revised IFRS 3 *Business Combinations* and an amended version of IAS 27 *Consolidated and Separate Financial Statements*. The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. IFRS 13, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

Investment management fees

BC128 Under some insurance contracts, the insurer is entitled to receive a periodic investment management fee. Some suggest that the insurer should, in determining the fair value of its contractual rights and obligations, discount the estimated future cash flows at a discount rate that reflects the risks associated with the cash flows. Some insurers use this approach in determining embedded values.

BC129 However, in the Board's view, this approach can lead to results that are not consistent with a fair value measurement. If the insurer's contractual asset management fee is in line with the fee charged by other insurers and asset managers for comparable asset management services, the fair value of the insurer's contractual right to that fee would be approximately equal to what it would cost insurers and asset managers to acquire similar contractual rights.[*] Therefore, paragraph 25(b) of the IFRS confirms that an insurer cannot introduce an accounting policy that measures those contractual rights at more than their fair value as implied by fees charged by others for comparable services; however, if an insurer's existing accounting policies involve such measurements, it may continue to use them in phase I.

BC130 The Board's agenda includes a project on revenue recognition.

Uniform accounting policies on consolidation

BC131 IAS 27 *Consolidated and Separate Financial Statements* requires entities to use uniform accounting policies.[#] However, under current national requirements, some insurers consolidate subsidiaries without conforming the measurement of insurance liabilities using the subsidiaries' own local GAAP to the accounting policies used by the rest of the group.

BC132 The use of non-uniform accounting policies reduces the relevance and reliability of financial statements. However, prohibiting this would force some insurers to change their accounting policies for the insurance liabilities of some subsidiaries in phase I. This could have required systems changes that might no longer be needed in phase II. Therefore, the Board decided that an insurer already using non-uniform accounting policies for insurance contracts could continue to do so in phase I. However, if an insurer already uses uniform accounting policies for insurance contracts, it could not switch to a policy of using non-uniform accounting policies (paragraph 25(c) of the IFRS).

Excessive prudence

BC133 Insurers sometimes measure insurance liabilities on what is intended to be a highly prudent basis that lacks the neutrality required by the *Framework*. However, phase I does not define how much prudence is appropriate and cannot, therefore, eliminate excessive prudence. Consequently, the IFRS does not attempt to prohibit existing measurements of insurance liabilities that lack neutrality because of excessive prudence. Nevertheless, it prohibits the introduction of additional prudence if an insurer already measures insurance liabilities with sufficient prudence (see paragraph 26 of the IFRS). The liability adequacy test in paragraphs 15-19 addresses the converse problem of understated insurance liabilities.

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[*] This approach is consistent with the discussion of servicing rights and obligations in IAS 39.

[#] The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011, but the accounting policy requirements were not changed.

BC151 Measurements of the intangible asset described in paragraph BC147(b) sometimes include future investment margins. Those margins are subject to the same requirements as future investment margins included in the measurement of the related insurance liability (see paragraphs BC134-BC144).

BC152 In some cases, an insurer's accounting policies under previous GAAP (ie those used before it adopted IFRSs) involved measuring the intangible asset described in paragraph BC147(b) on a basis derived from the carrying amounts of other assets and liabilities. In such cases, if an entity changes the measurements of its assets and liabilities on adopting IFRSs for the first time, shadow accounting may become relevant (see paragraphs BC181-BC184 for a discussion of shadow accounting).

BC153 Some respondents requested an exemption from fair value measurement for insurance liabilities assumed in a business combination. They argued that there is still too much uncertainty about how fair value should be defined and determined.* However, insurers have apparently been able to cope with the existing requirements in IFRSs and in national standards. The Board saw no compelling reason for a new exemption.

Discretionary participation features

BC154 Some insurance contracts contain a discretionary participation feature as well as a guaranteed element. The insurer has discretion over the amount and/or timing of distributions to policyholders, although that discretion may be subject to some contractual constraints (including related legal and regulatory constraints) and competitive constraints. Distributions are typically made to policyholders whose contracts are still in force when the distribution is made. Thus, in many cases, a change in the timing of a distribution means that a different generation of policyholders will benefit.

BC155 Although the issuer has contractual discretion over distributions, it is usually likely that current or future policyholders will ultimately receive some part of the accumulated surplus available, at the reporting date, for distribution to holders of contracts with discretionary participation features (ie distributable surplus). The main accounting question is whether that part of the distributable surplus is a liability or a component of equity. The Board will explore that question in phase II.

BC156 Features of this kind are found not only in insurance contracts but also in some investment contracts (ie financial liabilities). Requiring a particular accounting treatment in phase I for investment contracts with these features would create the risk that the Board might decide on a different treatment in phase II. Furthermore, in some cases, holders of insurance contracts and investment contracts have a contractual right to share in discretionary payments out of the same pool of assets. If the Board required a particular treatment for the discretionary participation features of the investment contracts in phase I, it might prejudge the treatment of these features in insurance contracts that are linked to the same pool of assets.

BC157 For these reasons, the Board decided not to address most aspects of the accounting treatment of such features in phase I, in either insurance contracts or investment contracts. However, paragraphs 34 and 35 of the IFRS confirm that it is unacceptable to classify a discretionary participation feature as an intermediate category that is neither liability nor equity, because this would be inconsistent with the *Framework*. If a balance sheet item does not meet the *Framework*'s definition of, and recognition criteria for, assets or liabilities, that item is included in equity.

* IFRS 13, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

resolved until phase II. Furthermore, requiring the premium to be split could involve system changes that might become redundant in phase II. To avoid unnecessary disruption in phase I, the Board decided that entities could continue presenting premiums as revenue, with a corresponding expense representing the change in the liability.

BC164 Conceptually, if part or all of a discretionary participation feature is classified as a component of equity, the related portion of the premium should not be included in profit or loss. However, the Board concluded that requiring each incoming premium to be split would require systems changes beyond the scope of phase I. Therefore, the Board decided that an issuer could recognise the entire premium as revenue without separating the portion that relates to the equity component. However, the Board confirmed that the portion of profit or loss attributable to the equity component is presented as an allocation of profit or loss (in a manner similar to the presentation of minority interests[*]), not as expense or income.

