

PROPOSED
INTERNATIONAL
ACCOUNTING STANDARD

IMPAIRMENT OF ASSETS

Exposure Draft E55

Issued for comment by 15 August 1997

EXPOSURE DRAFT



International
Accounting Standards
Committee

Proposed
International Accounting Standard

IMPAIRMENT OF ASSETS

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Issued for comment by 15 August 1997

This Exposure Draft is issued by the International Accounting Standards Committee for comment only. The recommendations in the draft may be modified in the light of the comments received before being issued in the form of an International Accounting Standard.

Comments should be submitted in writing so as to be received by **15 August 1997**. All replies will be put on public record unless confidentiality is requested by the commentator. Comments should be addressed to:

**The Secretary-General
International Accounting Standards Committee
167 Fleet Street
London EC4A 2ES
United Kingdom**

**Telefax: +44 (171) 353-0562
E-mail: iasc@iasc.org.uk**

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**International Accounting Standards Committee, 167 Fleet Street,
London EC4A 2ES, United Kingdom. Telephone: +44 (171) 353-0565,
Telefax: +44 (171) 353-0562, E-mail: iasc@iasc.org.uk**

Invitation to Comment

The Board of the International Accounting Standards Committee (IASC) has approved this Exposure Draft for distribution to professional accountancy bodies, members of the IASC Consultative Group, and other interested individuals and organisations for comment.

If adopted as a final International Accounting Standard, this Exposure Draft will supplement existing requirements in International Accounting Standards related to the accounting for the impairment of assets, other than assets specifically excluded from the scope of this proposed Standard. Appendix 2 to this Exposure Draft shows the consequences of the adoption of this proposed Standard for other International Accounting Standards. Appendix 3 to this Exposure Draft summarises:

- the principal proposals for revisions to existing requirements; and
- the Board's reasons for rejecting certain alternative solutions.

The Board does not intend to publish Appendix 3 with the final Standard.

Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, clearly explain the problem and provide a suggestion for alternative wording with supporting reasoning.

The Board would particularly welcome answers to the following questions, with reasons for those answers.

Measurement of Recoverable Amount

The issue of how to measure an asset's recoverable amount is one of the important issues to address in developing an International Accounting Standard on Impairment of Assets.

The Board indicates in this Exposure Draft its preferred approach, that is, that an asset's recoverable amount should be measured as the higher of its net selling price (the current net amount that can be obtained from the sale of the asset) and its value in use (the present value of estimated future cash flows from continuing use and subsequent disposal).

Some favour a different approach and believe that the recoverable amount should be based on the asset's fair value, that is, the amount for which the asset could be exchanged between knowledgeable, willing parties in an arm's length transaction. Proponents of the 'fair value' approach argue that quoted market prices in active markets are the best evidence of fair value and should be used as the basis for the measurement of recoverable amount, if available. However, proponents of the 'fair value' approach also recognise that, if no quoted active market prices are available, other valuation bases may need to be used including the present value of estimated future cash flows. Those who favour a 'fair value' approach are likely to see it as a more reliable measure of recoverable amount, safeguarding against excessive optimism on the part of preparers.

In many cases, the approach based on 'the higher of net selling price and value in use' and the approach based on 'fair value' will lead to the same or similar conclusions. Net selling price is a market price reduced by the costs of disposal of the asset. More importantly, few assets covered by the proposed International Accounting Standard are traded in active markets. In these cases, the use of value in use in accordance with the proposed International Accounting Standard would be likely to lead to the same conclusion as the use of a present value calculation of future cash flows to estimate fair value.

Differences between the two approaches might arise if an asset were traded in an active market but were regarded under the proposed International Accounting Standard as having a value in use in excess of the fair value. The frequency with which such differences might arise will depend partly on how 'active market' will be interpreted under a 'fair value' approach. If the term 'active market' is limited to very active markets such as a stock exchange, differences are likely to be very few because fair value will rarely be obtained from a market value, and value in use is not likely to be assessed at a significantly higher number when it is.

The potential for the difference may be illustrated by considering the case of an office building used for general administration. If the price of property has fallen since the building was acquired, and if the market for office buildings is regarded as an active market, the 'fair value' approach suggests that the carrying amount of the asset should be reduced to its current market value. This would not arise if the market for property were regarded as not an active market. Under the proposed International

Accounting Standard, it would be open to preparers of financial statements to demonstrate that an impairment loss should not be recognised because the value in use of the building exceeds its carrying amount, perhaps through considering the asset as part of a 'cash-generating unit'.

Those who favour the 'higher of net selling price and value in use' approach (the preferred approach of the IASC Board) argue that it is unnecessary to recognise an impairment loss if value in use is above fair value. The market price of an asset may genuinely be below the present value of future cash flows, just as acquisition of an asset in the first place may often be reasonably expected to generate cash flows having a present value in excess of cost.

1. Which of the following approaches do you support:
 - (a) the recoverable amount of an asset should be measured as the higher of its net selling price and its value in use (paragraphs 5 and 12-40 of the Exposure Draft and paragraphs 7-30 of the Basis for Conclusions)?
 - (b) the recoverable amount of an asset should be measured as the fair value of the asset, that is, the amount obtainable for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction. Fair value would be primarily based on the asset's market price if a market exists for that asset regardless of the value in use of the asset. If no market exists for the asset, fair value would be estimated in a similar way to value in use as defined in the Exposure Draft (paragraphs 13-19 of the Basis for Conclusions)?
 - (c) other (please specify)?
2. One consequence of the approach adopted in this Exposure Draft (or the alternative definition of recoverable amount based on fair value) is that present value techniques should be used to measure the recoverable amount of an asset, implicitly (net selling price) or explicitly (value in use) (paragraphs 7-9 and 11-12 of the Basis for Conclusions). Do you agree that present value techniques should be used to measure the recoverable amount of an asset, implicitly (net selling price) or explicitly (value in use)?

Assets Held for Disposal

3. Do you agree that the definition of recoverable amount in paragraph 5 of the Exposure Draft is just as applicable to an asset held for disposal as to an asset held for continuing use (paragraph 26 of the Basis for Conclusions)?

Recognition of Impairment Losses

4. Do you agree that an impairment loss should be recognised for an asset:
 - (a) whenever the recoverable amount of the asset is less than its carrying amount (paragraph 41 of the Exposure Draft and paragraphs 59-67 of the Basis for Conclusions); and
 - (b) only if the cash-generating unit to which the asset belongs is impaired (paragraphs 55-58 of the Exposure Draft and paragraphs 74-75 of the Basis for Conclusions)?

If you disagree with these proposals, please indicate criteria you would prefer for the recognition of an impairment loss in the financial statements.

Reversals of Impairment Losses

5. Do you agree that an impairment loss recognised in prior years for an asset carried on an historical cost basis should be reversed up to the depreciated historical cost of the asset if, and only if, there has been a change in the estimates used to determine the impaired asset's recoverable amount since the last impairment loss was recognised (paragraphs 70-76 of the Exposure Draft and paragraphs 83-87 of the Basis for Conclusions)?
6. Do you agree that an impairment loss recognised for goodwill and other intangible assets for which no active market exists should be reversed in a subsequent period if, and only if, the external event that caused the recognition of the impairment loss has reversed (paragraphs 77-78 of the Exposure Draft)?

The Board also welcomes answers to the following questions, with reasons for those answers.

Scope

7. Do you agree that the Standard should apply to all assets except those listed in paragraph 1 of the Exposure Draft (paragraphs 1-4 of the Exposure Draft and paragraphs 106-110 of the Basis for Conclusions)?

Identifying a Potentially Impaired Asset

8. Do you agree that:
 - (a) the recoverable amount of an asset should be estimated if, and only if, there is an indication that the asset is impaired; and
 - (b) the list of indicators of impairment included in paragraph 8 of the Exposure Draft will require an enterprise to estimate the recoverable amount whenever there is a significant risk that the asset is impaired?(paragraphs 6-12 of the Exposure Draft)

Net Selling Price

9. Do you agree that net selling price should be determined:
 - (a) based on “the amount obtainable from the sale of an asset in an arm’s length transaction between knowledgeable, willing parties” and that it is not necessary to determine net selling price by reference to an active market (paragraphs 5 and 17-18 of the Exposure Draft and paragraphs 31-38 of the Basis for Conclusions); and
 - (b) after deducting from the amount obtainable from the sale of an asset the incremental costs that are directly attributable to the disposal of the asset (excluding finance costs and income tax expense) (paragraphs 5 and 19-21 of the Exposure Draft and paragraph 35 of the Basis for Conclusions)?

Value in Use

10. Do you agree with the proposed requirements and guidance in the Exposure Draft for:
 - (a) the basis for estimates of future cash flows (paragraphs 23-27 of the Exposure Draft and paragraphs 24 and 40-42 of the Basis for Conclusions);
 - (b) the composition of estimates of future cash flows (paragraphs 28-35 of the Exposure Draft and paragraphs 43-46 and 50-58 of the Basis for Conclusions); and
 - (c) selecting the discount rate (paragraphs 36-40 of the Exposure Draft and paragraphs 47-49 of the Basis for Conclusions)?

Cash-Generating Units

11. Do you agree that, if an asset does not generate cash inflows that are largely independent of those from other assets, an enterprise should determine the recoverable amount of the asset's cash-generating unit (paragraphs 46-47 of the Exposure Draft)?
12. Do you agree with the requirements and guidance for determining the items that are included in a cash-generating unit (paragraphs 5 and 48-53 of the Exposure Draft)?
13. Do you agree with the requirement (and related guidance) to recognise and measure an impairment loss if there exists goodwill or other corporate assets (such as head office assets) that relate to a cash-generating unit (paragraphs 59-61 of the Exposure Draft and paragraphs 79-81 of the Basis for Conclusions)?
14. Do you agree with the procedures for allocating an impairment loss of a cash-generating unit between the assets of that unit (paragraphs 62-65 of the Exposure Draft and paragraphs 77-78 of the Basis for Conclusions)?

Disclosure

15. Do you agree with the disclosure requirements in paragraphs 79-81 of the Exposure Draft and that an enterprise should not be required to disclose more information, such as the amount of impairment losses that can be reversed in subsequent periods (paragraphs 88-92 of the Basis for Conclusions)?

16. Do you agree with the disclosure requirements in paragraph 82 of the Exposure Draft and that an enterprise should not be required to disclose for each individual asset (or cash-generating unit) for which significant impairment losses have been recognised or reversed during the period:
 - (a) the value in use of the asset (cash-generating unit) if the recoverable amount is based on the net selling price of the asset (cash-generating unit);
 - (b) the net selling price of the asset (cash-generating unit) if the recoverable amount is based on the value in use of the asset (cash-generating unit);
 - (c) if the recoverable amount is based on the value in use of the asset (cash-generating unit):
 - (i) the discount rate(s) used in the calculation; and
 - (ii) the assumed long-term average growth rate for the products, industries, and country or countries in which the enterprise operates or for the market in which the asset (cash-generating unit) is used; and
 - (d) other key assumptions used to determine the recoverable amount of an asset.

(paragraphs 24, 93-95 and 98-99 of the Basis for Conclusions)?

17. Do you agree with the disclosure requirements in paragraphs 83-84 of the Exposure Draft and that an enterprise should not be required to disclose information similar to that proposed in question 16 above for each individual asset (cash-generating unit) for which:
 - (a) recoverable amount has been determined during the period;

- (b) no impairment loss was recognised or reversed during the period;
and
 - (c) a small change in key assumptions could lead to the recognition
or reversal of a significant impairment loss?
- (paragraphs 24 and 96-97 of the Basis for Conclusions)?
- 18. Do you agree with the disclosure requirements in paragraph 85 of the Exposure Draft (paragraphs 24 and 100-101 of the Basis for Conclusions)?
 - 19. Do you agree that an enterprise should not be required to give information on how cash-generating units are determined (paragraphs 102-105 of the Basis for Conclusions)? If you believe that such information should be required, please indicate which details should be required.
 - 20. Should an enterprise be required to disclose any information other than that discussed in questions 15-19 to this Invitation to Comment?

Appendices

- 21. Should any material in Appendix 1 be amended or deleted? Should any further guidance be added to the appendix? (Note: the Board does not intend to publish appendix 3, Basis for Conclusions, with the final Standard.)
- 22. Do you agree with the consequential changes to IAS 16, Property, Plant and Equipment (Appendix 2, Proposed Amendments to Other International Accounting Standards)?

Other Comments

- 23. Do you have any other comments on the proposed International Accounting Standard?

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International Accounting Standard IAS --

Impairment of Assets

The standards, which have been set in bold italic type, should be read in the context of the background material and implementation guidance in this Standard, and in the context of the Preface to International Accounting Standards. International Accounting Standards are not intended to apply to immaterial items (see paragraph 12 of the Preface).

Objective

The objective of this Standard is to prescribe the accounting treatment for an asset that is impaired and the consequences of such an impairment. If an enterprise identifies an indication that an asset is potentially impaired, the Standard requires the enterprise to estimate the recoverable amount of that asset. If the recoverable amount of the asset is less than its carrying amount, the Standard requires the enterprise to recognise an impairment loss. The Standard also specifies when an enterprise should reverse an impairment loss, and it prescribes certain disclosures about impaired assets.

Scope

1. *This Standard should be applied in accounting for the impairment of all assets, other than:*
 - (a) *inventories (see IAS 2, Inventories);*
 - (b) *assets arising from construction contracts (see IAS 11, Construction Contracts);*
 - (c) *deferred tax assets (see IAS 12, Income Taxes);*
 - (d) *financial assets that are included in the scope of IAS 32, Financial Instruments: Disclosure and Presentation; and*
 - (e) *assets arising from employee benefits (see E54, Employee Benefits).*

2. This Standard does not apply to inventories, assets arising from construction contracts, deferred tax assets and assets arising from employee benefits because existing or proposed International Accounting Standards applicable to those assets already contain requirements for recognising and measuring impairment losses.
3. For financial assets that are included in the scope of IAS 32, Financial Instruments: Disclosure and Presentation, accounting requirements for impairment losses will depend on the outcome of the IASC project on accounting for financial instruments. Interests in subsidiaries, as defined in IAS 27, Consolidated Financial Statements and Accounting for Investments in Subsidiaries, interests in associates, as defined in IAS 28, Accounting for Investments in Associates, and interests in joint ventures, as defined in IAS 31, Financial Reporting of Interests in Joint Ventures, are financial assets but are excluded from the scope of IAS 32; therefore, this Standard applies to investments in subsidiaries and associates and interests in joint ventures.
4. When an enterprise applies the allowed alternative treatment for subsequent measurement of intangible assets and property, plant and equipment, IAS --, Intangible Assets¹, and IAS 16, Property, Plant and Equipment, require that revaluations should be made with sufficient regularity such that the carrying amount of a revalued asset does not differ materially from that which would have been determined using fair value at the balance sheet date. Once this requirement has been applied, an enterprise applies the requirements of this Standard to assess whether there is any indication that the recoverable amount of the revalued asset may be less than its carrying amount. If any such indication exists, the enterprise estimates the recoverable amount of the revalued asset in accordance with this Standard. If recoverable amount is less than the carrying amount of the revalued asset, the enterprise adjusts the carrying amount of the

¹ IAS --, Intangible Assets, refers to the future International Accounting Standard on Intangible Assets, for which publication of a second Exposure Draft is expected later in 1997. The IASC published a first Exposure Draft on Intangible Assets (E50) in June 1995. The Board does not intend to change E50's proposals on the revaluation of intangible assets (see E50, paragraphs 62 to 79), except for minor changes.

asset to its recoverable amount in accordance with the requirements in IAS 16² and IAS --, Intangible Assets.

Definitions

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

Recoverable amount *is the higher of an asset's net selling price and its value in use.*

Value in use *is the present value of estimated future cash flows expected to flow from the continuing use of an asset and from its disposal at the end of its useful life.*

Net selling price *is 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 expense.*

An impairment loss *is the amount by which the carrying amount of an asset is reduced to its recoverable amount.*

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

Depreciation (Amortisation) *is the systematic allocation of the depreciable amount of an asset over its useful life³.*

² The Board proposes to amend IAS 16 and E50 to clarify the relationship between the proposed Exposure Draft on Impairment of Assets and the current (proposed) requirements to revalue an asset to its fair value (see Appendix 2 of this Exposure Draft).