BC165 Some suggested that investment contracts containing a discretionary participation feature should be excluded from the fair value disclosure required by IAS 32[†]. They noted both conceptual and practical problems in determining the fair value of an instrument of this kind. However, instead of creating a new exclusion from the required disclosure of fair value, the Board added new paragraph 91A to IAS 32. This extends existing requirements in IAS 32 governing those unquoted equity instruments whose fair value cannot be determined reliably.

Issues related to IAS 39

Assets held to back insurance contracts

BC166 The IFRS does not address financial or non-financial assets held by insurers to back insurance contracts. IAS 39 identifies four categories of financial asset, with three different accounting treatments. In developing IAS 39, the Board's predecessor (IASC) acknowledged that most countries had a mixed measurement model, measuring some financial assets at amortised cost and others at fair value. IASC decided to retain, but regulate and structure, the different approaches as follows:

(a) financial assets classified as 'at fair value through profit or loss' (including all financial assets held for trading) are measured at fair value, with all changes in their fair value recognised in profit or loss. Furthermore, all derivatives are deemed to be held for trading, and hence measured at fair value, because this is the only method that provides sufficient transparency in the financial statements.

(b) available-for-sale assets (ie those that do not fall into any of the other categories) are measured at fair value, with changes in their fair value recognised in equity until the asset is derecognised or becomes impaired. Measurement at fair value is appropriate given that available-for-sale assets may be sold in response to, for example, changes in market prices or a liquidity shortage.

[*] In January 2008 the IASB issued an amended IAS 27 *Consolidated and Separate Financial Statements*, which amended 'minority interests' to 'non-controlling interests'. The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The term 'non-controlling interests' and the requirements for non-controlling interests were not changed.

[†] In August 2005, the IASB relocated all disclosures relating to financial instruments to IFRS 7 *Financial Instruments: Disclosures*.

BC184 Paragraph 30 of the IFRS permits, but does not require, shadow accounting. The Implementation Guidance includes an illustrative example to show how shadow accounting might become relevant in an environment where the accounting for assets changes so that unrealised gains are recognised (IG Example 4). Because the Board does not expect the feature underlying the use of shadow accounting to survive in phase II, the Board decided not to give further guidance.

Investment contracts

BC185 Many insurers issue investment contracts (ie financial instruments that do not transfer enough insurance risk to qualify as insurance contracts). Under IAS 39, the issuer measures investment contracts at either amortised cost or, with appropriate designation at inception, at fair value. Some aspects of the measurements under IAS 39 differ from the measurements that are often used at present under national accounting requirements for these contracts:

(a) The definition and treatment of transaction costs under IAS 39 may differ from the definition and treatment of acquisition costs in some national requirements.

(b) The condition in IAS 39 for treating a modification of a financial liability (or the exchange of the new liability for an old liability) as an extinguishment of the original liability may differ from equivalent national requirements.

(c) Future cash flows from assets do not affect the amortised cost or fair value of investment contract liabilities (unless the cash flows from the liabilities are contractually linked to the cash flows from the assets).

(d) The amortised cost of a financial liability is not adjusted when market interest rates change, even if the return on available assets is below the effective interest rate on the liability (unless the change in rates causes the liability cash flows to change).

(e) The fair value of a financial liability with a demand feature is not less than the amount payable on demand.

(f) The fair value of a financial instrument reflects its credit characteristics. [*]

(g) Premiums received for an investment contract are not recognised as revenue under IAS 39, but as balance sheet movements, in the same way as a deposit received.

BC186 Some argued that the Board should not require insurers to change their accounting for investment contracts in phase I because the scope of phase I is intended to be limited and because the current treatment of such contracts is often very similar to the treatment of insurance contracts. However, the Board saw no reason to delay the application of IAS 39 to contracts that do not transfer significant insurance risk. The Board noted that some of these contracts have features, such as long maturities, recurring premiums and high initial transaction costs, that are less common in other financial instruments. Nevertheless, applying a single set of accounting requirements to all financial instruments will make an insurer's financial statements more relevant and reliable.

[*] IFRS 13, issued in May 2011, states that the fair value of a liability reflects the effect of non-performance risk, which includes, but may not be limited to, an entity's own credit risk.

Fair value of insurance liabilities and insurance assets

BC224 ED 5 proposed that an insurer should disclose the fair value of its insurance liabilities and insurance assets. This proposal was intended (a) to give useful information to users of an insurer's financial statements and (b) to encourage insurers to begin work on systems that use updated information, to minimise the transition period for phase II.

BC225 Some respondents supported the proposed disclosure of fair value, arguing that it is important information for users. Some felt that this would be particularly important given the range of measurement practices in phase I. However, many respondents (including some who supported a fair value disclosure requirement in principle) suggested that the Board should delete this requirement or suspend it until phase II is completed. They offered the following arguments:

(a) Requiring such disclosure would be premature before the Board resolves significant issues about fair value measurement and gives adequate guidance on how to determine fair value.[*] The lack of guidance would lead to lack of comparability for users, place unreasonable demands on preparers and pose problems of auditability. Furthermore, disclosure cannot rectify that lack of comparability because it is difficult to describe the features of different models clearly and concisely.

(b) Disclosure by 2006 (as proposed in ED 5) would be impracticable because insurers would not have time to create and test the necessary systems.

(c) Expecting insurers to begin work on an unknown objective would be costly and waste time. Furthermore, in the absence of agreed methods for developing fair value, the systems developed for phase I disclosures of fair value might need changes for phase II.

(d) The proposal asked for a mandate for the IASB to interpret its own requirement before explaining what it means.

BC226 The Board did not view the proposed requirement to disclose fair value as conditional on the measurement model for phase II. In the Board's view, disclosure of the fair value of insurance liabilities and insurance assets would provide relevant and reliable information for users even if phase II does not result in a fair value model. However, the Board agreed with respondents that requiring disclosure of fair value would not be appropriate at this stage.

Summary of changes from ED 5

BC227 The following is a summary of the main changes from ED 5 to the IFRS. The Board:

(a) clarified aspects of the definition of an insurance contract (paragraphs BC36 and BC37).

(b) clarified the requirement to unbundle deposit components in some (limited) circumstances (paragraphs BC40-BC54).

[*] IFRS 13, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

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Revised Guidance on Implementing HKFRS 4

Insurance Contracts

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from paragraph

GUIDANCE ON IMPLEMENTING
IFRS 4 *INSURANCE CONTRACTS*

1.25	A contract permits the issuer to deduct a market value adjustment (MVA) from surrender values or death benefits to reflect current market prices for the underlying assets. The contract does not permit an MVA for maturity benefits.	The policyholder obtains an additional survival benefit because no MVA is applied at maturity. That benefit is a pure endowment (see IG Example 1.5). If the risk transferred by that benefit is significant, the contract is an insurance contract.
1.26	A contract permits the issuer to deduct an MVA from surrender values or maturity payments to reflect current market prices for the underlying assets. The contract does not permit an MVA for death benefits.	The policyholder obtains an additional death benefit because no MVA is applied on death. If the risk transferred by that benefit is significant, the contract is an insurance contract.
1.27	A contract permits the issuer to deduct an MVA from surrender payments to reflect current market prices for the underlying assets. The contract does not permit an MVA for death and maturity benefits. The amount payable on death or maturity is the amount originally invested plus interest.	The policyholder obtains an additional benefit because no MVA is applied on death or maturity. However, that benefit does not transfer insurance risk from the policyholder because it is certain that the policyholder will live or die and the amount payable on death or maturity is adjusted for the time value of money (see paragraph B27 of the IFRS). The contract is an investment contract. This contract combines the two features discussed in IG Examples 1.25 and 1.26. When considered separately, those two features transfer insurance risk. However, when combined, they do not transfer insurance risk. Therefore, it is not appropriate to separate this contract into two 'insurance' components. If the amount payable on death were not adjusted in full for the time value of money, or were adjusted in some other way, the contract might transfer insurance risk. If that insurance risk is significant, the contract is an insurance contract.
1.28	A contract meets the definition of an insurance contract. It was issued by one entity in a group (for example a captive insurer) to another entity in the same group.	If the entities present individual or separate financial statements, they treat the contract as an insurance contract in those individual or separate financial statements (see IAS 27 ~~*Consolidated and*~~ *Separate Financial Statements*). The transaction is eliminated from the group's consolidated financial statements. If the intragroup contract is reinsured with a third party that is not part of the group, the reinsurance contract is treated as a direct insurance contract in the consolidated financial statements because the intragroup contract is eliminated on consolidation.

…continued

IG Example 3: Unbundling a deposit component of a reinsurance contract

The following discussion addresses the accounting by the reinsurer. Similar principles apply to the accounting by the cedant.

Application of requirements: case 1—no claims

If there are no claims, the cedant will receive CU45 in year 5 (90 per cent of the cumulative premiums of CU50). In substance, the cedant has made a loan, which the reinsurer will repay in one instalment of CU45 in year 5.

If the reinsurer's accounting policies require it to recognise its contractual liability to repay the loan to the cedant, unbundling is permitted but not required. However, if the reinsurer's accounting policies would not require it to recognise the liability to repay the loan, the reinsurer is required to unbundle the contract (paragraph 10 of the IFRS).

If the reinsurer is required, or elects, to unbundle the contract, it does so as follows. Each payment by the cedant has two components: a loan advance (deposit component) and a payment for insurance cover (insurance component). Applying IAS 39 to the deposit component, the reinsurer is required to measure it initially at fair value. Fair value could be ~~determined~~ measured by discounting the future cash flows from the deposit component using a valuation technique. Assume that an appropriate discount rate is 10 per cent and that the insurance cover is equal in each year, so that the payment for insurance cover is the same in every year. Each payment of CU10 by the cedant is then made up of a loan advance of CU6.7 and an insurance premium of CU3.3.

The reinsurer accounts for the insurance component in the same way that it accounts for a separate insurance contract with an annual premium of CU3.3.

The movements in the loan are shown below.

Year	Opening Balance	Interest at 10 per cent	Advance (repayment)	Closing balance
	CU	CU	CU	CU
0	0.00	0.00	6.70	6.70
1	6.70	0.67	6.70	14.07
2	14.07	1.41	6.70	22.18
3	22.18	2.21	6.70	31.09
4	31.09	3.11	6.70	40.90
5	40.90	4.10	(45.00)	0.00
Total		11.50	(11.50)	

continued…

HKFRS 5

Revised ~~July 2012~~ June 2014

Effective for annual periods
beginning on or after 1 January 2005

Hong Kong Financial Reporting Standard 5

Non-current Assets Held for Sale and Discontinued Operations

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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BASIS FOR CONCLUSIONS

DISSENTING OPINIONS

IMPLEMENTATION GUIDANCE

Hong Kong Financial Reporting Standard 5 *Non-current Assets Held for Sale and Discontinued Operations* (HKFRS 5) is set out in paragraphs 1-45 and Appendices A-C and E. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the Standard. Definitions of other terms are given in the Glossary for Hong Kong Financial Reporting Standards. HKFRS 5 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting* ~~*the Preparation and Presentation of Financial Statements*~~. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

27 The entity shall measure a non-current asset that ceases to be classified as held for sale (or ceases to be included in a disposal group classified as held for sale) at the lower of:

(a) its carrying amount before the asset (or disposal group) was classified as held for sale, adjusted for any depreciation, amortisation or revaluations that would have been recognised had the asset (or disposal group) not been classified as held for sale, and

(b) its *recoverable amount* at the date of the subsequent decision not to sell.*

28 The entity shall include any required adjustment to the carrying amount of a non-current asset that ceases to be classified as held for sale in profit or loss[δ] from continuing operations in the period in which the criteria in paragraphs 7-9 are no longer met. Financial statements for the periods since classification as held for sale shall be amended accordingly if the disposal group or non-current asset that ceases to be classified as held for sale is a subsidiary, joint operation, joint venture, associate, or a portion of an interest in a joint venture or an associate. The entity shall present that adjustment in the same caption in the statement comprehensive income used to present a gain or loss, if any, recognised in accordance with paragraph 37.

29 If an entity removes an individual asset or liability from a disposal group classified as held for sale, the remaining assets and liabilities of the disposal group to be sold shall continue to be measured as a group only if the group meets the criteria in paragraphs 7-9. Otherwise, the remaining non-current assets of the group that individually meet the criteria to be classified as held for sale shall be measured individually at the lower of their carrying amounts and fair values less costs to sell at that date. Any non-current assets that do not meet the criteria shall cease to be classified as held for sale in accordance with paragraph 26.