³ In the case of an intangible asset (including goodwill), the term 'amortisation' is generally used instead of 'depreciation'. Both terms have the same meaning.

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

Useful life is either:

- (a) the period of time over which an asset is expected to be used by the enterprise; or
- (b) the number of production or similar units expected to be obtained from the asset by the enterprise.

A **cash-generating unit** is the smallest identifiable group of assets that generates cash inflows from use that are largely independent of the cash inflows from other assets or groups of assets.

Identifying a Potentially Impaired Asset

6. An asset is impaired when an impairment loss needs to be recognised in the financial statements because the carrying amount of the asset exceeds its recoverable amount. Paragraphs 7 to 12 describe the indications that an impairment loss may have occurred: if any of those indications are present, an enterprise is required to make a formal estimate of recoverable amount. If no indications of a potential impairment loss are present, there is little risk that an impairment loss has occurred and, consequently, there is no need to make a formal estimate of recoverable amount.
7. *An enterprise should perform a review at each balance sheet date to assess whether there is any indication that an asset may be impaired. If any such indication exists, the enterprise should estimate the recoverable amount of the asset.*
8. *In identifying whether an asset may be impaired, an enterprise should consider, as a minimum, the following indications:*

External sources of information

- (a) *during the period, an asset's market value has declined significantly more than would be expected as a result of the normal process of depreciation (amortisation);*
- (b) *significant adverse changes 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 enterprise operates or for 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 decrease materially the asset's recoverable amount;*

Internal sources of information

- (d) evidence is available of obsolescence or physical damage;*
- (e) significant adverse changes 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;*
- (f) evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected; and*

Assets for which the last estimate of recoverable amount was the asset's value in use

- (g) actual cash flows are materially less than those previously estimated, before any effect of discounting.*
9. The list in paragraph 8 is not exhaustive, and an enterprise may identify other indications that an asset is potentially impaired that may justify the determination of the recoverable amount.
 10. In using information from external sources or internal reporting, an enterprise considers whether the information is reliable. Examples of factors to assess are whether or not an enterprise usually sets aggressive targets, how frequently budgets or forecasts are updated and whether budgets and forecasts are an objective and reliable basis for comparisons.
 11. Evidence from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected includes:
 - (a) costs of acquiring the asset, or subsequent needs for its funding (if any), that are significantly higher than those originally expected;
 - (b) a significantly worse outcome for actual net cash flows or operating profit or loss flowing from the asset compared to the budgeted level;
 - (c) a significant decline in budgeted net cash flows or operating profit or a significant increase in loss flowing from the asset; or

- (d) the existence of operating losses or net cash outflows for the asset when current-period figures are aggregated with either past figures or budgeted figures.
12. 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 enterprise need not re-estimate the asset's recoverable amount if no events have occurred that would eliminate that difference.

Measurement of Recoverable Amount

13. It is not always necessary to determine both an asset's net selling price and its value in use to determine the asset's recoverable amount. For example, 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. Similarly, if there is no reason to believe that the asset's value in use materially exceeds its net selling price, the asset's recoverable amount is its net selling price. This may be the case when an asset is held for disposal and the sale is imminent: the asset's value in use is likely to be close to its net selling price, because the value in use will consist mainly of the net amount to be received for the disposal of the asset.
14. Sometimes it will not be possible to determine net selling price, for example, if there is no basis for determining the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable and willing parties. In this case, the recoverable amount of the asset may be taken to be its value in use. The absence of an active market does not necessarily mean that net selling price cannot be determined for an asset.
15. Paragraphs 46 to 54 explain how to determine the recoverable amount of an asset that does not generate cash inflows that are largely independent of those from other assets.
16. Sometimes, the disposal of an asset would require the buyer to take over a liability, and only a single net selling price or a single net cash inflow is available for both the asset and the liability. Paragraphs 51 to 53 explain how to determine the recoverable amount of an asset in such cases.

Net Selling Price

17. If an asset is traded in an active market, the asset's market price, adjusted for incremental costs that would be directly attributable to its disposal, provides the best evidence of net selling price. 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 net selling price, provided that there has not been a significant change in economic circumstances between the transaction date and the date at which the estimate is made.

18. If no active market exists for the asset, net selling price is determined based on the best information available in the circumstances in order to reflect the amount that an enterprise could obtain, at the date of the estimate, for the disposal of the asset through an arm's length transaction between knowledgeable, willing parties, less the costs of disposal.
19. Costs of disposal are deducted in determining net selling price. Examples of costs of disposal are legal costs, stamp duty and similar transaction taxes and costs of removing the asset.
20. *The costs of disposal of an asset should not include:*
 - (a) *costs that have already been recognised as liabilities; and*
 - (b) *restructuring or reorganisation costs.*
21. Even when an enterprise intends to incur restructuring or reorganisation costs if it disposes of an asset, those restructuring or reorganisation costs are not costs of disposal. Those costs are recognised as a liability if, and only if, that is required by other International Accounting Standards.

Value in Use

22. 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.

In some cases, estimates, averages and computational shortcuts may provide a reasonable approximation of the detailed computations illustrated in this Standard.

Basis for Estimates of Future Cash Flows**23. *In measuring value in use:***

- (a) cash flow projections should be based on reasonable and supportable assumptions that represent management's best estimate of the probable set of economic conditions that will exist over the remaining useful life of the asset. Greater weight should be given to evidence that can be verified objectively;*
 - (b) short-term cash flow projections should be based on the most recent financial budgets/forecasts that have been approved by management with an appropriate degree of authority. Short-term projections should cover a maximum period of five years unless a longer period can be justified; and*
 - (c) long-term cash flow projections should be based on extrapolation from the short-term projections using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified. This growth rate should not exceed the long-term average growth rate for the products, industries, or country or countries in which the enterprise operates or for the market in which the asset is used, unless a higher rate can be justified.*
24. When formulating the assumptions, an enterprise considers economic conditions and trends prevailing at the balance sheet date.
25. Detailed, explicit and reliable forecasts of future cash flows for periods longer than five years are generally not available. For that reason, management's estimates of future cash flows are used for a maximum period of five years, unless management can demonstrate its ability to forecast cash flows accurately over longer periods. In such a case, disclosure is required by paragraphs 82 and 83.
26. Economic benefits to be received until the end of an asset's useful life are estimated by extrapolating the management's short-term cash flow projections, using a growth rate for subsequent years. This long-term rate is normally steady or declining, unless an increase in the rate matches objective information about patterns over a product life cycle. If an enterprise can justify the use of an increasing growth rate, appropriate disclosure is required by paragraphs 82 and 83.

27. The long-term growth rate does not normally exceed the average growth rate (over, say, twenty years) for the products, industries, or country or countries in which the enterprise operates or for the market in which the asset is used. Enterprises will have difficulty in exceeding the average over the long term because, where conditions are very favourable, competitors are likely to enter the market and restrict growth. If an enterprise can justify the use of a higher rate than the average long-term rate, appropriate disclosure is required by paragraphs 82 and 83.

Composition of Estimates of Future Cash Flows

28. *Estimates of future cash flows should 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 that 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.*
29. As far as possible, estimates of cash inflows reflect only cash inflows relating to the asset that was initially recognised (or the remaining portion of that asset if part of it has been already consumed or sold). This avoids including in the asset's value in use cash inflows flowing from internally generated goodwill or from other assets. IAS --, Intangible Assets, prohibits the recognition of internally generated goodwill as an asset⁴. However, if operations become fully integrated and information systems are merged, or if the asset has been modified, it is sometimes impossible to distinguish cash inflows relating to the asset that was initially recognised. In this case, future cash inflows from the asset in its current condition are used, whether or not those future cash inflows flow from the asset that was initially recognised or from its subsequent enhancement or modification.

⁴ In preparing a revised Exposure Draft on Intangible Assets, the Board intends to propose to keep E50's proposal that internally generated goodwill should not be recognised as an asset (see E50, paragraphs 36 to 39).

When an enterprise can no longer identify the cash inflows relating to the asset that was initially recognised, it is likely that the enterprise will have to determine the recoverable amount not for the individual asset but for the cash-generating unit to which the asset belongs (see paragraphs 46 to 61).

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.

The enterprise considers only those cash inflows generated by the remaining 8,000 (10,000 less 2,000) customers from the list acquired. However, if cash inflows from those customers cannot be distinguished from cash inflows from new customers, the value in use of the customer list is based on cash inflows generated by all 11,000 customers (8,000 plus 3,000).

30. Projections of cash outflows include overhead costs that can be attributed, or allocated on a reasonable and consistent basis, to the use of the asset.
31. When the carrying amount of an asset does not yet include all the costs to be incurred before the asset is ready for use or sale, the estimate of cash outflows includes an estimate of any further cost 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.
32. *Estimates of future cash flows should not include:*
 - (a) *cash outflows that will be required to settle obligations that have already been recognised as liabilities;*
 - (b) *cash inflows or outflows from financing activities; and*
 - (c) *income tax receipts or payments.*

33. To avoid double-counting, estimates of cash outflows do not include cash outflows that will be required to settle obligations that have already been recognised as liabilities. Also, 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. 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 doubled-counted or ignored. Therefore, because the discount rate is determined on a pre-tax basis, future cash flows are also estimated on a pre-tax basis.
34. ***The estimate of net cash flows to be received (or paid) for the disposal of an asset at the end of its useful life should be the amount that an enterprise 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.***
35. 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 net selling price, except that, in estimating those net cash flows:
- (a) an enterprise uses prices prevailing at the date of the estimate for similar assets that have reached the end of the asset's estimated useful life and that have operated under conditions similar to those in which the asset will be used; and
 - (b) those prices are adjusted for the effect of both future price increases due to general inflation and specific future price increases (decreases). However, if estimates of future cash flows from the asset's continuing use and the discount rate exclude the effect of general inflation, this effect is also excluded from the estimate of net cash flows on disposal.

Discount Rate

36. ***The discount rate (or rates) should be a pre-tax market-determined rate (or rates) that reflects current assessments of the time value of money and the risks specific to the asset.***

37. A market-determined rate that reflects current assessments of the time value of money and the risks specific to the asset for periods up until the end of the asset's useful life is the return that investors would require if they were to choose an investment of equal risk and duration as an alternative to operating the asset.
38. A current risk-adjusted discount rate usually encompasses all of the following factors:
- (a) the time value of money;
 - (b) price increases due to general inflation, if this factor is also taken into account in estimating the future cash flows; and
 - (c) specific risks associated with the particular asset under review such as country risk, currency risk, price risk, etc.
39. The discount rate is independent of the enterprise's capital structure because the return required on an enterprise's assets does not depend on the way in which the enterprise finances the asset. For that reason, an enterprise does not use a rate that considers a specific type of financing for the asset nor does it use the enterprise's incremental borrowing rate. When an enterprise is not able to determine the asset-specific discount rate, the enterprise may use, as a surrogate, the weighted average cost of capital (excluding tax and financing effects) of an enterprise that has a single asset (or a portfolio of assets) similar in terms of service potential and risks, to the asset under review. If no such information is available the enterprise's weighted average cost of capital determined using techniques such as the Capital Asset Pricing Model, although not an appropriate discount rate, may provide a useful starting point before adjustment for the particular risks associated with the asset.
40. An enterprise normally uses a single discount rate for the estimate of an asset's value in use. However, an enterprise uses separate discount rates for different future periods where consideration of different risks and the term structure of interest rates have a material effect on the estimate of value in use.

Recognition and Measurement of Impairment Losses

41. *If the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount. That reduction is an impairment loss and should be recognised as an expense immediately in the income statement⁵.*
42. *When the amount estimated for the impairment loss is greater than the carrying amount of the asset, an enterprise should recognise a liability if, and only if, that is required by other International Accounting Standards.*
43. *After the recognition of an impairment loss, the depreciation (amortisation) charge for the asset should 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 depreciation (amortisation) period.*
44. The recognition of an impairment loss for an asset might also indicate that the residual value, the remaining depreciation (amortisation) period or the depreciation (amortisation) method for the asset need to be reviewed in accordance with the International Accounting Standard applicable to the asset.
45. If an impairment loss is recognised, any related deferred tax assets or liabilities are determined in accordance with IAS 12, Income Taxes, by comparing the revised carrying amount of the asset with its tax base.

⁵ If an asset is carried on a revalued basis in accordance with the allowed alternative treatment of IAS 16, Property, Plant and Equipment, or IAS --, Intangible Assets, any decrease in the revalued asset's carrying amount is treated as a revaluation decrease (see paragraphs 57 to 60 of Appendix 2). This is true even if part or all of that decrease arises because the recoverable amount of the asset has fallen below its fair value.

Cash-Generating Units

46. *The recoverable amount of each asset should be estimated individually. If it is not possible to estimate the recoverable amount of an asset individually, an enterprise should determine the recoverable amount of the asset's cash-generating unit.*
47. In some cases, an 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. To measure an impairment loss of a cash-generating unit, an enterprise applies the requirements and guidance in paragraphs 13 to 45 and the additional requirements and guidance in paragraphs 48 to 65.

Example

A mining enterprise owns a private railway to support its mining activities. The private railway could only be sold for scrap value and cash inflows from using the private railway cannot be identified separately from all of the operations directly connected with the mine.

It is not possible to estimate the recoverable amount of the private railway because the value in use of the private railway alone cannot be determined. Therefore, the enterprise estimates the recoverable amount of the cash-generating unit to which the private railway belongs, that is, the mine as a whole.

Identification, Carrying Amount and Recoverable Amount of an Asset's Cash-Generating Unit

48. An asset's cash-generating unit is determined by identifying the smallest group of assets that includes the asset under review and that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

Example

An enterprise operates a bus company that 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 enterprise 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 cash inflows generated by the five routes altogether. The cash-generating unit for each route is the bus company as a whole.

49. *The carrying amount of an asset's cash-generating unit should include the carrying amount of all assets that can be directly attributed, or allocated on a reasonable and consistent basis, to the asset's cash-generating unit.*
50. The carrying amount of an asset's cash-generating unit includes only the carrying amount of the assets that generate the estimated future cash flows. In some cases, the carrying amount of certain assets, although they contribute to the estimated future cash flows of the asset's cash-generating unit, cannot be allocated to the cash-generating units on a reasonable and consistent basis. This might be the case, for example for goodwill or other corporate assets such as head office assets. Paragraphs 59 to 61 indicate how to test such assets for impairment.

51. *The carrying amount of an asset's cash-generating unit should be determined after deducting the carrying amount of a liability if, and only if, the recoverable amount of the asset's cash-generating unit cannot be determined without consideration of this liability.*
52. Because the recoverable amount of an asset's cash-generating unit is determined without considering costs, or estimates of future cash outflows, that have already been recognised as liabilities, the asset's cash-generating unit does not include the carrying amount of liabilities.
53. However, sometimes, it may be necessary to consider certain liabilities in order to determine the recoverable amount of an asset's cash-generating unit. This may occur if the sale of a cash-generating unit would require the buyer to take over a liability. In this circumstance, the net selling price (or the estimated cash flow from ultimate disposal) of the cash-generating unit is the estimated selling price of the assets of the cash-generating unit and the liability together, less the costs of disposal of the cash-generating unit. In order to perform a meaningful comparison between the carrying amount of the cash-generating unit and its recoverable amount, the carrying amount of the liability, at the date of the estimate, is deducted in determining the carrying amount of the cash-generating unit. If the enterprise had not previously recognised that liability in its financial statements, the liability's carrying amount is nil and the carrying amount of the cash-generating unit is not adjusted.

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. In accordance with the proposals included in the Draft Statement of Principles on Provisions and Contingencies, 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 enterprise is testing the recoverability of the carrying amount of the mine, which is 1,000. The enterprise has received various offers to buy the mine with a proposed purchase price of around 800; this price encompasses the fact that the buyer will take over the obligation to restore the overburden. Incremental disposal costs for the mine are negligible. The present value of the estimated future cash flows (before restoration costs) if the enterprise operates the mine is approximately 1,200. The carrying amount of the provision for restoration costs is 500, which is equal to the present value of the restoration costs.