Presentation and disclosure

30 An entity shall present and disclose information that enables users of the financial statements to evaluate the financial effects of discontinued operations and disposals of non-current assets (or disposal groups).

Presenting discontinued operations

31 A *component of an entity* comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. In other words, a component of an entity will have been a cash-generating unit or a group of cash-generating units while being held for use.

32 A discontinued operation is a component of an entity that either has been disposed of, or is classified as held for sale, and

(a) represents a separate major line of business or geographical area of operations,

* If the non-current asset is part of a cash-generating unit, its recoverable amount is the carrying amount that would have been recognised after the allocation of any impairment loss arising on that cash-generating unit in accordance with HKAS 36.

δ Unless the asset is property, plant and equipment or an intangible asset that had been revalued in accordance with HKAS 16 or HKAS 38 before classification as held for sale, in which case the adjustment shall be treated as a revaluation increase or decrease.

(b) is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations or

(c) is a subsidiary acquired exclusively with a view to resale.

33 An entity shall disclose:

(a) a single amount in the statement of comprehensive income comprising the total of:

(i) the post-tax profit or loss of discontinued operations and

(ii) the post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation.

(b) an analysis of the single amount in (a) into:

(i) the revenue, expenses and pre-tax profit or loss of discontinued operations;

(ii) the related income tax expense as required by paragraph 81(h) of HKAS 12; and

(iii) the gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation; and

(iv) [deleted]~~the related income tax expense as required by paragraph 81(h) of HKAS 12.~~

The analysis may be presented in the notes or in the statement of comprehensive income. If it is presented in the statement of comprehensive income it shall be presented in a section identified as relating to discontinued operations, ie separately from continuing operations. The analysis is not required for disposal groups that are newly acquired subsidiaries that meet the criteria to be classified as held for sale on acquisition (see paragraph 11).

(c) the net cash flows attributable to the operating, investing and financing activities of discontinued operations. These disclosures may be presented either in the notes or in the financial statements. These disclosures are not required for disposal groups that are newly acquired subsidiaries that meet the criteria to be classified as held for sale on acquisition (see paragraph 11).

(d) the amount of income from continuing operations and from discontinued operations attributable to owners of the parent. These disclosures may be presented either in the notes or in the statement of comprehensive income.

33A If an entity presents the ~~components~~ items of profit or loss in a separate ~~income~~ statement as described in paragraph ~~81~~10A of HKAS 1 (as ~~revised~~ amended in ~~2007~~2011), a section identified as relating to discontinued operations is presented in that separate statement.

an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

44B HKAS 27 *Consolidated and Separate Financial Statements* (as amended in 2008) added paragraph 33(d). An entity shall apply that amendment for annual periods beginning on or after 1 July 2009. If an entity applies HKAS 27 (amended 2008) for an earlier period, the amendment shall be applied for that earlier period. The amendment shall be applied retrospectively.

44C Paragraphs 8A and 36A were added by *Improvements to HKFRSs* issued in October 2008. An entity shall apply those amendments for annual periods beginning on or after 1 July 2009. Earlier application is permitted. However, an entity shall not apply the amendments for annual periods beginning before 1 July 2009 unless it also applies HKAS 27 (as amended in March 2008). If an entity applies the amendments before 1 July 2009 it shall disclose that fact. An entity shall apply the amendments prospectively from the date at which it first applied HKFRS 5, subject to the transitional provisions in paragraph 45 of HKAS 27 (amended March 2008).

44D Paragraphs 5A, 12A and 15A were added and paragraph 8 was amended by Hong Kong (IFRIC) Interpretation 17 *Distributions of Non-cash Assets to Owners* in December 2008. Those amendments shall be applied prospectively to non-current assets (or disposal groups) that are classified as held for distribution to owners in annual periods beginning on or after 1 July 2009. Retrospective application is not permitted. Earlier application is permitted. If an entity applies the amendments for a period beginning before 1 July 2009 it shall disclose that fact and also apply HKFRS 3 *Business Combinations* (as revised in 2008), HKAS 27 (as amended in March 2008) and Hong Kong (IFRIC) Interpretation 17.

44E Paragraph 5B was added by *Improvements to HKFRSs* issued in May 2009. An entity shall apply that amendment prospectively for annual periods beginning on or after 1 January 2010. Earlier application is permitted. If an entity applies the amendment for an earlier period it shall disclose that fact.

44F [This paragraph refers to amendments that are not yet effective, and is therefore not included in this edition.]

44G HKFRS 11 Joint Arrangements, issued in June 2011, amended paragraph 28. An entity shall apply that amendment when it applies HKFRS 11.

44H HKFRS 13 Fair Value Measurement, issued in June 2011, amended the definition of fair value in Appendix A. An entity shall apply that amendment when it applies HKFRS 13.

44I Presentation of Items of Other Comprehensive Income (Amendments to HKAS 1), issued in July 2011, amended paragraph 33A. An entity shall apply that amendment when it applies HKAS 1 as amended in July 2011.

Withdrawal of ssap 33

45 This HKFRS supersedes SSAP 33 *Discontinuing Operations*.

disposal group	A group of assets to be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction. The group includes goodwill acquired in a business combination if the group is a **cash-generating unit** to which goodwill has been allocated in accordance with the requirements of paragraphs 80-87 of HKAS 36 *Impairment of Assets* or if it is an operation within such a cash-generating unit.
fair value	~~The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.~~ *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. (See HKFRS 13.)
firm purchase commitment	An agreement with an unrelated party, binding on both parties and usually legally enforceable, that (a) specifies all significant terms, including the price and timing of the transactions, and (b) includes a disincentive for non-performance that is sufficiently large to make performance **highly probable**.
highly probable	Significantly more likely than **probable**.
non-current asset	An asset that does not meet the definition of a **current asset**.
probable	More likely than not.
recoverable amount	The higher of an asset's **fair value** less **costs to sell** and its **value in use**.
value in use	The present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life.

HKFRS 5 BC
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Basis for Conclusions on
Hong Kong Financial Reporting Standard 5

Non-current Assets Held for Sale and Discontinued Operations

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HKFRS 5 is based on IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. In approving HKFRS 5, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IFRS 5. Accordingly, there are no significant differences between HKFRS 5 and IFRS 5. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IFRS 5 referred to below generally correspond with those in HKFRS 5.

CONTENTS *from paragraph*

BC13 The Board also reconsidered the exclusions from the scope proposed in ED 4. The Board noted that the classification and presentation requirements of the IFRS are applicable to all non-current assets and concluded that any exclusions should relate only to the measurement requirements. In relation to the measurement requirements, the Board decided that non-current assets should be excluded only if (i) they are already carried at fair value with changes in fair value recognised in profit or loss or (ii) there would be difficulties in determining their fair value less costs to sell. The Board therefore concluded that only the following non-current assets should be excluded from the measurement requirements of the IFRS:

Assets already carried at fair value with changes in fair value recognised in profit or loss:

(a) financial assets within the scope of IAS 39.

(b) non-current assets that have been accounted for using the fair value model in IAS 40 *Investment Property*.

(c) non-current assets that have been measured at fair value less estimated point-of-sale costs in accordance with IAS 41 *Agriculture*.[†]

Assets for which there might be difficulties in determining their fair value:

(a) deferred tax assets.

(b) assets arising from employee benefits.

(c) assets arising from insurance contracts.

BC14 The Board acknowledged that the scope of the IFRS would differ from that of SFAS 144 but noted that SFAS 144 covers the impairment of non-current assets held for use as well as those held for sale. Furthermore, other requirements in US GAAP affect the scope of SFAS 144. The Board therefore concluded that convergence with the scope of SFAS 144 would not be possible.

BC14A The Board identified a need to clarify the disclosure requirements for non-current assets (or disposal groups) classified as held for sale or discontinued operations in accordance with IFRS 5. Some believed that IFRS 5 and other IFRSs that specifically refer to non-current assets (or disposal groups) classified as held for sale or discontinued operations set out all the disclosures required in respect of those assets or operations. Others believed that all disclosures required by IFRSs whose scope does not specifically exclude non-current assets (or disposal groups) classified as held for sale or discontinued operations apply to such assets (or disposal groups).[‡]

BC14B The Board noted that paragraph 30 of IFRS 5 requires an entity to 'present and disclose information that enables users of the financial statements to evaluate the financial effects of discontinued operations and disposals of non-current assets (or disposal groups).' Paragraph BC17 below states that 'the Board concluded that

[†] In *Improvements to IFRSs* issued in May 2008 the Board amended IAS 41 : the term 'estimated point-of-sale costs' was replaced by 'costs to sell'. IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

[‡] Paragraphs BC14A-BC14E were added as a consequence of amendments to IFRS 5 by *Improvements to IFRSs* issued in April 2009.

Plan to sell the controlling interest in a subsidiary*

BC24A In 2007 the Board considered situations in which an entity is committed to a plan to sell the controlling interest in a subsidiary and, after the sale, retains a non-controlling interest in its former subsidiary, taking the form of an investment in an associate, an investment in a joint venture or a financial asset. The Board considered how the classification as held for sale applies to the subsidiary in the consolidated financial statements of the entity.

BC24B The Board noted that paragraph 6 states that 'An entity shall classify a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use.' The Board also noted that IAS 27 *Consolidated and Separate Financial Statements* (as amended in January 2008) defines control and requires a parent to consolidate a subsidiary until control is lost.# At the date control is lost, all the subsidiary's assets and liabilities are derecognised and any investment retained in the former subsidiary is recognised. Loss of control is a significant economic event that changes the nature of an investment. The parent-subsidiary relationship ceases to exist and an investor-investee relationship begins that differs significantly from the former parent-subsidiary relationship. Therefore, the new investor-investee relationship is recognised and measured initially at the date when control is lost.

BC24C The Board concluded that, under the sale plan described above, the controlling interest in the subsidiary is, in substance, exchanged for a non-controlling interest. Therefore, in the Board's view, being committed to a plan involving loss of control of a subsidiary should trigger classification as held for sale. The Board also noted that this conclusion is consistent with IAS 27.

BC24D The Board noted that the subsidiary's assets and liabilities meet the definition of a disposal group in accordance with paragraph 4. Therefore, the Board concluded that all the subsidiary's assets and liabilities should be classified as held for sale, not only the portion of the interest to be disposed of, regardless of whether the entity will retain a non-controlling interest.

BC24E The Board considered the comments received on the proposal set out in its exposure draft of October 2007. In response to comments from some respondents, the Board clarified in the amendment that the criteria for classification as held for sale need to be met.

Assets to be exchanged for other non-current assets

BC25 Under SFAS 144, long-lived assets that are to be exchanged for similar productive assets cannot be classified as held for sale. They are regarded as disposed of only when exchanged. The Basis for Conclusions on SFAS 144 explains that this is because the exchange of such assets is accounted for at amounts based on the carrying amount of the assets, not at fair value, and that using the carrying amount is more consistent with the accounting for a long-lived asset to be held and used than for a long-lived asset to be sold.

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* This section and paragraphs BC77A and BC79A were added as a consequence of amendments to IFRS 5 by *Improvements to IFRSs* issued in May 2008.

\# The consolidation requirements in IAS 27 were superseded, and the definition of control was consequently revised, by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The requirement to consolidate a subsidiary until control is lost did not change. In October 2012 the Board issued *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27), which required investment entities, as defined in IFRS 10 *Consolidated Financial Statements*, to measure their investments in subsidiaries, other than those providing investment-related services or activities, at fair value through profit or loss.

BC53 The Board agreed that all subsidiaries should be consolidated and that all assets (and disposal groups) that meet the criteria to be classified as held for sale should be treated in the same way. The exemption from consolidation in IAS 27 *Consolidated and Separate Financial Statements* for subsidiaries acquired and held exclusively with a view to resale prevents those assets and disposal groups within such subsidiaries that meet the criteria to be classified as held for sale from being treated consistently with other assets and disposal groups. ED 4 therefore proposed that the exemption in IAS 27 should be removed.[#]

BC54 Some respondents disagreed with this proposal, on the grounds that the information provided by consolidation of such subsidiaries would be less useful than that provided by the current requirement to measure the investment in such subsidiaries at fair value. The Board noted that the impact of the proposals in ED 4 would be limited to the following:

(a) the measurement of a subsidiary that currently is within the scope of the exemptions would change from fair value as required by IAS 39 to the lower of cost and fair value less costs to sell.