The net selling price for the mine is 800. The value in use for the mine is 700, which is the present value of estimated future cash flows from continuing use of the mine (1,200) less the present value of the restoration costs that will be incurred on the ultimate disposal of the mine (500). The carrying amount of the mine (the cash-generating unit) is 500, which is the carrying amount of the mine (1,000) less the carrying amount of the provision for restoration costs (500).

54. Once the enterprise has identified all the items to be included in the asset's cash-generating unit, the enterprise determines the recoverable amount of that unit (the higher of the cash-generating unit's net selling price and its value in use) in accordance with paragraphs 13 to 40.

Impairment Losses for a Cash-Generating Unit

55. *An impairment loss should be recognised for a cash-generating unit if, and only if, its recoverable amount is less than the aggregate of the carrying amounts of all the items of that unit.*
56. *If the recoverable amount of an asset cannot be determined individually, an impairment loss should be recognised for that asset if, and only if, an impairment loss is recognised for the asset's cash-generating unit.*
57. Consistently with the requirement to measure the recoverable amount of an asset as the higher of its net selling price and its value in use, an impairment loss is recognised for an asset whose recoverable amount can be assessed only for that asset's cash-generating unit if, and only if, both the net selling price of the asset and the recoverable amount of the asset's cash-generating unit are below their respective carrying amounts.

Example

The net selling price of the land on which a petrol station stands is lower than its carrying amount.

The land does not generate cash flows that are independent of the cash flows generated by the petrol station as a whole. Therefore, the cash-generating unit for the land is the petrol station. An impairment loss will be recognised for that land if, and only if, the recoverable amount of the petrol station (the cash-generating unit) is less than its carrying amount.

58. If an asset's value in use can be assessed independently of the value in use of other assets, the asset's cash-generating unit only includes the asset under review. This is the case for assets to be disposed of since, in most cases, their value in use can be assessed independently from other assets. This is because the value in use of such an asset consists mainly of the estimate of the net cash flows to be received (or paid) for the disposal of the asset.

Example

A machine has suffered physical damage but is still working, although not as well as it used to. The net selling price of the machine is less than its carrying amount. The value in use of the machine alone cannot be determined independently of the value in use of other assets. 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 value in use of the production line shows that the production line taken as a whole is not impaired.

Assumption 1: the enterprise has no intention to replace that machine.

The cash-generating unit for the machine is the production line: the value in use of the asset cannot be assessed independently of the value in use of the production line. The production line's value in use has not fallen below carrying amount, therefore, no impairment loss is recognised for the machine. Nevertheless, the enterprise may need to re-assess 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 consumed by the enterprise.

Assumption 2: the enterprise will replace the machine and sell it.

The machine's cash-generating unit is the machine itself: the recoverable amount of the machine can now be assessed independently. It is likely that the value in use of the machine is close to its net selling price, since the future cash flows from the continuing use of the machine can reasonably be assumed to be close to nil. Since the machine's net selling price is less than its carrying amount, an impairment loss is recognised.

Goodwill and Other Corporate Assets

59. *In some cases, there exists goodwill (or other corporate assets) that relates to an asset's cash-generating unit. In determining whether the cash-generating unit is impaired:*

- (a) an enterprise should first perform a 'bottom-up' test: the enterprise should identify any portion of the carrying amount of goodwill (or other corporate assets) that can be allocated on a reasonable and consistent basis to the asset's cash-generating unit. The enterprise should then determine the recoverable amount of the asset's cash-generating unit. If the recoverable amount of the asset's cash-generating unit is less than its carrying amount (including the carrying amount of allocated goodwill or other corporate assets, if any), an impairment loss is recognised for that cash-generating unit; and***
- (b) secondly, if there exists no reasonable and consistent basis for allocating all or part of the goodwill (or other corporate assets) to the asset's cash-generating unit, the enterprise should also perform a 'top-down' test: the enterprise should identify the smallest cash-generating unit to which the unallocated goodwill (or other corporate assets) can be allocated on a reasonable and consistent basis, and which includes the asset's cash-generating unit. The enterprise should then determine the recoverable amount of that cash-generating unit. If the recoverable amount of that cash-generating unit is less than its carrying amount (including the carrying amount of allocated goodwill or other corporate assets), the enterprise recognises an impairment loss for that cash-generating unit.***

60. Where assets are grouped for recoverability assessments, it is important to include all assets that generate the relevant stream of economic benefits in that group. Otherwise, the net carrying amount of the asset's cash-generating unit may appear to be fully recoverable when in fact an impairment loss has occurred. Because goodwill represents unidentifiable assets that generate future economic benefits, it is difficult to identify cash-generating units to which the goodwill relates, unless the cash-generating unit represents the same business unit that was acquired when the goodwill was recognised. Similarly, it may be difficult to apportion other corporate assets, such

as head office assets, to cash-generating units on a reasonable and consistent basis. In order to ensure that goodwill and other corporate assets will be tested with the appropriate cash-generating unit, an enterprise applies, depending on the circumstances described in paragraph 59, either the 'bottom-up' test only or both the 'bottom-up' and 'top-down' tests. Applying the 'top-down' test often means that an enterprise tests the recoverable amount of a whole business.

61. If goodwill (or other corporate assets) can be allocated on a reasonable and consistent basis to an asset's cash-generating unit, the enterprise performs the 'bottom-up' test only. If all or part of the goodwill (or other corporate assets) cannot be allocated on a reasonable and consistent basis to an asset's cash-generating unit, the enterprise performs first the 'bottom-up' test and then the 'top-down' test. The 'bottom-up' test ensures that, if need be, any impairment loss is recognised for an asset's cash-generating unit (excluding consideration of goodwill or other corporate assets); the 'top-down' test ensures that, if need be, any impairment loss is then recognised for the unallocated goodwill (or other corporate assets) that relates to an asset's cash-generating unit. In fact, by applying the 'bottom-up' test first, if an impairment loss exists for the cash-generating unit identified by the 'top-down' test, that impairment loss clearly relates only to the unallocated goodwill (or other corporate assets) of that unit.

Allocation of an Impairment Loss Within a Cash-Generating Unit

62. *If an impairment loss is recognised for a cash-generating unit, the impairment loss should be allocated between all assets of the cash-generating unit in the following order:*
 - (a) *first, to the goodwill allocated to the cash-generating unit (if any);*
 - (b) *secondly, to any intangible asset for which no active market exists as defined in IAS --, Intangible Assets⁶;*

⁶ The Board intends that the revised Exposure Draft on Intangible Assets will include a definition of an 'active market'. That definition will be similar to the definition of an 'active secondary market' in paragraph 65 of E50, Intangible Assets.

- (c) *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 to which the impairment loss is allocated.*
63. An impairment loss of a cash-generating unit is allocated, in priority, to the assets that have the most subjective values. The goodwill allocated to a cash-generating unit is reduced before reducing the carrying amount of the other assets because there can no longer remain any future economic benefits embodied in the unidentifiable assets related to the cash-generating unit. Also, it is likely that intangible assets for which there is no active market are similar to goodwill. Therefore, the carrying amount of those assets is reduced before other assets.
64. If the net selling price of an asset is less than its carrying amount, this provides a reasonable basis for allocating part of the impairment loss to that asset rather than to other assets.
65. *In allocating an impairment loss in accordance with paragraph 62, the carrying amount of an asset should not be reduced below the asset's net selling price or, if there is no net selling price for that asset, below zero. The excess amount of the impairment loss that would otherwise have been allocated to such an asset should be allocated:*
- (a) *first, to assets whose net selling price is less than their carrying amount, on a pro rata basis based on their carrying amount; and*
 - (b) *then, to the other assets of the cash-generating unit on a pro rata basis based on the carrying amount of each asset in the unit to which the excess amount of impairment loss is allocated.*

Example

At 1 January, an enterprise acquired for 1,000 a company whose main activity consists of fishing. The acquired company owns two boats and a fishing licence without which it could not operate. The net selling prices at 1 January of each boat and of the fishing licence are 300. The company has no insurance cover.

At 1 February, one boat sinks. Because of its reduced capacity, the enterprise estimates the value in use of the business at 650. Amortisation and depreciation at 1 February are negligible and, to keep this example simple, the tax effects are not considered.

At 1 February, the enterprise recognises an impairment loss for 350 (1,000 less 650) as follows:

	<i>1 January</i>	<i>Impairment loss</i>	<i>1 February</i>
<i>Goodwill</i>	<i>100</i>	<i>(50)</i>	<i>50</i>
<i>Intangible assets</i>	<i>300</i>	<i>-</i>	<i>300</i>
<i>Equipment</i>	<i><u>600</u></i>	<i><u>(300)</u></i>	<i><u>300</u></i>
<i>Total</i>	<i><u>1,000</u></i>	<i><u>(350)</u></i>	<i><u>650</u></i>

An impairment loss of 300 is recognised first for the boat that sank because its recoverable amount can be assessed individually (it no longer forms part of the cash-generating unit that was formed by the two boats and the licence). The remaining impairment loss (50) is attributed to goodwill.

At 15 February, a survey reveals that the fish population has declined by 23% because of over-fishing. The enterprise re-determines the value in use of the business as 500. Also, the net selling price for the fishing licence decreases to 230 (the market anticipates that the government will decrease the quota attached to the licence). The boat's net selling price has not changed.

At 15 February, the enterprise recognises a further impairment loss of 120 as follows:

	<i>1 February</i>	<i>Impairment loss</i>	<i>15 February</i>
<i>Goodwill</i>	<i>50</i>	<i>(50)</i>	<i>-</i>
<i>Intangible assets</i>	<i>300</i>	<i>(70)</i>	<i>230</i>
<i>Equipment</i>	<u><i>300</i></u>	<u><i>-</i></u>	<u><i>300</i></u>
<i>Total</i>	<u><i>650</i></u>	<u><i>(120)</i></u>	<u><i>530</i></u>

Although the value in use of the business (500) is lower than the sum of the individual assets' net selling prices (530), carrying amounts of the fishing licence and the remaining boat are not decreased below their net selling price.

Subsequent Review of an Impaired Asset

66. Once an enterprise has recognised an impairment loss for an asset, the enterprise makes a new estimate of the recoverable amount of that asset in later years if there is an indication that the asset may be further impaired, or if there is an indication that the impairment loss recognised in prior years may have decreased. To determine whether an asset may be further impaired the enterprise applies the requirements in paragraphs 7 and 8.
67. *An enterprise should perform a review at each balance sheet date to assess whether there is any indication that an impairment loss recognised for an asset in prior years may no longer exist or may have decreased. If any such indication exists, the enterprise should estimate the recoverable amount of that asset.*
68. *In identifying whether an impairment loss recognised for an asset in prior years may no longer exist or may have decreased, an enterprise should consider, as a minimum, the following indications:*

External sources of information

- (a) *the asset's market value has increased significantly during the period;*
- (b) *significant favourable changes 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 enterprise operates or for 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 increase materially the asset's recoverable amount;*

Internal sources of information

- (d) *significant favourable changes 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;*
- (e) *evidence is available from internal reporting that indicates that the economic performance of the asset is, or will be, better than expected; and*

Assets for which the last estimate of recoverable amount was the asset's value in use

- (f) *actual cash flows are materially above those previously estimated, before any effect of discounting.*

69. Indications of a potential decrease in an impairment loss in paragraph 68 mirror the indications of a potential impairment loss in paragraph 8.

Reversals of Impairment Losses

70. *The carrying amount of an asset for which an impairment loss has been recognised in prior years should be increased to its recoverable amount 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. That increase is a reversal of an impairment loss and should be recognised as income immediately in the income statement⁷.*
71. *The increased carrying amount of the asset should 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.*

⁷ If an asset is carried on a revalued basis in accordance with the allowed alternative treatment of IAS 16, Property, Plant and Equipment, or IAS --, Intangible Assets, any increase in the revalued asset's carrying amount is treated as a revaluation increase (see paragraphs 57 to 60 of Appendix 2).

72. A reversal of an impairment loss reflects an increase in the estimated service potential of an asset, either from use or sale, since the date when an enterprise last recognised an impairment loss for that asset. This requires an enterprise to identify the change in estimates that causes the increase in estimated service potential. This might be, for example, an increase in market prices, an increase in estimated cash flows (before any effect of discounting) or a decrease in the discount rate for the asset (see Appendix 1, Example 3, for an illustration of a reversal of an impairment loss).
73. An impairment loss is not reversed when there has been no change in the estimates that were used to measure the last impairment loss. For example, if recoverable amount was the asset's value in use: if actual cash flows and the new estimates of future cash flows do not differ materially from those estimated previously (before any effect of discounting) and if the asset's discount rate has not changed, an impairment loss is not reversed, even if the asset's value in use is higher than its carrying amount. This is because the service potential of the asset is not better than expected: the difference between the asset's recoverable amount and its carrying amount is due to the 'unwinding' of the discount with the passage of time.
74. *After the reversal of an impairment loss, the depreciation (amortisation) charge for an asset should 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 depreciation (amortisation) period.*
75. The reversal of an impairment loss might also indicate that the residual value, the depreciation (amortisation) period or the depreciation (amortisation) method need to be reviewed in accordance with the International Accounting Standard applicable to the asset.
76. Any increase in the carrying amount above the depreciated (amortised) historical cost of the asset is a revaluation and is accounted for in accordance with the International Accounting Standard applicable to the asset.

77. *As an exception to the requirement in paragraph 70, an impairment loss recognised for goodwill and other intangible assets for which no active market exists should be reversed in a subsequent period if, and only if, the specific external event that caused the recognition of the impairment loss has reversed.*
78. IAS --, Intangible Assets, prohibits the recognition of internally generated goodwill⁸. Any subsequent increase in the recoverable amount of goodwill, or other intangible assets for which no active market exists (see definition of an active market in IAS --, Intangible Assets⁹), is likely to be an increase in internally generated goodwill. Consequently, an impairment loss recognised on such assets is reversed in a subsequent period if, and only if, the enterprise can demonstrate clearly that the impairment loss was caused by a specific external event and the event has reversed.

⁸ Refer to footnote 4.

⁹ Refer to footnote 6.

Disclosure

79. For each class of assets, the financial statements should disclose:

- (a) impairment losses recognised during the period and the line item(s) of the income statement in which those impairment losses are included; and*
- (b) reversals of impairment losses recognised during the period and the line item(s) of the income statement in which those impairment losses are reversed.*

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

81. The information required in paragraph 79 can be presented with other information disclosed for the class of assets. For example, information required in paragraph 79 may be included in a table that shows the reconciliation of the carrying amount of property, plant and equipment, at the beginning and end of the period in accordance with IAS 16.

82. For each individual asset, or cash-generating unit, for which significant impairment losses have been recognised or reversed during the period, the financial statements should disclose:

- (a) the nature of the asset (cash-generating unit), its carrying amount and the reportable segment (as defined in IAS 14, Segment Reporting) to which it belongs;*
- (b) the amount of impairment loss that has been recognised or reversed during the period for the asset (cash-generating unit) and the events and circumstances that lead to its recognition or reversal;*
- (c) whether the recoverable amount of the asset (cash-generating unit) is its net selling price or its value in use; and*
- (d) where the recoverable amount is based on the value in use of the asset (cash-generating unit):*
 - (i) the period over which management's projections of short-term future cash flows have been used if that period is more than five years, and the justification for using that period;*

- (ii) *the rate used to extrapolate management's short-term projections, and the justification for using that rate, if that rate is increasing or exceeds the long-term average growth rate for the products, industries, and country or countries in which the enterprise operates or for the market to which the asset (cash-generating unit) is dedicated; and*
 - (iii) *the fact that value in use significantly exceeds net selling price (if this is the case).*
- 83. *If an asset's (cash-generating unit's) value in use has been determined during the period and no impairment loss was recognised or reversed during the period for that asset (cash-generating unit), the financial statements should disclose the following information:*
 - (a) *the period over which management's projections of short-term future cash flows have been used if that period is more than five years, and the justification for using that period;*
 - (b) *the rate used to extrapolate management's short-term projections, and the justification for using that rate, if that rate is increasing or exceeds the long-term average growth rate for the products, industries, and country or countries in which the enterprise operates or for the market to which the asset (cash-generating unit) is dedicated; and*
 - (c) *the fact that carrying amount significantly exceeds the asset's net selling price (if this is the case).*
- 84. An enterprise is encouraged to disclose any key assumptions used to determine an asset's (cash-generating unit's) recoverable amount, especially if a small change in those key assumptions could lead to the recognition or reversal of a significant impairment loss for that asset (cash-generating unit).
- 85. *If an asset's recoverable amount is its value in use, an enterprise should compare in each subsequent period the actual cash flows with the estimates that were made, before any effect of discounting, when value in use was last determined. If the actual cash flows are materially less than (greater than) those estimates, the enterprise should re-estimate the value in use that was last determined using*

actual cash flows but leaving all the other assumptions unchanged. If the use of actual cash flows in previous periods would have required the recognition or the reversal of an impairment loss in those periods, an enterprise should disclose:

- (a) the amount of the impairment loss that would have been recognised or reversed if actual cash flows had been used in the estimate of value in use in prior years;*
- (b) the amount of any impairment loss that has been recognised or reversed for the asset during the current period; and*
- (c) the nature of the changes in assumptions that explain why the amounts disclosed in accordance with (a) and (b) above differ (if this is the case).*

Effective Date

- 86.** *This International Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 January 1999. If an enterprise applies this Standard for financial statements covering periods beginning before 1 January 1999, the enterprise should disclose that fact.*

Appendix 1

Illustrative Examples

The appendix is illustrative only and does not form part of the standards. The purpose of the appendix is to illustrate the application of the standards to assist in clarifying their meaning.

All the examples in this appendix assume the enterprises concerned have no transactions other than those described.

Example 1: Calculation of Value in Use and Recognition of an Impairment Loss (Group of Assets)

In this example, ignore tax effects.

Background

At beginning of Year 1, Company T acquires Company M. Company M has manufacturing factories in 3 countries. The total purchase price paid by T for M is 10,000. A 15-year life is anticipated for the resulting merged activities. Data relevant to the acquisition is as follows:

<u>Beginning of Year 1</u>	<i>Allocation of purchase price</i>	<i>Fair value of identifiable assets</i>	<i>Goodwill</i>
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
Totals	10,000	7,000	3,000

T uses straight-line depreciation and amortisation for the Country A group of assets over a 15-year life and no residual value is anticipated.

In Year 4, a new political party is elected into office in Country A. It passes legislation significantly restricting exports of Company T's major

manufactured product. As a result, and for the foreseeable future, production of T's product must be cut by 40%.

The significant export restriction and the resulting production decrease require Company T to estimate the recoverable amount of the goodwill and net assets of the Country A operations. The cash-generating unit for the goodwill and the identifiable assets of the Country A operations is the Country A operations, since no independent cash inflows can be identified for individual assets.

The Country A cash-generating unit's net selling price is not available and is assumed to be zero, as it is unlikely that a ready buyer exists for all the assets of that unit.

Recognition and Measurement of an Impairment Loss

To determine the value in use for the Country A cash-generating unit, T prepares revised cash flow forecasts for the next five years (Years 5-9) and estimates subsequent cash flows (Years 10-15) based on declining growth rates. The growth rate for Year 10 is estimated to be 3%. This rate is lower than the average long-term growth rate for the market in Country A. T selects a 15% discount rate, which represents the pre-tax current market-determined rate that reflects the time value of money and the risks specific to the Country A operations. The management-approved cash flow projections are provided in Schedule 1.

The recoverable amount of the Country A cash-generating unit is 1,361: the higher of the Country A cash-generating unit's net selling price (0) and its value in use (1,361).

Company T compares the Country A cash-generating unit's recoverable amount with its carrying amount (see Schedule 2).

Company T recognises an impairment loss of 839 (2,200 less 1,361) immediately in the income statement for the Country A cash-generating unit. The carrying amount of the goodwill related to the Country A operations is eliminated before reducing the carrying amount of other identifiable assets within the Country A cash-generating unit (see paragraph 62 of the Standard).

Tax effects are accounted for separately in accordance with IAS 12, Income Taxes (see Example 2A).

Schedule 1. Calculation at the end of Year 4 of value in use for the Country A cash-generating unit

<i>Year</i>	<i>Long-term growth rates</i>	<i>Future cash flows (from revised forecast)</i>	<i>Present value factor at 15% discount rate⁽³⁾</i>	<i>Discounted future cash flows</i>
5 (n=1)		230 ⁽¹⁾	0.86957	200
6		253 ⁽¹⁾	0.75614	191
7		273 ⁽¹⁾	0.65752	180
8		290 ⁽¹⁾	0.57175	166
9		304 ⁽¹⁾	0.49718	151
10	3%	313 ⁽²⁾	0.43233	135
11	-2%	307 ⁽²⁾	0.37594	115
12	-6%	289 ⁽²⁾	0.32690	94
13	-15%	245 ⁽²⁾	0.28426	70
14	-25%	184 ⁽²⁾	0.24719	45
15	-67%	61 ⁽²⁾	0.21494	13
Value in use				1,361

(1) Amount based on management's best estimate of net cash flow projections.

(2) Amount based on an extrapolation from preceding year net cash flow using declining growth rates.

(3) The present value factor is calculated as $k = 1/(1+a)^n$, where a = discount rate and n = period of discount.

Schedule 2. Calculation and allocation of the impairment loss for the Country A cash-generating unit

<i>End of Year 4</i>	<i>Goodwill</i>	<i>Identifiable assets</i>	<i>Total</i>
Historical cost	1,000	2,000	3,000
Accumulated depreciation/ amortisation (Years 1-4)	(267)	(533)	(800)
Carrying amount	733	1,467	2,200
Impairment Loss	(733)	(106)	(839)
Carrying amount after impairment loss	0	1,361	1,361

Example 2 - Deferred Tax Effects of the Recognition of an Impairment Loss

Example 2A - Deferred Tax Effects of the Recognition of an Impairment Loss on a Group of Assets

Use the data for Company T as presented in Example 1, with supplementary information as provided in this example.

At the end of Year 4, the tax base for the identifiable assets of the Country A operations is 1,100. Impairment loss is not deductible for tax purposes. The tax rate is 40%.

The recognition of an impairment loss on the identifiable assets of the Country A operations reduces the taxable temporary difference related to those identifiable assets. The deferred tax liability is reduced accordingly.

In accordance with IAS 12, Income Taxes, no deferred tax related to the goodwill was recognised initially. Therefore, the impairment loss relating to the goodwill does not give rise to a deferred tax adjustment.

<i>End of Year 4</i>	<i>Identifiable assets before impairment loss</i>	<i>Impairment loss</i>	<i>Identifiable assets after impairment loss</i>
Carrying amount (Example 1)	1,467	(106)	1,361
Tax base	1,100		1,100
Taxable temporary difference	367	(106)	260
Deferred tax liability at 40%	146	(42)	104

Example 2B - Recognition of an Impairment Loss Creates a Deferred Tax Asset

An enterprise has an asset with a carrying amount, before impairment, of 1,000 and a recoverable amount of 650. The tax rate is 30% and the tax base of the asset is 800. Impairment losses are not deductible for tax purposes. The effect of the impairment loss is as follows.

	<i>Before impairment</i>	<i>Effect of impairment</i>	<i>After impairment</i>
Carrying amount	1,000	(350)	650
Tax base	800	-	800
Taxable (deductible) temporary difference	200	(350)	(150)
Deferred tax liability (asset) at 30%	60	(105)	(45)

In accordance with IAS 12, Income Taxes, the enterprise recognises the deferred tax asset to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised.

Example 3 - Reversal of an Impairment Loss

Use the data for Company T as presented in Example 1, with supplementary information as provided in this example. In this example, ignore tax effects.

Background

In Year 6, the political party is still in office in Country A, but the business situation is improving. The effects of the export laws on T's production are proving to be less drastic than initially expected by management. As a result, T management estimates that production of their product will increase from the previous 60% to 80% of the originally anticipated amount. This favourable change requires T to estimate the current recoverable amount of the net assets of the Country A operations (see paragraphs 67-68 of the Exposure Draft). The cash-generating unit of the net assets of the Country A operations is still the Country A operations.

Similar calculations to those in Example 1 show that the Country A cash-generating unit's recoverable amount is now 1,710.

Reversal of an Impairment Loss

Company T compares the recoverable amount with the Country A cash-generating unit's net carrying amount (see Schedule 1).

T increases the carrying amount of the Country A identifiable assets by 86 (see Schedule 3), i.e. up to the lower of recoverable amount (1,710) and the identifiable assets' depreciated historical cost (1,200) (see Schedule 2). This increase is recognised in the income statement immediately.

The impairment loss on goodwill is not reversed because it is considered that the external event that led to the recognition of the impairment loss on goodwill has not reversed (the legislation that significantly restricts exports of Company's T products is still in place, even though its effect is not as severe as expected).

Schedule 1. Calculation of the Country A cash-generating unit's carrying amount at end of Year 6

	<i>Goodwill</i>	<i>Identifiable assets</i>	<i>Total</i>
Historical cost (Example 1)	1,000	2,000	3,000
<i>End of Year 4 (Example 1)</i>			
Accumulated depreciation/ amortisation (4 years)	(267)	(533)	(800)
Impairment loss	(733)	(106)	(839)
Carrying amount after impairment loss	<u>0</u>	<u>1,361</u>	<u>1,361</u>
<i>End of Year 6</i>			
Additional depreciation (2 years)	-	(247)	(247)
Carrying amount	<u>0</u>	<u>1,114</u>	<u>1,114</u>
Recoverable amount			<u>1,710</u>
Excess of recoverable amount over carrying amount			<u>596</u>

After recognition of the impairment loss at the end of Year 4, Company T revised the depreciation charge for the Country A identifiable assets (from 133.3 per year to 123.7 per year), based upon the revised carrying amount and remaining useful life (11 years).

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Schedule 2. Determination at the end of Year 6 of the depreciated historical cost of Country A identifiable assets

<i>End of Year 6</i>	<i>Identifiable assets</i>
Historical cost	2,000
Accumulated depreciation (133.3 * 6 years)	(800)
Depreciated historical cost	1,200
Carrying amount (from Schedule 1)	1,114
Difference	86

Schedule 3. Carrying amount of the Country A assets at end of Year 6

<i>End of Year 6</i>	<i>Goodwill</i>	<i>Identifiable assets</i>	<i>Total</i>
Gross carrying amount	1,000	2,000	3,000
Accumulated amortisation	(267)	(780)	(1,047)
Accumulated impairment loss	(733)	(106)	(839)
Carrying amount	0	1,114	1,114
Reversal of impairment loss	0	86	86
Carrying amount after reversal of impairment loss	0	1,200	1,200

Appendix 2

Proposed Amendments to Other International Accounting Standards

The revision of accounting for impairments of assets will require, for consistency, amendments to existing International Accounting Standards. This appendix includes the Board's proposals for amendments.

The Board has identified that the following International Accounting Standards will need to be amended, for consistency, if E55, Impairment of Assets, is approved as a final International Accounting Standard:

- (a) IAS 9, Research and Development Costs;
- (b) IAS 16, Property, Plant and Equipment;
- (c) IAS 17, Accounting for Leases; and
- (d) IAS 22, Business Combinations.

As part of its project on Intangible Assets, the IASC Board is currently proposing that IAS 9 be merged with the proposed Standard on Intangible Assets and that IAS 22 be subject to a limited revision. Separate Exposure Drafts on Intangible Assets and on Business Combinations are expected to be published later in 1997. Those Exposure Drafts will include proposals to test intangible assets and goodwill for impairment and those proposals will refer to E55, Impairment of Assets.

The IASC Board published Exposure Draft E56, Leases, in April 1997. E56 includes proposals to test leased assets for impairment. Those proposals are consistent with E55, Impairment of Assets.

This Appendix includes the IASC Board's proposal to update IAS 16, Property, Plant and Equipment, for consistency with E55, Impairment of Assets. The only significant change to IAS 16's existing principles is E55's proposal to measure recoverable amount by using discounting techniques implicitly (if recoverable amount is based on the asset's net selling price) or explicitly (if recoverable amount is based on the asset's value in use). IAS 16 currently allows an enterprise to determine

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recoverable amount on either a discounted or undiscounted basis. The proposed changes to IAS 16 also clarify how to apply E55, Impairment of Assets, to a revalued asset.

Proposed additions to IAS 16's existing text are underlined and proposed deletions are struck through. Among other changes to IAS 16, the Board proposes to insert new paragraphs 70A, 73 and 74 after paragraphs 70 and 72. The Board does not intend to change the original paragraph numbers so that references to other paragraphs of IAS 16 will not be changed.

International Accounting Standard IAS 16

(revised 1993, updated 199X)

Property, Plant and Equipment

Objective

The objective of this Standard is to prescribe the accounting treatment for property, plant and equipment. The principal issues in accounting for property, plant and equipment are the timing of recognition of the assets, the determination of their carrying amounts and the depreciation charges to be recognised in relation to them, ~~and the determination and accounting treatment of other impairments to the carrying amounts.~~

This Standard requires an item of property, plant and equipment to be recognised as an asset when it satisfies the definition and recognition criteria for an asset in the Framework for the Preparation and Presentation of Financial Statements.

Scope

1. *This Standard should be applied in accounting for property, plant and equipment except when another International Accounting Standard requires or permits a different accounting treatment.*
2. ~~{Original paragraph renumbered as paragraph 73 and amended}. This Standard supersedes International Accounting Standard IAS 16, Accounting for Property, Plant and Equipment, approved in 1981. This Standard also supersedes International Accounting Standard IAS 4, Depreciation Accounting, with respect to depreciation of property, plant and equipment. While application of the principles contained in this Standard may also be appropriate for other assets such as long-term intangible assets, IAS 4, Depreciation Accounting, continues to apply to such assets.~~

[...]

Definitions

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

Property, plant and equipment *are tangible assets that:*

- (a) *are held by an enterprise for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and*
- (b) *are expected to be used during more than one period.*

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

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

Useful life *is either:*

- (a) *the period of time over which an asset is expected to be used by the enterprise; or*
- (b) *the number of production or similar units expected to be obtained from the asset by the enterprise.*

Cost *is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction.*

Residual value *is the net amount which the enterprise expects to obtain for an asset at the end of its useful life after deducting the expected costs of disposal.*

Fair value *is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.*

An impairment loss is the amount by which the carrying amount of an asset is reduced to its recoverable amount.

Carrying amount is the amount at which an asset is included in the balance sheet after deducting any accumulated depreciation and accumulated impairment losses thereon.

Recoverable amount is the amount which the enterprise expects to recover from the future use of an asset, including its residual value on disposal.

[...]

Measurement Subsequent to Initial Recognition

Benchmark Treatment

29. *Subsequent to initial recognition as an asset, an item of property, plant and equipment should be carried at its cost less any accumulated depreciation and any accumulated impairment losses, subject to the requirement in paragraph 56 to write an asset down to its recoverable amount.*

Allowed Alternative Treatment

30. *Subsequent to initial recognition as an asset, an item of property, plant and equipment should be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and any accumulated impairment losses. Revaluations should be made with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date.*

Revaluations

31. The fair value of land and buildings is usually its market value for existing use which presupposes continued use of the asset in the same or a similar business. This value is determined by appraisal normally undertaken by professionally qualified valuers.