(b) any change in fair value of the investment in the subsidiary would, in accordance with the current requirements in IAS 27, be presented as a single amount in profit or loss as a held-for-trading financial asset in accordance with IAS 39. As discussed in paragraph BC72, the subsidiary would be a discontinued operation and, in accordance with the IFRS's requirements (see paragraphs BC73-BC76), any recognised change in the value of the disposal group that comprises the subsidiary would be presented as a single amount in profit or loss.

(c) the presentation in the balance sheet would change from a single amount for the investment in the subsidiary to two amounts—one for the assets and one for the liabilities of the disposal group that is the subsidiary.[*]

BC55 The Board reaffirmed its conclusion set out in paragraph BC 53. However, it noted that the limited impact of the proposals apply only to the amounts required to be presented on the face of the balance sheet and the income statement. Providing the required analyses of those amounts in the notes could potentially involve the entity having to obtain significantly more information. The Board therefore decided not to require the disclosure of the analyses of the amounts presented on the face of the balance sheet and income statement for newly acquired subsidiaries and to clarify in an example the computational short cuts that could be used to arrive at the amounts to be presented on the face of the balance sheet and income statement.

Presentation of non-current assets held for sale

BC56 SFAS 144 requires an entity to present:

(a) a long-lived asset classified as held for sale separately in the balance sheet; and

[#] The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. IFRS 10 does not contain an exception from consolidation for subsidiaries acquired and held exclusively with a view to resale.

[*] Greater disaggregation of the disposal group in the statement of financial position is permitted but not required.

BC72 Lastly, the Board considered whether newly acquired subsidiaries that meet the criteria to be classified as held for sale should always be classified as discontinued. The Board concluded that they should be so classified because they are being disposed of for one of the following reasons:

(a) the subsidiary is in a different line of business from the entity, so disposing of it is similar to disposing of a major line of business.

(b) the subsidiary is required to be disposed of by regulators because the entity would otherwise have too much of a particular type of operation in a particular geographical area. In such a case the subsidiary must be a significant operation.

Changes to a plan of sale (amendment 2011)

BC72A During its redeliberation of the exposure draft ED 9 *Joint Arrangements* the Board decided that if a disposal group or non-current asset that ceases to be classified as held for sale is a subsidiary, a joint operation, a joint venture, an associate, or a portion of an interest in a joint venture or associate, an entity should amend its financial statements for the periods since the classification as held for sale was made.

Presentation of discontinued operations

BC73 SFAS 144 requires the results of a discontinued operation to be presented as a separate component in the income statement (net of income tax) for all periods presented.

BC74 IAS 35 did not require the results of a discontinuing operation to be presented as a net amount on the face of the income statement. Instead, specified items are disclosed either in the notes or on the face of the income statement.

BC75 In ED 4, the Board noted that it was considering the presentation of discontinued operations in the income statement in its project on reporting comprehensive income and that it did not wish to prejudge the outcome of that project by changing the requirements of IAS 35 in respect of the components to be disclosed. Given that the project on reporting comprehensive income will not be completed as soon as previously expected, the Board decided to proceed with its decisions on the presentation of discontinued operations in this IFRS.

BC76 The Board believes that discontinued operations should be shown in a section of the income statement separately from continuing operations because of the different cash flows expected to arise from the two types of operations. The Board concluded that it is sufficient to show a single net figure for discontinued operations on the face of the income statement because of the limited future cash flows expected to arise from the operations. The IFRS therefore permits an analysis of the single net amount to be presented either in the notes or in the income statement.*

* IAS *Presentation of Financial Statements* (as revised in 2007) requires an entity to present all income and expense items in one statement of comprehensive income or in two statements (a separate income statement and a statement of comprehensive income).

BC77 A substantial majority of the respondents to ED 4 supported such a presentation.

BC77A The Board considered the comments received on the draft amendments in the 2007 exposure draft of proposed *Improvements to International Financial Reporting Standards*. Some respondents asked the Board to clarify the effects of the proposed amendment on the income statement when the disposal group meets the definition of a discontinued operation. The Board concluded that when a subsidiary is a disposal group that meets the definition of a discontinued operation in accordance with paragraph 32, an entity that is committed to a sale plan involving loss of control of the subsidiary should disclose the information required by paragraphs 33-36. The Board agreed with respondents that presentation should not differ simply because of the form of the disposal group.

Transitional arrangements

BC78 Some respondents to ED 4 noted that there could be difficulties in obtaining the information necessary to apply the IFRS retrospectively. The Board agreed that hindsight might be involved in determining at what date assets or disposal groups met the criteria to be classified as held for sale and their fair value at that date. Problems might also arise in separating the results of operations that would have been classified as discontinued operations in prior periods and that had been derecognised in full before the effective date of the IFRS.

BC79 The Board therefore decided to require application of the IFRS prospectively and allow retrospective application only when the necessary information had been obtained in the prior periods in question.

BC79A The Board concluded that the effective date of the amendments in paragraphs 8A and 36A for presentation purposes should be 1 July 2009 to be consistent with the effective date of the amendments to IAS 27 (as amended in January 2008) for measurement purposes. Because paragraph 45(c) of IAS 27 provides an exception to retrospective application of the amendments relating to the loss of control of a subsidiary for measurement purposes, the Board required an entity to consider the applicable transitional provisions in IAS 27 when implementing the amendments in paragraphs 8A and 36A.[*]

Terminology

BC80 Two issues of terminology arose in developing the IFRS:

(a) the use of the term ‘probable’ and

(b) the use of the term ‘fair value less costs to sell’[#].

BC81 In SFAS 144, the term *probable* is described as referring to a future sale that is ‘likely to occur’. For the purposes of IFRSs, probable is defined as ‘more likely than not’. To converge on the same meaning as SFAS 144 and to avoid using the term ‘probable’ with different meanings in IFRSs, this IFRS uses the phrase ‘highly probable’. The Board regards ‘highly probable’ as implying a significantly higher probability than ‘more likely than not’ and as implying the same probability as the FASB’s phrase ‘likely to occur’. This is consistent with the Board’s use of ‘highly probable’ in IAS 39.

BC82 The measurement basis ‘fair value less costs to sell’ used in SFAS 144 is the same as the measurement ‘net selling price’ used in IAS 36 (as issued in 1998). SFAS 144 defines fair value of an asset as “the amount at which that asset could be bought or sold in a current transaction between willing parties, that is, other than in a forced or liquidation sale”, and costs to sell as “the incremental direct costs to transact a sale, that is, the costs that result directly from and are essential to a sale transaction and that would not have been incurred by the entity had the decision to sell not been made.” IAS 36 defines net selling price as the amount obtainable from the sale of an asset in an arm’s length transaction between knowledgeable, willing parties, less the costs of disposal. Costs of disposal are incremental costs directly attributable to the disposal of an asset, excluding finance costs and income tax expenses.