32. The fair value of items of plant and equipment is usually their market value determined by appraisal. When there is no evidence of market value because of the specialised nature of the plant and equipment and because these items are rarely sold, except as part of a continuing business, they are valued at their depreciated replacement cost.
33. In determining fair value, an item of property, plant and equipment is valued on the basis of its existing use. However, an asset for which a change in use is probable is valued on the same basis as other similar assets held for the same intended use. For example, it is inappropriate to value a factory and the equipment within it at their value in use, while valuing the factory site at the open market value of the land for redevelopment as a shopping centre.
34. The frequency of revaluations depends upon the movements in the fair values of the items of property, plant and equipment being revalued. When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is necessary. Some items of property, plant and equipment may experience significant and volatile movements in fair value thus necessitating annual revaluation. Such frequent revaluations are unnecessary for items of property, plant and equipment with only insignificant movements in fair value. Instead, revaluation every three or five years may be sufficient.
35. When an item of property, plant and equipment is revalued, any accumulated depreciation at the date of the revaluation is either:
- (a) restated proportionately with the change in the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its revalued amount. This method is often used when an asset is revalued by means of an index to its depreciated replacement cost; or
 - (b) eliminated against the gross carrying amount of the asset and the net amount restated to the revalued amount of the asset. For example, this method is used for buildings which are revalued to their market value.

The amount of the adjustment arising on the restatement or elimination of accumulated depreciation forms part of the increase or

decrease in carrying amount which is dealt with in accordance with paragraphs 39 and 40.

36. ***When an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs should be revalued.***
37. A class of property, plant and equipment is a grouping of assets of a similar nature and use in an enterprise's operations. The following are examples of separate classes:
 - (a) land;
 - (b) land and buildings;
 - (c) machinery;
 - (d) ships;
 - (e) aircraft;
 - (f) motor vehicles;
 - (g) furniture and fixtures; and
 - (h) office equipment.
38. The items within a class of property, plant and equipment are revalued simultaneously in order to avoid selective revaluation of assets and the reporting of amounts in the financial statements which are a mixture of costs and values as at different dates. However, a class of assets may be revalued on a rolling basis provided revaluation of the class of assets is completed within a short period of time and provided the revaluations are kept up to date.
39. ***When an asset's carrying amount is increased as a result of a revaluation, the increase should be credited directly to equity under the heading of revaluation surplus. However, a revaluation increase should be recognised as income to the extent that it reverses a revaluation decrease or an impairment loss of the same asset previously recognised as an expense.***

40. *When an asset's carrying amount is decreased as a result of a revaluation, the decrease should be recognised as an expense. However, a revaluation decrease should be charged directly against any related revaluation surplus to the extent that the decrease does not exceed the amount held in the revaluation surplus in respect of that same asset.*
41. The revaluation surplus included in equity may be transferred directly to retained earnings when the surplus is realised. The whole surplus may be realised on the retirement or disposal of the asset. However, some of the surplus may be realised as the asset is used by the enterprise; in such a case, the amount of the surplus realised is the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost. The transfer from revaluation surplus to retained earnings is not made through the income statement.
42. The effects on taxes on income, if any, resulting from the revaluation of property, plant and equipment are dealt with in IAS 12, Income Taxes.

[...]

Recoverability of the Carrying Amount - Impairment Losses

Impairment

General

- ~~56. The carrying amount of an item or a group of identical items of property, plant and equipment should be reviewed periodically in order to assess whether the recoverable amount has declined below the carrying amount. When such a decline has occurred, the carrying amount should be reduced to the recoverable amount. The amount of the reduction should be recognised as an expense immediately, unless it reverses a previous revaluation in which case it should be charged to equity in accordance with paragraph 40.~~
- [56]. To determine whether an item of property, plant, and equipment is impaired, an enterprise applies IAS --, Impairment of Assets. That Standard explains how an enterprise reviews the carrying amount of its assets, how it determines the recoverable amount of an asset and when it recognises or reverses an impairment loss.
57. ~~The cost or revalued amount of an item of property, plant and equipment is normally recovered on a systematic basis over the useful life of the asset. If the usefulness of an item or a group of identical items is impaired, for example by damage or technological obsolescence or other economic factors, the recoverable amount may be less than the carrying amount of the asset. In such circumstances, a write down of the asset is necessary. A write down may also be necessary when an item of property, plant and equipment remains idle for a considerable period either prior to it being put into use or during its useful life.~~

Assets Carried Under the Allowed Alternative Treatment

[57]. For a revalued item of property, plant, and equipment carried under the allowed alternative treatment in paragraph 30, an impairment loss or a reversal of an impairment loss should be recognised as follows:

(a) an impairment loss should be treated in the same way as a revaluation decrease and should be recognised in accordance with paragraph 40; and

(b) a reversal of an impairment loss should be treated in the same way as a revaluation increase and should be recognised in accordance with paragraph 39.

58. The recoverable amount of individual assets or a group of identical assets is determined separately and the carrying amount reduced to recoverable amount on an individual asset, or group of identical assets, basis. However, there may be circumstances when it may not be possible to assess the recoverable amount of an asset on this basis, for example when all the plant and equipment in a factory is used for the same purpose. In such circumstances, the carrying amount of each of the related assets is reduced in proportion to the overall decline in recoverable amount of the smallest grouping of assets for which it is possible to make an assessment of recoverable amount. This Standard does not require or preclude the discounting of cash flows in determining the recoverable amount.

[58]. In determining whether or not it is necessary to estimate the recoverable amount of a revalued asset in accordance with IAS --, Impairment of Assets, that is, the higher of the asset's net selling price and value in use, an enterprise considers the basis used to determine the fair value of the revalued asset:

(a) if an asset's fair value is based on the asset's market value, the only difference between the asset's fair value and its net selling price is the direct incremental costs to dispose of the asset. If the disposal costs are negligible, the recoverable amount of the revalued asset is necessarily close to, or greater than, its fair value. In this case, an enterprise need not determine recoverable amount. If the disposal costs are material, net selling price is

necessarily less than fair value, therefore, an enterprise verifies that the carrying amount of the revalued asset does not exceed its value in use; and

- (b) if an asset's fair value is determined on a basis other than market value (for example, if fair value is based on depreciated replacement cost), fair value may be greater or lower than recoverable amount. Hence, an enterprise verifies that the carrying amount of the revalued asset does not exceed its recoverable amount.

Subsequent Increase in Recoverable Amount—Benchmark Treatment

59. ~~*A subsequent increase in the recoverable amount of an asset, dealt with in accordance with the benchmark treatment described in paragraph 29, should be written back when the circumstances and events that led to the write down or write off cease to exist and there is persuasive evidence that the new circumstances and events will persist for the foreseeable future. The amount written back should be reduced by the amount that would have been recognised as depreciation had the write down or write off not occurred.*~~

[59]. IAS --, Impairment of Assets, requires that an enterprise reverses an impairment loss to the extent that the recoverable amount of an asset exceeds its carrying amount. However, that requirement is subject to the condition, among other things, that the carrying amount of the asset is not increased above the asset's depreciated historical cost. This condition does not preclude an enterprise from revaluing a previously impaired asset above its depreciated historical cost, in accordance with the allowed alternative treatment set out in paragraphs 30-42.

Subsequent Increase in Recoverable Amount—Allowed Alternative Treatment

60. ~~*{Original paragraph deleted} A subsequent increase in the recoverable amount of an asset, dealt with in accordance with the allowed alternative treatment described in paragraph 30, should be accounted for in accordance with paragraph 39.*~~

Retirements and Disposals

[...]

65. Property, plant and equipment which is retired from active use and held for disposal is carried at its carrying amount at the date when the asset is retired from active use. At each balance sheet date, an enterprise reviews the recoverable amount of the asset, the lower of its carrying amount and in accordance with IAS --, Impairment of Assets ~~not realisable value~~ and recognises any resulting impairment loss (or reversal of an impairment loss) accordingly.

Disclosure

66. *The financial statements should disclose, in respect of each class of property, plant and equipment:*

- (a) the measurement bases used for determining the gross carrying amount. When more than one basis has been used, the gross carrying amount for that basis in each category should be disclosed;*
- (b) the depreciation methods used;*
- (c) the useful lives or the depreciation rates used;*
- (d) the gross carrying amount and the accumulated depreciation (including accumulated impairment losses) at the beginning and end of the period;*
- (e) a reconciliation of the carrying amount at the beginning and end of the period showing:*
 - (i) additions;*
 - (ii) disposals;*
 - (iii) acquisitions through business combinations;*
 - (iv) increases or decreases resulting from revaluations in accordance with paragraphs 30, 39, 40, and from impairment losses recognised or reversed during the period in accordance with paragraph 57 and 60;*

- (v) ~~impairment losses recognised in the income statement during the period~~~~reductions in carrying amount in accordance with paragraph 56;~~
- (vi) ~~impairment losses reversed in the income statement during the period~~~~amounts written back in accordance with paragraph 59;~~
- (vii) depreciation;
- (viii) the net exchange differences arising on the translation of the financial statements of a foreign entity; and
- (ix) other movements.

67. The financial statements should also disclose:

- ~~(a) whether, in determining the recoverable amount of items of property, plant and equipment, expected future cash flows have been discounted to their present values;~~
- ~~(ab)~~ the existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities;
- ~~(be)~~ the accounting policy for restoration costs relating to items of property, plant and equipment;
- ~~(cd)~~ the amount of expenditures on account of property, plant and equipment in the course of construction; and
- ~~(de)~~ the amount of commitments for the acquisition of property, plant and equipment.

[...]

70. When items of property, plant and equipment are stated at revalued amounts the following should be disclosed:

- (a) the basis used to revalue the assets;
- (b) the effective date of the revaluation;
- (c) whether an independent valuer was involved;
- (d) the nature of any indices used to determine replacement cost;

- (e) *the carrying amount of each class of property, plant and equipment that would have been included in the financial statements had the assets been carried at cost less depreciation (including any accumulated impairment losses) in accordance with the benchmark treatment; and*
- (f) *the revaluation surplus, indicating the movement for the period and any restrictions on the distribution of the balance to shareholders.*

70A. An enterprise discloses information on impaired property, plant and equipment in accordance with IAS --, Impairment of Assets, in addition to the information required by paragraph 66(e)(iv) to (vi). The disclosure requirements in IAS --, Impairment of Assets, apply to assets that are carried under the allowed alternative treatment as well as assets that are carried under the benchmark treatment.

[...]

Effective Date

72. This International Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 January 1995.

73. This Standard supersedes:

- (a) IAS 16, Property, Plant and Equipment, approved in 1981; and
- (b) IAS 4, Depreciation Accounting, with respect to depreciation of property, plant and equipment.

74. This Standard was updated in 199X to be consistent with IAS --, Impairment of Assets, approved in 199X. The only significant change of substance is the new requirement in IAS --, Impairment of Assets, that an asset's recoverable amount should be determined on a discounted basis.

Appendix 3

Basis for Conclusions

This appendix gives reasons for supporting or rejecting certain alternative solutions related to the accounting for the impairment of assets. The Board does not intend to publish this appendix with the final Standard.

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Background

1. The Exposure Draft will, if approved by the IASC Board as a final Standard, replace current requirements in certain International Accounting Standards for the accounting for the impairment of assets. Reference to impairment is made, directly or indirectly, in the following International Accounting Standards and Exposure Drafts:
 - (a) IAS 2, Inventories;
 - (b) IAS 9, Research and Development Costs;
 - (c) IAS 10, Contingencies and Events Occurring After the Balance Sheet Date;
 - (d) IAS 11, Construction Contracts;
 - (e) IAS 12, Income Taxes;
 - (f) IAS 16, Property, Plant and Equipment;
 - (g) IAS 22, Business Combinations;
 - (h) IAS 25, Accounting for Investments;
 - (i) E48, Financial Instruments; and
 - (j) E50, Intangible Assets.
2. The Board decided in June 1996 to prepare an International Accounting Standard on Impairment of Assets for the following reasons:
 - (a) combining the requirements for identifying, measuring, recognising and reversing an impairment loss in one International Accounting Standard will ensure that those requirements are consistent;
 - (b) existing requirements and guidance in International Accounting Standards are not detailed enough to ensure that enterprises identify, recognise and measure impairment losses in a similar way. For example, there is a need to eliminate certain alternatives for measuring an impairment loss such as the current option not to use discounting;

- (c) the Board intends to propose that the amortisation period of intangible assets and goodwill can, in certain circumstances, exceed 20 years¹ if those assets are subject to a detailed and reliable annual impairment test.
3. Some national standard setters, particularly from Australia, New Zealand and the United Kingdom, have undertaken projects to develop or review national accounting standards that deal with the impairment of assets. Furthermore, the standard setter of the United States of America has a project to issue additional guidance on a number of issues related to Statement 121, "Accounting for the Impairment of Long-Lived Assets and Long-Lived Assets to be disposed of" to address impairment of goodwill, and to establish a single model for assets to be disposed of. In developing the proposals included in E55, Impairment of Assets, the IASC Board has considered the proposals of these national standard setters.
 4. As a result of the discussions of a "working group" consisting of some Board members and senior staff members of the standard-setting bodies in Australia, Canada, New Zealand, the United Kingdom, the United States of America and IASC, these bodies intend to publish in the third quarter of 1997 a discussion paper on an "International Review of Accounting Standards Specifying the Recoverable Amount Test for Long-Lived Assets".
 5. This discussion paper will:
 - (a) note the key features of the working group members' accounting standards which specify the recoverable amount test, and compare those standards; and
 - (b) propose the views of the working group on the major issues.

¹ IAS 22, Business Combinations, revised in 1993, requires that the amortisation period for goodwill should not exceed 5 years unless a longer period, not exceeding 20 years from the date of acquisition, can be justified. IASC published in June 1995 an Exposure Draft on Intangible Assets (E50) which includes largely similar proposals for the amortisation of intangible assets. Many commentators on E50 opposed the 20-year limit to the amortisation period of intangible assets. The Board expects to issue later in 1997 a second Exposure Draft on Intangible Assets and an Exposure Draft for a limited revision to IAS 22, Business Combinations.

Summary of E55's Proposals and Changes Proposed to Existing IASC Requirements

6. A summary of the proposals in E55 is the following:

- (a) although certain individual International Accounting Standards include a requirement to review the carrying amount of an asset at each balance sheet date, they do not specify how to perform the review. The Exposure Draft explains that the recoverable amount of an asset should be estimated whenever specified indicators of a potential impairment loss are triggered. If additional reviews are needed for certain assets, the Board will include additional requirements in the International Accounting Standard applicable to these assets²;
- (b) the Exposure Draft specifies that the recoverable amount of an asset is the higher of its net selling price and its value in use. Both amounts are based, implicitly or explicitly, on present value calculations. Consequently, the use of undiscounted amounts to measure the recoverable amount of an asset will no longer be permitted;
- (c) in determining net selling price, an enterprise should estimate the amount that an enterprise could obtain, at the date of the estimate, from the sale of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting any direct incremental disposal costs;
- (d) in determining value in use, the enterprise should use a pre-tax market-determined discount rate that reflects current assessments of the time value of money and the risks specific to the asset; short-term cash flow projections should be based on management's most recent budget/forecast up to 5 years and long-term cash flows should be based on an extrapolation of the short-term cash flows by applying a steady or declining growth rate that does not exceed the long-term average growth rate for

² For example, the Board intends to include in the revised Exposure Draft on Intangible Assets, and in the Exposure Draft on the limited revision of IAS 22, Business Combinations, a proposal to estimate annually the recoverable amount of intangible assets and goodwill which are amortised over more than 20 years.

the products, industries, and country or countries in which the enterprise operates or for the market to which the asset is dedicated. Estimates of future cash flows should include all estimated cash inflows and cash outflows except for cash flows from financing activities and income tax receipts or payments;

- (e) consistent with the requirements in existing International Accounting Standards, an impairment loss should be recognised whenever the recoverable amount of an asset is less than its carrying amount;
- (f) the Exposure Draft includes requirements and guidance for determining the recoverable amount of an asset that does not generate cash inflows that are largely independent from the cash inflows from other assets, that is by determining the recoverable amount of the asset's cash-generating unit. It also specifies when to recognise an impairment loss for an asset's cash-generating unit and how to allocate the impairment loss between the assets within that cash-generating unit. It requires that the goodwill (and other corporate assets such as head office assets) related to an asset, or to a cash-generating unit, should be considered in measuring an impairment loss;
- (g) the Exposure Draft requires that an impairment loss recognised in prior years should be reversed when there has been a change in the estimates used to determine an impaired asset's recoverable amount since the last impairment loss was recognised. This requirement applies to goodwill and intangible assets for which no active market exists if, and only if, the specific external event that caused the recognition of the impairment loss has reversed. IAS 9, Research and Development Costs, and IAS 16, Property, Plant and Equipment, require the reversal of an impairment when circumstances and events that led to the recognition of the impairment loss cease to exist and there is persuasive evidence that the new circumstances and events will persist for the foreseeable future. IAS 22, Business Combinations, prohibits the reversal of an impairment loss on goodwill; and
- (h) improvements have been made to the disclosure requirements.

Measurement of Recoverable Amount (Exposure Draft: paragraphs 13-40)

7. When an asset is impaired, an enterprise will either keep the asset or dispose of it. The Board believes that if an enterprise behaves rationally, the resulting decision is, in substance, an investment decision. For example, if the enterprise discovers that the service potential of the asset has decreased:
 - (a) the enterprise may decide to sell the asset if the proceeds from the sale would provide a higher return on investment than continuing use in operations; or
 - (b) the enterprise may decide to keep and use the asset for use in operations, 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 but not as much as expected originally.
8. As a consequence of the Board's assumption that an enterprise will make an investment decision once the recoverability of the asset has been tested, the Exposure Draft permits only two techniques for measuring the recoverable amount of an asset: net selling price and value in use. These techniques are based on investment appraisal techniques that involve a present value calculation (implicit or explicit) of estimated net future cash flows expected from the asset. Consideration is given to the time value of money and the risks specific to the asset that the amount and timing of the actual cash flows to be received from the asset might differ from estimates.
9. Net selling price reflects the market's expectation of the present value of the future cash flows to be derived from an asset, less the costs to dispose of the asset. This measurement may differ from the estimate

made by the enterprise (referred to in the Exposure Draft as the value in use) because the market may not use the same assumptions about future cash flows as an individual enterprise.

10. Four alternatives for determining the recoverable amount of an asset are discussed in the following paragraphs:
 - (a) recoverable amount should be the sum of expected future cash flows at undiscounted amounts;
 - (b) recoverable amount should be the asset's fair value: more specifically, recoverable amount should be primarily derived from the asset's market value. If market value cannot be determined, then recoverable amount of the asset should be based on its value in use as a proxy for market value;
 - (c) recoverable amount should be the asset's value in use; and
 - (d) recoverable amount should be the higher of the asset's net selling price and value in use.

Recoverable Amount Based on the Sum of Undiscounted Cash Flows

11. Arguments against discounting future cash flows are 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's cost; and
 - (b) the nominal amount of the 'investment' (the cost of an asset less applicable amortisation or depreciation) should be compared only to the nominal amount of the net cash flows expected to be generated by the asset because the historical cost basis does not recognise changes in the measuring unit - nominal currency - which occur over time as a result of changes in the level of prices.

12. The Board rejected measurement of the recoverable amount based on the sum of undiscounted cash flows because:
- (a) the historical cost approach does not provide for comparability through time. Because of interperiod changes in the level of prices, the historical cost of an asset is expressed in different currency amounts from the currency amount to which it is compared;
 - (b) 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 be recorded at the same amount. However, their market values and costs if purchased now would be different because all rational economic transactions take account of the time value of money. In other words, unlike items would appear alike; and
 - (c) measurements that take into consideration both the time value of money and risk 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.

Recoverable Amount Based Primarily on the Fair Value of an Asset

13. IAS 32, Financial Instruments: Disclosure and Presentation, defines 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...”
14. As an illustration of how the concept of fair value is used in International Accounting Standards, these are the different requirements or guidance for a fair value measurement:
- (a) for the purpose of revaluation to fair value, IAS 16, Property, Plant and Equipment, indicates that fair value is usually the asset’s market value for existing use 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) E50, Intangible Assets, proposes to restrict measurement of fair value to market values obtained from an active secondary market³;
 - (c) IAS 22, Business Combinations, sets out a range of techniques for estimating fair value. These techniques include reference to estimated values, market values, present value calculations of estimated cash flows or depreciated replacement cost; and
 - (d) IAS 32 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, the 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. Also, the fair value takes into account the costs that would be incurred to exchange or settle the financial instrument.
15. Some argue that fair value is the only appropriate measurement for the recoverable amount. Fair value would be based on quoted market prices or, if no quoted market prices exist, estimated using consideration of prices for similar assets and the results of discounted future cash flows calculations. Proponents of fair value argue that:
- (a) management intent to keep or sell an asset should not be considered in determining the recoverable amount of an asset;
 - (b) an enterprise's estimate of the present value of future cash flows is subjective and in some cases may be abused; quoted market prices that reflect the judgement of the market place, if available, are a more reliable measurement of the amounts that will be recovered from the assets;
 - (c) if assets are 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

³ In preparing a revised Exposure Draft on Intangible Assets, the Board intends to keep E50's proposal that an intangible asset can be revalued if, and only if, fair value can be determined by reference to an active market. The revised Exposure Draft on Intangible Assets will include a definition of an 'active market'. That definition will be similar to the guidance for an 'active secondary market' in paragraph 65 of E50, Intangible Assets.

stemming from the synergy of the business and its management team. These above-market cash flows should be excluded from assessments of the asset's recoverable amount;

- (d) 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; and
- (e) a fair value measurement would be consistent with the proposals of the IASC Steering Committee on Financial Instruments for the measurement of financial instruments⁴.

16. The Board rejected the idea that an asset's recoverable amount should be determined primarily by reference to its fair value, where fair value is based on quoted market prices or, if no quoted market prices exist, estimated using consideration of prices for similar assets and the results of present valuation calculations of estimated future cash flows. The reasons are the following:

- (a) if the service potential of an asset is greater than its net selling price, 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 asset⁵. Therefore, the Board supports the view that recoverable amount should not necessarily refer to a transaction between two parties (which is unlikely to happen) but should also consider the asset's service potential;
- (b) the Board believes that no preference should be given to the market's expectation of the recoverable amount of an asset (basis for fair value when there are market values and for net selling price) over a reasonable estimate performed by the individual enterprise that owns the asset (basis for fair value when market

⁴ The IASC Steering Committee on Financial Instrument published in March 1997 a discussion paper on "Accounting for Financial Assets and Financial Liabilities". Among other proposals, the Steering Committee proposes a measurement of all financial assets and financial liabilities at fair value (i.e., at current market, or equivalent, value) regardless of management's intent to hold or trade the items.

⁵ It should also be noted that, under that proposal, recoverable amount would not meet the current IASC definition of fair value which requires, among other things, that fair value represents the amount that could be exchanged between knowledgeable, willing buyers and sellers.

values are not available and for value in use). For example, an enterprise may have information about future cash flows that is superior to, or simply different from, the information available in the market place. Another example would be that an enterprise may plan to use an asset in a manner different from the market's view of the best use;

- (c) the Board believes that in assessing the recoverable amount of an asset, what counts is the amounts that an enterprise can expect to recover from that asset, including the effect of synergy with other assets;
- (d) if recoverable amount were based on fair value primarily determined by reference to market prices, measurement of recoverable amount –and, hence, impairment losses (see discussion in paragraphs 59 to 73 of this appendix)– could be volatile; and
- (e) the IASC Steering Committee on Financial Instruments has indicated that different measurement bases for non-financial assets and for financial assets would be acceptable because “...the value of a non-financial asset to an enterprise will depend on how effectively it is used in the production/revenue-generating process...” and that “...the value of a financial asset to an enterprise does not depend on a transformation/realisation process; its value is determined by its contractual rights...” (see Chapter 2, section 5 of the discussion paper on “Accounting for Financial Assets and Financial Liabilities”)⁶.

⁶ Note that the IASC Board has not yet deliberated the proposals of the IASC Steering Committee on Financial Instruments.

Example

This example illustrates the proposal (rejected by the Board) that an enterprise should measure an asset's recoverable amount at its fair value (where fair value is primarily based on market values).

An enterprise bought its headquarters building 10 years ago for 2,000. Since then, the real estate market has collapsed and the building's market value at balance sheet date is 1,000. The building's carrying amount at 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, in accordance with the proposals included in the Exposure Draft. That calculation shows that the building's cash-generating unit is not impaired.

Proponents of fair value would measure the recoverable amount of the building at 1,000 and, hence, would recognise an impairment loss of 500 (1,500 less 1,000) even if the enterprise is highly profitable..

The IASC Board does not support this approach and proposes that since the building's cash-generating unit is not impaired, no impairment loss should be recognised for that building. The IASC Board's proposal reflects the view that the enterprise will not be willing to sell the building for 1,000 and that it will continue to use the building.

17. The Board considers that value in use would be a reasonable estimate of fair value if no market exists. Quoted 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, in accordance with E55, will be similar to a recoverable amount based primarily on fair value.

18. There may be cases of assets covered by E55 where quoted 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. The Board acknowledges that measurement of 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 16(b) above, the market may not use the same assumptions about future cash flows as an individual enterprise.
19. The Board believes that the Exposure Draft includes sufficient requirements to prevent an enterprise from using unjustified assumptions different from the market place. For example:
 - (a) an enterprise is required to determine value in use using cash flow projections based on reasonable and supportable assumptions [...] and giving greater weight to evidence that can be verified objectively (see paragraph 23(a) of the Exposure Draft); and
 - (b) whenever the recoverable amount is based on value in use, an enterprise should disclose the fact that value in use significantly exceeds net selling price (if an impairment loss has been recognised or reversed during the period) or the fact that the carrying of the asset significantly exceeds the asset's net selling price (if no impairment loss has been recognised or reversed during the period but recoverable amount was estimated during that period) (see paragraphs 82(d)(iii) and 83(c) of the Exposure Draft).

Recoverable Amount Based Primarily on the Value in Use of an Asset

20. The Exposure Draft defines an asset's value in use as the present value of estimated future cash flows expected to flow from continuing use of the asset and from its disposal at the end of its useful life.

21. Some argue that value in use is the only appropriate measurement for the recoverable amount of an asset because:
- (a) the result would be that assets would never be carried at amounts higher than their service potential; and
 - (b) a market value does not necessarily reflect the service potential of an asset. The value in use reflects the service potential of an asset.
22. The Board 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 the recoverable amount on the asset's net selling price in order to avoid recognising an impairment loss that is more or less certain to be excessive; and
 - (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.

Recoverable Amount Based on the Higher of an Asset's Net Selling Price and Value in Use

23. The Board's proposal that the 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 the 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 16-19 and 22 of this appendix). Whether the assumptions of the market or the enterprise are more likely to be true cannot be answered. Currently, perfect markets do not exist, and it is unlikely that predictions for the future will be fully accurate, whoever makes them.

24. The Board acknowledges that an enterprise will use judgement in determining whether an impairment loss needs to be recognised. For that reason, the Board proposes various safeguards in the Exposure Draft to limit the risk that an enterprise may make an over-optimistic estimate of recoverable amount:
- (a) the Exposure Draft proposes to require a formal estimate of recoverable amount whenever there is an indication that the asset is potentially impaired. For this purpose, the Board proposes a relatively detailed (although not exhaustive) list of indicators of potential impaired assets (see paragraph 8 of the Exposure Draft); and
 - (b) the Exposure Draft proposes limits to the use of management's projections of future cash flows that are used to estimate value in use (see paragraph 23 of the Exposure Draft); and
 - (c) the Exposure Draft proposes certain disclosure requirements if value in use significantly exceeds net selling price and if actual cash flows are materially less than (greater than) the estimates used in a value in use calculation (see paragraphs 82 to 85 of the Exposure Draft).
25. The Board considered the cost of requiring an enterprise to determine both net selling price and value in use. The Board concluded that the benefits of such a requirement outweigh the costs.

Assets Held for Disposal

26. The Board 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 an asset is close to its value in use. Indeed, the value in use consists mostly of the net proceeds to be received for the asset since future cash flows from continuing are close to nil. The Board believes that the definition of recoverable amount as included in the Exposure Draft is appropriate for assets held for disposal without need for further requirement or guidance.

Other Refinements for the Measurement of Recoverable Amount

Replacement Cost as a Ceiling

27. Some argue that the replacement cost of an asset should be adopted as a ceiling value to the recoverable amount of an asset. The replacement cost would be estimated directly from the current market buying price of the identical or equivalent asset (reference asset), using quoted market prices if available. If the asset would be replaced by an asset with a different capacity to perform a similar function, the current market buying price of the reference asset would be adjusted for the different capacity.
28. Proponents of limiting the recoverable amount of an asset to its replacement cost argue that an asset should not be carried at greater amount than the enterprise would have been willing to pay for the asset at balance sheet date. They believe that an asset's 'value to the business' is the amount of the entire loss, direct and indirect, that the enterprise would suffer if deprived of the asset at balance sheet date.
29. The Board believes that replacement cost techniques are not appropriate to measure 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

30. In some cases, an enterprise might seek external appraisal of recoverable amount. External appraisal is not a separate technique in its own right. The Board believes that if appraisal values are used, an enterprise should verify that the external appraisal follows the proposals included in the Exposure Draft.

Net Selling Price (Exposure Draft: paragraphs 17-21)

31. Net selling price is the amount obtainable, at the date of the estimate, from the sale of the asset in an arm's length transaction between knowledgeable, willing parties, less the direct incremental costs to dispose of the asset.
32. In other words, net selling price represents the market's expectations of the future cash flows for the asset after the market's consideration of the time value of money and the risks inherent in receiving those cash flows.
33. Some fear that an enterprise may abuse the concept of the higher of net selling price and value in use and that the enterprise may determine an unreliable net selling price to override a lower value in use. They propose that, in order to determine a reliable measurement of net selling price, it should be determined by reference to an active market⁷ or, as a minimum, by reference to a market where items traded may be individually unique but where comparisons with sufficient numbers of transactions in that market for other individual items, similar but not necessarily identical or homogeneous, can provide a reasonable basis for determining the selling price of the asset (for example, a real estate market).
34. The Board believes that the definition of net selling price will lead to a reliable measurement of the net amount that an enterprise can expect to recover from the sale of an asset.
35. Direct incremental costs are deducted from the amount obtainable for the sale of the asset. Otherwise, net selling price would not represent the net amount that an enterprise could expect to recover for the sale of the asset at the date of the measurement of recoverable amount.
36. The Board acknowledges that the definition of 'net selling price' is similar to what would be a definition of 'net fair value'. The Board believes that the terminology 'net selling price' better explains the

⁷ See paragraph 65 of E50, Intangible Assets.

amount that the enterprise should determine (a market-specific measure) and that will be compared with the asset's value in use (an entity-specific measure).

Net Realisable Value

37. 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...”

38. The Board decided not to use the term ‘net realisable value’ 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 be determined for the sale of an asset other than in the ordinary course of the business; and
- (c) it is important that net selling price uses, as a starting point, a selling price agreed between knowledgeable, willing buyers and sellers.

Value in Use (Exposure Draft: paragraphs 22-40)

39. Value in use is an entity-specific measure of the amount that can be recovered from using an asset until the end of its useful life.

Bases for Estimates of Future Cash Flows (Exposure Draft: paragraphs 23-27)

40. In estimating future cash flows, the question arises whether to reflect the effect of expected future events. The Board believes that expectation of those events affect the value of the asset at the balance sheet date and should be reflected in estimating future cash flows.
41. Some argue that, to reflect uncertainties in timing and amounts inherent in estimated future cash flows better, expected future cash flows should be used in determining value in use. This expected value approach uses all expectations about possible future cash flows instead of the single, most likely, future cash flows from an asset. For example, an enterprise has made two scenarios for future cash flows: a first possibility of future cash flows amounts to 120 with a 40 per cent probability of realisation and a second possibility amounts to 80 with a 60 per cent probability. In such a situation, the most probable future cash flows are 80 and the expected future cash flows are 96 ($80 \times 60\% + 120 \times 40\%$).
42. For projects other than impairment of assets that also use present value calculations (such as the project on accounting for employee benefits), the Board proposes to require the use of an expected value approach. For estimating an asset's value in use, the Board neither requires, or precludes, the use of expected values of future cash flows. In most cases, an enterprise will make only a single estimate of future cash flows and the discount rate will approximately reflect uncertainties. The Board does not believe that an expected value approach should be required to measure the value in use of an asset. However, if an enterprise is able to project a number of cash flow scenarios and to estimate the probability of each scenario reliably, this enterprise should be able to use those different scenarios, weighted by their respective probabilities.