[*] The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. Paragraph 45(c) in IAS 27 was moved to paragraph C6(c) of IFRS 10; however, the transition provisions were not changed.

[#] IFRS 13, issued in May 2011, defines fair value and contains the requirements for measuring fair value.

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Guidance on Implementing
Hong Kong Financial Reporting Standard 5

Non-current Assets Held for Sale and Discontinued Operations

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GUIDANCE ON IMPLEMENTING IFRS 5 *NON-CURRENT ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS*

Example 3

An entity acquires through foreclosure a property comprising land and buildings that it intends to sell.

(a) The entity does not intend to transfer the property to a buyer until after it completes renovations to increase the property's sales value. The delay in the timing of the transfer of the property imposed by the entity (seller) demonstrates that the property is not available for immediate sale. The criterion in paragraph 7 would not be met until the renovations are completed.

(b) After the renovations are completed and the property is classified as held for sale but before a firm purchase commitment is obtained, the entity becomes aware of environmental damage requiring remediation. The entity still intends to sell the property. However, the entity does not have the ability to transfer the property to a buyer until after the remediation is completed. The delay in the timing of the transfer of the property imposed by others before a firm purchase commitment is obtained demonstrates that the property is not available for immediate sale. The criterion in paragraph 7 would not continue to be met. The property would be reclassified as held and used in accordance with paragraph 26.

Completion of sale expected within one year (paragraph 8)

Example 4

To qualify for classification as held for sale, the sale of a non-current asset (or disposal group) must be highly probable (paragraph 7), and transfer of the asset (or disposal group) must be expected to qualify for recognition as a completed sale within one year (paragraph 8). That criterion would not be met if, for example:

(a) an entity that is a commercial leasing and finance company is holding for sale or lease equipment that has recently ceased to be leased and the ultimate form of a future transaction (sale or lease) has not yet been determined.

(b) an entity is committed to a plan to 'sell' a property that is in use, and the transfer of the property will be accounted for as a sale and finance leaseback.

Exceptions to the criterion that the sale should be expected to be completed in one year ~~in~~ (paragraphs 8 and B1)

An exception to the one-year requirement in paragraph 8 applies in limited situations in which the period required to complete the sale of a non-current asset (or disposal group) will be (or has been) extended by events or circumstances beyond an entity's control and specified conditions are met (paragraphs 9 and B1). Examples 5-7 illustrate those situations.

Example 5

An entity in the power generating industry is committed to a plan to sell a disposal group that represents a significant portion of its regulated operations. The sale requires regulatory approval, which could extend the period required to complete the sale beyond one year. Actions necessary to obtain that approval cannot be initiated until after a buyer is known and a firm purchase commitment is obtained. However, a firm purchase commitment is highly probable within one year. In that situation, the conditions in paragraph B1(a) for an exception to the one-year requirement in paragraph 8 would be met.

Example 9

In October 20X5 an entity decides to abandon all of its cotton mills, which constitute a major line of business. All work stops at the cotton mills during the year ended 31 December 20X6. In the financial statements for the year ended 31 December 20X5, results and cash flows of the cotton mills are treated as continuing operations. In the financial statements for the year ended 31 December 20X6, the results and cash flows of the cotton mills are treated as discontinued operations and the entity makes the disclosures required by paragraphs 33 and 34 of the IFRS.

Allocation of an impairment loss on a disposal group

Paragraph 23 of the IFRS requires an impairment loss (or any subsequent gain) recognised for a disposal group to reduce (or increase) the carrying amount of the non-current assets in the group that are within the scope of the measurement requirements of the IFRS, in the order of allocation set out in paragraphs 104 and 122 of IAS 36. Example 10 illustrates the allocation of an impairment loss on a disposal group.

Example 10

An entity plans to dispose of a group of its assets (as an asset sale). The assets form a disposal group, and are measured as follows:

	Carrying amount at the end of the reporting period before classification as held for sale	Carrying amount as remeasured immediately before classification as held for sale
	CU*	CU
Goodwill	1,500	1,500
Property, plant and equipment (carried at revalued amounts)	4,600	4,000
Property, plant and equipment (carried at cost)	5,700	5,700
Inventory	2,400	2,200
AFS financial assets	1,800	1,500
Total	**16,000**	**14,900**

The entity recognises the loss of CU1,100 (CU16,000-CU14,900) immediately before classifying the disposal group as held for sale.

The entity ~~estimates that~~measures the fair value less costs to sell of the disposal group ~~amounts to~~ as CU13,000. Because an entity measures a disposal group classified as held for sale at the lower of its carrying amount and fair value less costs to sell, the entity recognises an impairment loss of CU1,900 (CU14,900-CU13,000) when the group is initially classified as held for sale.

The impairment loss is allocated to non-current assets to which the measurement requirements of the IFRS are applicable. Therefore, no impairment loss is allocated to inventory and AFS financial assets. The loss is allocated to the other assets in the order of allocation set out in paragraphs 104 and 122 of IAS 36.

* In this guidance, monetary amounts are denominated in 'currency units' (CU).

… continued

Current liabilities		
KKK	X	X
LLL	X	X
MMM	X	X
Liabilities directly associated with non-current assets classified as held for sale	3,300	-
	X	X
Total liabilities	X	X
Total equity and liabilities	X	X

The presentation requirements for assets (or disposal groups) classified as held for sale at the end of the reporting period do not apply retrospectively. The comparative statement of financial position for any previous periods are therefore not re-presented.

Measuring and presenting subsidiaries acquired with a view to resale and classified as held for sale

A subsidiary acquired with a view to sale is not exempt from consolidation in accordance with ~~IAS 27~~ IFRS 10 *Consolidated ~~and Separate~~ Financial Statements*. However, if it meets the criteria in paragraph 11, it is presented as a disposal group classified as held for sale. Example 13 illustrates these requirements.