Composition of Estimates of Future Cash Flows (Exposure Draft: paragraphs 28-35)

43. The Board proposes that an enterprise should estimate future cash flows from the estimated use of the asset. All relevant cash flows should be taken into account, including an allocation of central overhead costs that can be allocated on a reasonable and consistent basis.
44. Estimated future cash flows reflect assumptions that are consistent with the way the discount rate is determined. This is to avoid the possibility that some assumptions are counted twice or ignored. As a consequence, estimates of future cash flows do not include cash flows from financing activities.
45. The Exposure Draft proposes that cash inflows should avoid, as far as possible, the inclusion of internally generated goodwill. This results from the Board's view that internally generated goodwill should not be recognised as an asset. However, the Board acknowledges that in many cases, especially when businesses are merged, it will not be possible in practice to distinguish an asset's future cash flows from future cash flows from internally generated goodwill. The Board believes that, in such cases, it is more important to focus on whether the carrying amount of the asset, or an asset's cash-generating unit, will be recovered, rather than on whether the recovery stems partly from internally generated goodwill.
46. The Exposure Draft proposes that cash outflows to prepare an asset for its intended use or sale should be considered in determining its value in use. This is consistent with IAS 9, Research and Development Costs, which requires in paragraph 25 that "...further development costs, related production costs, and selling and administrative costs directly incurred in marketing the product..." be considered when assessing whether or not an impairment loss should be recognised. IAS 16, Property, Plant and Equipment, is silent on how to measure the recoverable amount of an asset in progress.

Discount Rate (Exposure Draft: paragraphs 36-40)

47. 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 because 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 interest 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; and
 - (b) the value of the future cash flows is affected by the variability (i.e. the risks) associated with the cash flows. As with the time value of money, all rational economic transactions will reflect risk.
48. 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 assessment both of the time value of money and of the risks specific to the cash flows associated with the asset. The Board believes that determination of such a rate would necessarily involve subjectivity which cannot be verified objectively. Therefore, the Board proposes that the enterprise should estimate its own cash flows but that the discount rate should reflect the market's view of the time value of money and risks.
49. As a consequence the Board decided:
- (a) to reject a discount rate based on a historical rate, that is the effective rate implicit in future payments. A subsequent estimate of recoverable amount has to be based on current interest rates because management's decisions about whether to keep the asset are based on current economic conditions. Historical rates do not reflect current economic conditions (see paragraph 12 of this appendix);

- (b) to reject a discount rate based on a risk-free rate because the discount rate should consider the risks specific to the cash flows associated with the asset; and
- (c) to require that the discount rate should be a market-determined rate that reflects current assessments of the time value of money and the risks specific to the cash flows associated with the asset.

Income Taxes

50. Income tax cash flows may affect recoverable amount. It is convenient to analyse those tax cash flows into two components:
- (a) the tax cash flows that would result from any difference between the tax base of the 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 (revised), Income Taxes, as 'temporary differences'; and
 - (b) the tax cash flows that would result if the tax base of the asset were equal to its recoverable amount.
51. 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. To avoid double counting, the tax consequences of those temporary differences are not considered in determining recoverable amount.
52. For most assets, the tax base of an asset on initial recognition is equal to its cost. In such cases, net selling price implicitly reflects market participants' assessment of the 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 the net selling price to reflect this second component.

53. In principle, value in use should include the present value of the tax cash flows that would result if the tax base of the asset were equal to its value in use. Nevertheless it may be burdensome to estimate the effect of that component. That 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 because the value in use itself reflects a tax base equal to that value in use.

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

54. 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 value, 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. Thus, the pre-tax discount rate is not always the post-tax discount rate grossed up by a standard rate of tax.
55. The Exposure Draft proposes that recoverable amount should be based on present value calculations, whereas under IAS 12, Income Taxes, an enterprise determines deferred tax assets and liabilities by comparing the carrying amount of the asset (a present value if the carrying amount is based on recoverable amount) with its tax base (an undiscounted amount). One way to eliminate this inconsistency would be to measure deferred tax assets and liabilities on a discounted basis, but the Board believes that there is not currently a consensus to support such a change in existing practice. Therefore, this Standard requires an enterprise to measure the tax effects of temporary differences using the principles set out in IAS 12.
56. 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.

57. The most important case where such adjustments may be relevant is where the amortisation of goodwill is not deductible for tax purposes. IAS 12 prohibits the recognition of deferred tax liabilities arising from goodwill for which amortisation is not deductible for tax purposes. In the absence of the prohibition, an enterprise would recognise a deferred tax liability and increase the carrying amount of the goodwill by the same amount. Therefore, some argue that, in estimating an impairment loss of a cash-generating unit that includes goodwill, an enterprise should notionally gross up the carrying amount of the goodwill by the amount of the unrecognised deferred tax liability in order to permit a valid comparison with the value in use, which is determined on the basis of pre-tax cash flows.

Example

This example illustrates the proposal (rejected by the Board) that an enterprise should notionally gross up the carrying amount of the goodwill for impairment testing purposes.

A cash-generating unit includes goodwill of 225 and identifiable assets of 1,300. The value in use of the cash-generating unit is 1,400 (determined on the basis of pre-tax cash flows). The tax rate is 40%. No net selling price is available for the cash-generating unit.

Before making any comparison with the value in use of the cash-generating unit, the enterprise notionally adjusts the goodwill to a pre-tax carrying amount:

(1) (Post-tax) carrying amount of goodwill	225
(2) Notional pre-tax carrying amount of goodwill (225/(1-40%))	375
(3) Pre-tax carrying amount of identifiable assets	<u>1,300</u>
(4) Total pre-tax carrying amount of the cash-generating unit (2) + (3))	<u>1,675</u>

The enterprise is now ready to compare the pre-tax carrying amount of the cash-generating unit with its pre-tax value in use.

The enterprise would recognise a notional pre-tax impairment loss of 275 (1,675 less 1,400), which would be fully attributed to goodwill.

The notional pre-tax carrying amount of goodwill would become 100 (375 less 275). The post-tax carrying amount of goodwill after recognition of the notional impairment loss would be 60 (100 at (100%-40%)). An impairment loss would be recognised as an expense for the reduction in the post-tax carrying amount of goodwill, i.e. 165 (225 less 60). In this case, the impairment loss would also be the reduction in the pre-tax carrying amount of goodwill less the tax effect (275 at (100%-40%) = 165).

Note 1: under the Board's proposal, the enterprise recognises an impairment loss of 125 (1,525 less 1,400) as an expense instead of 165.

Note 2: if the impairment loss is sufficiently large such that the carrying amount of the goodwill is completely eliminated, the Board's proposal will lead to the same result as the grossing up computation rejected by the Board.

58. The Board acknowledges the conceptual merit of such adjustments but believes that they would add unnecessary complexity. Therefore, the Exposure Draft neither requires nor permits such adjustments.

Recognition of Impairment Losses

(Exposure Draft: paragraphs 41-45)

59. The Board proposes that an impairment loss should be recognised whenever the recoverable amount of an asset is below its carrying amount. The Board 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 the asset is impaired, that is, if it is probable that an enterprise will not recover the carrying amount of an asset ('probability criterion'); and
 - (c) immediate recognition whenever the recoverable amount is below the carrying amount ('economic criterion').

Recognition of an Impairment Loss Based on a 'Permanent' Criterion

60. Supporters of the 'permanent' criterion, that is, recognition of an impairment loss if the recoverable amount is lower than the carrying amount and it is expected that such an impairment loss will never reverse, argue that:
- (a) this criterion avoids the recognition of temporary decreases in the recoverable amount of an asset; and
 - (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.
61. The Board 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; and

- (b) this criterion seems at odds with the basic concept that an asset represents future economic benefits that an enterprise expects to receive by using it. Cost-based accrual accounting cannot reflect events without reference to future expectations. If the events that led to such a decrease have already taken place, it seems unreasonable to argue that a decrease in carrying amount should not be recognised because it is estimated on future events.

Recognition of an Impairment Loss Based on a 'Probability' Criterion

Different Criteria for Recognising and Measuring an Impairment Loss

62. Some national standard setters support the use of 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 if the sum of the future cash flows (undiscounted and without allocation of interest costs) is less than the carrying amount of the asset. The impairment loss, when recognised, is measured by the difference between the carrying amount and the recoverable amount. In this case, recoverable amount is fair value which is either based on quoted market prices or, if no quoted market prices exist, estimated using consideration of 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.
63. 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 the asset is lower than its carrying amount, no impairment loss will be recognised in the financial statements as long as the sum of undiscounted cash flows (without allocation of interest charge) is greater than the carrying amount. This might occur especially if the asset has a long useful life.

64. The arguments that support such an approach are:

- (a) it is a practical way to apply the 'probability criterion' for impairment loss recognition;
- (b) although using the same basis for recognition and measurement assures consistent outcomes for identical fact situations, the 'economic criterion' presupposes that a fair value is available for every asset on an ongoing basis whereas fair values may not be available in practice (note that fair value is determined under this approach as explained in paragraph 62 of this appendix);
- (c) it avoids recognising volatile impairment losses. This approach is operational in an area of significant uncertainty; and
- (d) 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.

65. The Board considered the arguments listed above but rejected that approach because:

- (a) the use of a list of indicators of impairment loss is likely to be an effective tool in identifying whether an asset is potentially impaired and the list will avoid the need to estimate the recoverable amount of each asset every year;
- (b) the requirement to measure the recoverable amount of an asset based on the higher of net selling price and value in use will limit the volatility of impairment losses and the difficulty of determining the recoverable amount;
- (c) recognising an impairment loss if the sum of undiscounted cash flows is less than the carrying amount of the asset may mean that the risk is high that an impairment loss may not be recognised in some cases, particularly for an asset with a long life; and
- (d) the use of the sum of undiscounted future cash flows, together with the measurement of impaired assets at their fair value, implies that a small change in those cash flows could lead to very significant differences in estimating the recoverable amount.

66. The Board decided to reject the 'probability criterion', i.e. recognition of an impairment loss if it is considered probable that the carrying amount of an asset cannot be fully recovered. The Board considered that this criterion is difficult to apply and that it introduces another unnecessary layer of probability. Indeed, probability factors are already encompassed in estimating recoverable amount.

Recognition of an Impairment Loss Based on an 'Economic' Criterion

67. The Board proposes the 'economic criterion' for the recognition of an impairment loss, that is, recognition of an impairment loss whenever the recoverable amount is below the carrying amount of the asset. This is the criterion that already exists in IAS 9, Research and Development Costs, IAS 16, Property, Plant and Equipment, and IAS 22, Business Combinations. The Board considers that this is the best criterion to give information which is useful to users in assessing future cash flows to be generated by the enterprise. All factors, such as the probability or permanence of the impairment loss, are subsumed in the measurement attributes, particularly if that measurement is based on estimated future cash flows.

Revalued Assets: Recognition of an Impairment Loss in the Income Statement versus Directly in Equity

68. IAS 16, Property, Plant and Equipment, 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 charged directly to equity to the extent that it reverses a previous revaluation⁸.

⁸ E53, Presentation of Financial Statements, includes the Board's proposal to provide for a new statement, the statement of non-owner movements in equity, so that items of income and expense that are not recognised in the income statement and that are recorded directly to equity can be adequately disclosed to users. There is no reference to the statement of non-owner movements in equity in the proposed amendments to IAS 16, Property, Plant and Equipment (see Appendix 2). This does not mean that the final update of IAS 16 will not refer to that statement or other statement eventually. This will depend on the outcome of the IASC project on Presentation of Financial Statements.

69. Some propose that:

- (a) when there is a clear reduction in the quantum of service potential (example: physical damage) of a revalued asset, the impairment loss should be recognised in the income statement; and
- (b) when there is a decrease in the profitability of a revalued asset but its useful life remains the same (example: fall in value of an investment property), the impairment loss should be recognised directly in equity until the carrying amount reaches depreciated historical cost. Any further impairment loss below depreciated historical cost should be recognised in the income statement.

70. Others argue that an impairment loss should always be recognised as an expense in the income statement. The logic of this proposal 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 proposal question why the treatment for an impairment loss of a revalued asset should be different than for depreciation.

71. The Board believes that it is difficult to identify whether an impairment loss is a downward revaluation or a decrease in profitability. Therefore, the Board decided to retain the treatment used in IAS 16, that is 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).

72. The amendments that are proposed to IAS 16 and that are included in Appendix 2 of the Exposure Draft (see paragraphs 56 to 60 of Appendix 2) explain how the requirements proposed in E55, Impairment of Assets, apply to revalued assets. In fact, all the requirements in E55 apply to revalued assets except that:

- (a) it is not always necessary to calculate the recoverable amount of a revalued asset if an indicator of potentially impaired assets is triggered because, depending on the basis used to revalue the asset, there may be no risk that the asset is impaired eventually;

- (b) an impairment loss is not recognised in the income statement if there remains any revaluation surplus for the asset;
 - (c) a reversal of an impairment loss is not recognised in the income statement if the impairment loss was initially recognised directly in equity; and
 - (d) a reversal of an impairment loss is not limited by the depreciated historical cost of the asset, as that would be inconsistent with applying revaluation principles for subsequent measurement.
73. The distinction whether an adjustment of a revalued asset's carrying amount to its recoverable amount is an 'impairment loss' ('reversal of an impairment loss') or a 'revaluation decrease' ('revaluation increase') is important for the purpose of disclosure requirements. If a significant impairment loss has been recognised or reversed, more information is required by E55, Impairment of Assets, than for the mere recognition of a revaluation in accordance with IAS 16.

Cash-Generating Units (Exposure Draft: paragraphs 46-65)

74. The Board supports the view that, where an asset does not generate cash inflows that are largely independent of those from other assets, the recoverable amount of the asset's cash-generating unit should be determined. An impairment loss is recognised for such an asset if, and only if, the two following conditions are met:
- (a) the asset's cash generating is impaired (see paragraph 56 of the Exposure Draft); and
 - (b) the asset's net selling price is less than the asset's carrying amount (this second condition follows from the allocation procedures set out in paragraph 65 of the Exposure Draft).
75. This is consistent with IAS 16, Property, Plant and Equipment, which indicates in paragraph 58 that "...there may be circumstances when it may not be possible to assess the recoverable amount of an [individual] asset [separately], for example when all the plant and equipment in a factory is used for the same purpose. In such circumstances, the carrying amount of each of the related assets is reduced in proportion to the overall decline in recoverable amount of the smallest grouping of assets for which it is possible to make an assessment of recoverable amount...".
76. The Board rejected certain proposals for determining an impairment loss of a cash-generating unit, such as:
- (a) comparing the recoverable amount of a cash-generating unit with its carrying amount, plus the excess of the net selling price of individual assets within the cash-generating unit over their carrying amount (see paragraphs 77-78 of this appendix); and
 - (b) recognising an impairment loss, excluding the portion that may be related to an impairment loss of unrecognised internally generated goodwill (see paragraphs 79-81 of this appendix).

Adjustment to the Carrying Amount of a Cash-Generating Unit by the Excess of the Net Selling Price of Individual Assets Over Their Carrying Amount

77. Some argue that, in determining the carrying amount of a cash-generating unit, the carrying amount of individual assets within that unit should be increased up to their net selling price if higher than the individual asset's carrying amount. For example, when a cash-generating unit comprises goodwill and other assets, this requirement would ensure that the impairment loss of the goodwill within a business is not missed if one of the assets with an obvious net selling price is carried in the financial statements at an amount much less than its real value and if goodwill is overvalued.
78. The Board rejected this proposal because the Board supports the principle that when the lowest possible level for assessing an asset's recoverable amount is the asset's cash-generating unit, an impairment loss should be considered for the cash-generating unit as a whole and, consequently, individual assets within that cash-generating unit should not be considered separately.