Example 13

Entity A acquires an entity H, which is a holding company with two subsidiaries, S1 and S2. S2 is acquired exclusively with a view to sale and meets the criteria to be classified as held for sale. In accordance with paragraph 32(c), S2 is also a discontinued operation.

The ~~estimated~~ fair value less costs to sell of S2 is CU135. A accounts for S2 as follows:

- initially, A measures the identifiable liabilities of S2 at fair value, say at CU40
- initially, A measures the acquired assets as the fair value less costs to sell of S2 (CU135) plus the fair value of the identifiable liabilities (CU40), ie at CU175
- at the end of the reporting period, A remeasures the disposal group at the lower of its cost and fair value less costs to sell, say at CU130. The liabilities are remeasured in accordance with applicable IFRSs, say at CU35. The total assets are measured at CU130+CU35, ie at CU165

HKFRS 8
Revised ~~November 2009~~June 2014

Effective for annual periods
beginning on or after 1 January 2009

Hong Kong Financial Reporting Standard 8

Operating Segments

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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Hong Kong Financial Reporting Standard 8 *Operating Segments* (HKFRS 8) is set out in paragraphs 1-37 and Appendices A and B. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Definition of terms are given in the Glossary for Hong Kong Financial Reporting Standards. HKFRS 8 should be read in the context of its core principle and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting~~the Preparation and Presentation of Financial Statements~~*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Information about profit or loss, assets and liabilities

23 An entity shall report a measure of profit or loss for each reportable segment. An entity shall report a measure of total assets and liabilities for each reportable segment if such amounts are regularly provided to the chief operating decision maker. An entity shall also disclose the following about each reportable segment if the specified amounts are included in the measure of segment profit or loss reviewed by the chief operating decision maker; or are otherwise regularly provided to the chief operating decision maker; even if not included in that measure of segment profit or loss:

(a) revenues from external customers;

(b) revenues from transactions with other operating segments of the same entity;

(c) interest revenue;

(d) interest expense;

(e) depreciation and amortisation;

(f) material items of income and expense disclosed in accordance with paragraph 97 of HKAS 1 *Presentation of Financial Statements* (as revised in 2007);

(g) the entity’s interest in the profit or loss of associates and joint ventures accounted for by the equity method;

(h) income tax expense or income; and

(i) material non-cash items other than depreciation and amortisation.

An entity shall report interest revenue separately from interest expense for each reportable segment unless a majority of the segment’s revenues are from interest and the chief operating decision maker relies primarily on net interest revenue to assess the performance of the segment and make decisions about resources to be allocated to the segment. In that situation, an entity may report that segment’s interest revenue net of its interest expense and disclose that it has done so.

24 An entity shall disclose the following about each reportable segment if the specified amounts are included in the measure of segment assets reviewed by the chief operating decision maker or are otherwise regularly provided to the chief operating decision maker, even if not included in the measure of segment assets:

(a) the amount of investment in associates and joint ventures accounted for by the equity method, and

(b) the amounts of additions to non-current assets* other than financial instruments, deferred tax assets, ~~post-employment~~ net defined benefit assets (see HKAS 19 *Employee Benefits* ~~paragraphs 54-58~~) and rights arising under insurance contracts.

* For assets classified according to a liquidity presentation, non-current assets are assets that include amounts expected to be recovered more than twelve months after the reporting period.

HKFRS 8 BC
Issued ~~March 2007~~June 2014

Basis for Conclusions on
Hong Kong Financial Reporting Standard 8

Operating Segments

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Basis for Conclusions
HKFRS 8 *Operating Segments*

HKFRS 8 is based on IFRS 8 *Operating Segments*. In approving HKFRS 8, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IFRS 8. Accordingly, there are no significant differences between HKFRS 8 and IFRS 8. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IFRS 8 referred to below generally correspond with those in HKFRS 8.

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requiring full compliance with the IFRS would prevent an entity outside its scope from voluntarily disclosing sales information for segments without also disclosing segment profit or loss. The Board concluded that an entity should be able to provide segment information on a voluntary basis without triggering the need to comply fully with the IFRS, so long as the disclosure is not referred to as segment information.

BC23 A respondent to ED 8 asked for clarification on whether the scope of the proposed IFRS included the consolidated financial statements of a group whose parent has no listed financial instruments, but includes a listed minority interest[*] or a subsidiary with listed debt. The Board decided that such consolidated financial statements should not be included in the scope and that the scope should be clarified accordingly. The Board also noted that the same clarification should be made to the scope of IAS 33 *Earnings per Share*.

Aspects of the management approach

Specific measurement requirements for some items

BC24 In ED 8, the Board invited comments on whether the proposed IFRS should depart from the management approach in SFAS 131 by setting measurement requirements for specified items. Some respondents to ED 8 supported an approach that would define the measurement of the key terms such as segment revenues, segment expenses, segment results, segment assets and segment liabilities in order to enhance comparability between reporting entities. Other respondents disagreed with any departure from SFAS 131 on the grounds that defined measurements for specified items would eliminate the major benefits of the management approach.

BC25 The IFRS requires the entity to explain the measurements of segment profit or loss and segment assets and liabilities and to provide reconciliations of the total segment amounts to the amounts recognised in the entity's financial statements. The Board believes that such reconciliations will enable users to understand and judge the basis on which the segment amounts were determined. The Board also noted that to define the measurement of such amounts would be a departure from the requirements of SFAS 131 that would involve additional time and cost for entities and would be inconsistent with the management perspective on segment information.

BC26 Therefore, the Board decided not to require defined measures of segment revenues, segment expenses, segment result, segment assets and segment liabilities.

Matrix form of organisations

BC27 In ED 8 the Board proposed that when more than one set of segments could be identified, for example when entities use a matrix form of organisation, the components based on products and services should be the basis for the operating segments. Some respondents noted that matrix organisational structures are commonly used for large complex organisations and that mandating the use of components based on products and services was inconsistent with the management approach. The Board agreed with this view. Accordingly, the IFRS requires the identification of operating segments to be made by reference to the core principle of the IFRS.

Quantitative thresholds

BC28 In ED 8 the Board proposed quantitative thresholds for identifying reportable segments. Some respondents argued that such requirements represent adoption of a

[*] In January 2008 the IASB issued an amended IAS 27 *Consolidated and Separate Financial Statements*, which amended 'minority interest' to 'non-controlling interests'. The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The term 'non-controlling interests' and the requirements for non-controlling interests were not changed.