Impairment Loss Related to Unrecognised Internally Generated Goodwill

79. Some national standard setters have proposed that if an acquired business is merged with an existing business such that a cash-generating unit contains both purchased and (unrecognised) internally generated goodwill:
 - (a) the value of the internally generated goodwill at the date of merging the business should be estimated and notionally added to the carrying amount of the cash-generating unit for the purpose of estimating an impairment loss in the cash-generating unit;
 - (b) any impairment loss arising on merging the business should be apportioned solely to the purchased goodwill;
 - (c) subsequent impairment losses should be apportioned on a pro rata basis between the purchased and (notional) internally generated goodwill; and

- (d) only impairment losses apportioned to the purchased goodwill (and, if necessary, to any intangible or tangible assets) should be recognised as an expense in the income statement.

Example

Company A purchases company B for 1,500. At the time of acquisition, the fair value of A's and B's identifiable assets less identifiable liabilities are respectively 2,000 and 1,000. 500 goodwill is recognised for the acquisition of B and the unrecognised internally generated goodwill for A is estimated at 1,000.

At acquisition	Net assets	Goodwill	Total
Company A	2,000	1,000 (unrecognised)	3,000
Company B	1,000	500 (recognised)	1,500
Total	<u>3,000</u>	<u>1,500</u>	<u>4,500</u>

After the acquisition, A and B's activities are merged and cannot be distinguished any longer. For the purpose of the example, it is assumed that 5 years later net assets have not changed and the recoverable amount of the merged business (company A plus company B) is 4,200 (amortisation of goodwill is also ignored).

The proposal in paragraph 79 of this appendix (rejected by the Board) would require that 300 notional impairment loss (4,200 less 4,500) be allocated between A's unrecognised internally generated goodwill and B's purchased goodwill. 100 impairment loss would be recognised as an expense for the reduction in the carrying amount of the goodwill attributable to B:

At Year 5	Net assets	Goodwill	Impairment loss	Net goodwill	Total
Company A	2,000	1,000 (unrecognised)	(200) (unrecognised)	800 (unrecognised)	2,800
Company B	1,000	500 (recognised)	(100) (recognised)	400 (recognised)	1,400
Total	<u>3,000</u>	<u>1,500</u>	<u>(300)</u>	<u>1,200</u>	<u>4,200</u>

80. The proposal in paragraph 79 of this appendix could also avoid, to a certain extent, a reduction in an asset's carrying amount by an impairment loss that is attributable to some internally generated goodwill that has never been recognised in the financial statements.

Example

An acquirer A has purchased a highly profitable company B for 200 and has net assets of 200 (excluding investment in B). The acquisition of B led to the recognition in A's financial statements of B's net assets at a fair value of 150 and goodwill of 50 related to B's activities. At the time of the acquisition, the value in use of A's business is 150. No impairment loss is recognised for A's assets because the net selling price of each individual asset of A is higher than its carrying amount. In subsequent years, the operations of A and B are merged and they can no longer be distinguished. For the purpose of the example, it is assumed that the value in use of the merged business is the sum of the value in use of each business before the acquisition and that net assets have not changed (amortisation of goodwill is also ignored). The value in use of the merged business (350) shows that an impairment loss (50) should be recognised. In accordance with the proposal in E55, the impairment loss is allocated to the goodwill.

	Enterprise A (acquirer)	Enterprise B (acquiree)	Merged Enterprise
Net assets	200	150	350
Goodwill	<u>-</u>	<u>50</u>	<u>50</u>
Total	<u>200</u>	<u>200</u>	<u>400</u>
Value in use	150	200	<u>350</u>
Impairment loss	0	0	<u>(50)</u>

It is probable that the impairment loss stems from A's low value in use before the merger. However, because of the merger, separate identification is not possible and an impairment loss will be recognised for the goodwill that relates to B, even if B continues to be highly profitable.

81. The Board agrees with the theory behind the proposal in paragraph 79 of this appendix because it believes that an impairment loss should exclude, as far as possible, any items related to internally generated goodwill (refer to paragraph 29 of the Exposure Draft). However, the Board believes that it would be costly and difficult, or even impossible, to distinguish items related to internally generated goodwill from those specific to the asset, especially if businesses are merged. The Board acknowledges that it is possible that internally generated goodwill may be included in the estimate of an asset's recoverable amount and therefore that it gives rise to a potential overstatement or understatement of the asset's carrying amount. The Board believes that its proposals represent an acceptable compromise between theory and practice, and that they provide reasonable information for users at an acceptable cost.

Can the Recoverable Amount of an Asset Always Be Estimated?

82. The Board considered a proposal that the carrying amount of an asset should be recognised as an expense immediately if the asset's recoverable amount cannot be determined reliably. The Board rejected this proposal for the following reasons:

- (a) it is unlikely that an enterprise will not be able to estimate the recoverable amount of an asset; and
- (b) although the uncertainty about a reliable measurement of the recoverable amount may be so pervasive that it is not possible to arrive at a single figure that represents a best estimate, it may be possible to estimate a minimum amount or, alternatively a range within which the recoverable amount is reasonably expected to lie. In such a situation, it would be wrong to write off the asset totally since it is clear that the recoverable amount is at least that minimum amount. Accordingly, the recoverable amount should be recognised for at least that minimum. However, the minimum amount will not necessarily be the appropriate amount to use; a larger amount should be used if it is a better estimate.

Reversals of Impairment Losses (Exposure Draft: paragraphs 70-78)

83. IAS 9, Research and Development Costs, and IAS 16, Property, Plant and Equipment, require that an impairment loss recognised for an asset covered by these Standards should be reversed when "...the circumstances and events that led to the recognition of the impairment loss have changed and when there is persuasive evidence that the new circumstances and events will persist for the foreseeable future...". IAS 22, Business Combinations, prohibits any reversal of an impairment loss recognised in prior periods in respect of goodwill.
84. Opponents of the reversal of an impairment loss argue that:
- (a) reversal of an impairment loss is contrary to the historical cost accounting system. When the carrying amount is written down, the recoverable amount becomes the new cost basis for the asset. Consequently, reversing an impairment loss is no different from revaluing an asset upward. Indeed, in many cases, the recoverable amount is similar to the measurement basis used for the revaluation of an asset. Hence, a reversal of an impairment loss should be either prohibited or recognised in equity as a revaluation;
 - (b) periodic, short term income measurements should not be affected by unrealised changes in the measurement attribute of a long-lived asset;
 - (c) reversal of an impairment loss leads to abuses and 'smoothing' behaviour in practice; and
 - (d) the follow-up for verifying whether an impairment loss needs to be reversed is costly.

85. The Board proposes that an impairment loss should be reversed if, and only if, there has been a change in the estimates used to determine an impaired asset's recoverable amount since the last impairment loss was recognised. The reasons are set out below:⁹
- (a) this is consistent with the IASC Framework and the view that future economic benefits that were not previously expected to flow from the asset have been re-assessed as probable;
 - (b) this is consistent with the application of the 'economic' criterion for recognising an impairment loss immediately if the recoverable amount of an asset is lower than its carrying amount;
 - (c) a reversal of an impairment loss is not a revaluation and it is consistent with the historical cost accounting system as long as the reversal does not exceed the original cost of the asset less amortisation/depreciation, had the impairment loss not been recognised. Accordingly, the reversal of an impairment loss should be recognised as income and any amount in excess of the depreciated historical cost should be accounted for as a revaluation;
 - (d) estimates of impairment loss are subject to future changes. It is inappropriate to prohibit the adjustment of previous estimates for the effect of uncertain future events on the value of the assets. Also, IAS 8, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies, requires that a change in accounting estimate 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 Exposure Draft acknowledges that any change in the measurement of an impairment loss is similar to a change in estimate. Also, IAS 2, Inventories, requires that a new assessment of net realisable value should be performed for inventories in the subsequent period to which they have been written down to their net realisable value and that the carrying amount should be adjusted accordingly;

⁹ See also additional discussion on reversals of impairment losses in the discussion paper "International Review of Accounting Standards Specifying the Recoverable Amount Test for Long-Lived Assets".

- (e) this treatment provides users with a more useful indication of the value of assets or groups of assets; and
 - (f) results of operations are more fairly stated in the current period and in future periods because depreciation or amortisation will be re-estimated and adjusted accordingly. Prohibition of the reversal of an impairment loss can lead to abuses such as recording a significant loss one year with the resulting lower amortisation/depreciation charge and higher profits in subsequent years.
86. The exception to the proposed general requirement is that an impairment loss on goodwill and intangible assets for which no active market exists should be reversed if, and only if, the specific external event that caused the recognition of the impairment loss has reversed. The Exposure Draft explains in paragraph 78 why such an exception has been made.
87. It should be noted that the proposals in the Exposure Draft will require amendments to some International Accounting Standards (for example, IAS 16). There will no longer be a criterion that "...there is a persuasive evidence that the new circumstances and events will persist for the foreseeable future...". Indeed, as explained before, this requirement refers to a 'permanent' criterion for the recognition or de-recognition of an impairment loss that the Board rejected.

Disclosures (Exposure Draft: paragraphs 79-85)

Information on Impaired Assets by Class of Assets (Exposure Draft: paragraphs 79-81)

88. The Board rejected a proposal to require, for each class of impaired assets, the disclosure of:

- (a) the gross carrying amount;
- (b) the accumulated depreciation (amortisation);
- (c) the accumulated impairment losses net of reversals (if any); and
- (d) the amount of impairment losses that could be reversed at balance sheet date.

89. Proponents of such disclosures argue that:

- (a) disclosure of the gross carrying amount, accumulated depreciation (amortisation) and accumulated impairment losses net of reversals (if any) enables users to develop a more accurate profile of a company, its economic characteristics and its unique operating, financial, and investment characteristics. This information is particularly useful for making comparisons with other companies. For example, the recognition of impairment losses can severely distort the financial ratios that indicate the average age and useful lives of these assets. Based on financial statement amounts, these assets will seem to be older than similar assets of companies that have not recognised impairment losses. Therefore, investors will forecast the need for greater capital investment and/or maintenance expenditures for such assets. It is also more useful to know specifically that a class of impaired assets, representing only 10 per cent of total assets, has been written-down by approximately 50 per cent of its gross carrying amount. If the only disclosure is that total assets have been written down by 5 per cent of their gross carrying amount, users will not know how isolated or extensive the impairment problem is and incorrectly forecast the earning power of those assets; and

- (b) at a minimum, disclosure of the amount of impairment losses that could be reversed at balance sheet date is necessary for users to forecast the future earnings effects of such reversals. For example, using financial statement information and other economic data, investors will develop their own forecasts of corporate profitability and future reported earnings. When investors believe that the situation that led to the asset impairment has reversed or the market prices of such assets are rising, information about the amount that can be reversed is critical to developing more accurate estimates of future earnings.
90. Opponents to such disclosure requirements argue that:
- (a) the information that is relevant to users is really the amount of impairment losses recognised (or reversed) during the period and there is no benefit in disclosing information about impaired assets in subsequent periods; and
 - (b) these requirements would compel enterprises to maintain separate records for impaired assets with no real benefits.
91. Others argue that the information on impaired assets required by paragraph 79(a) and (b) of the Exposure Draft that is disclosed by class of assets should also be disclosed by reportable segments (see IAS 14, Segment Reporting).
92. The Board does not support this view:
- (a) segment information is supposed to help understanding the enterprise as a whole. Since disclosure of an asset's reportable segment for which a significant impairment loss has been recognised or reversed during the period is already proposed to be required (see paragraph 82(a) of the Exposure Draft), the Board does not believe that further information is needed; and
 - (b) recognition or reversal of impairment losses could be considered as unusual items. The Board decided not to require disclosure of unusual items in IAS 14 (revised 1997), Segment Reporting¹⁰.

¹⁰ IAS 14 (revised 1997), Segment Reporting, which was approved by the Board in January 1997, will be published later in 1997.

Information on Significant Impairment Losses (or their Reversal) (Exposure Draft: paragraph 82)

93. The Board rejected a proposal to require that an enterprise should disclose for each individual asset (cash-generating unit) for which significant impairment losses have been recognised or reversed during the period:
 - (a) the value in use of the asset (cash-generating unit) if the recoverable amount is based on the net selling price of the asset (cash-generating unit);
 - (b) the net selling price of the asset (cash-generating unit) if the recoverable amount is based on the value in use of the asset (cash-generating unit);
 - (c) if the recoverable amount is based on the value in use of the asset (cash-generating unit):
 - (i) the discount rate(s) used in the calculation; and
 - (ii) the assumed long-term average growth rate for the products, industries, and country or countries in which the enterprise operates or for the market in which the asset (cash-generating unit) is used; and
 - (d) other key assumptions used to determine the recoverable amount of an asset.

94. Proponents of the above mentioned disclosure argue that since judgement will be used in determining an impairment loss and since no preference is 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), users should be provided with enough information so that they can make their own judgement in respect of management's judgement.

95. Opponents of such disclosure argue that:

- (a) it is not the role of users of financial statements to verify how recoverable amount has been estimated as this is the role of the external auditors;
- (b) the information proposed to be disclosed may be prejudicial to the interests of the enterprise; and
- (c) there is a requirement in paragraph 82(d)(iii) of the Exposure Draft that, where recoverable amount is based on value in use, an enterprise should disclose the fact that value in use significantly exceeds net selling price (if this is the case). This information will provide users with a sufficient warning signal that, perhaps, more enquiry is necessary.

Information on the Sensitivity of Recoverable Amount

96. The Board rejected a proposal to require disclosure of information similar to that proposed in paragraph 93 of this appendix for each individual asset (cash-generating unit) for which:

- (a) recoverable amount has been determined during the period;
- (b) no impairment loss was recognised or reversed during the period; and
- (c) a small change in key assumptions could lead to the recognition or reversal of a significant impairment loss.

97. Arguments to support or reject such a proposal are similar to those expressed in paragraphs 94 and 95 above. It should also be noted that the Exposure Draft requires in paragraph 83(c) disclosure of the fact that, where recoverable amount is based on value in use, an asset's carrying amount significantly exceeds the asset's net selling price (if this is the case).

Information Where Recoverable Amount is Value in Use (Exposure Draft: paragraphs 82(d), 83 and 85)

Information on Estimate of Value in Use (Exposure Draft: paragraphs 82(d) and 83)

98. Paragraphs 82(d)(i) and (ii) and 83(a) and (b) of the Exposure Draft require that, where recoverable amount is value in use, an enterprise should disclose:
- (a) the period over which management's projections of short-term future cash flows have been used if that period is more than five years, and the justification for using that period;
 - (b) the rate used to extrapolate management's short-term projections, and the justification for using that rate, if that rate is increasing or exceeds the long-term average growth rate for the products, industries, and country or countries in which the enterprise operates or for the market to which the asset (cash-generating unit) is dedicated.
99. As mentioned in paragraphs 25 to 27 of the Exposure Draft, cases where this disclosure will be required are expected to be unusual. Therefore, the Board supports the view that disclosure should be required.

Subsequent Monitoring of Estimates of Future Cash Flows (Exposure Draft: paragraph 85)

100. Paragraph 85 of the Exposure Draft requires that, if an asset's recoverable amount has been determined and if it is the asset's value in use, the estimates of future cash flows should be compared with actual cash flows in each subsequent period. If the actual cash flows are materially less than (greater than) those estimates, the enterprise should re-estimate the value in use that was last determined using actual cash flows but leaving all the other assumptions unchanged. If the use of actual cash flows in previous periods would have required the recognition or the reversal of an impairment loss in those periods, an enterprise should disclose:

- (a) the amount of the impairment loss that would have been recognised or reversed if actual cash flows had been included in the estimate of value in use in prior years;
 - (b) the amount of any impairment loss that has been recognised or reversed for the asset during the current period (as a consequence of applying paragraphs 7 and 8(g) and paragraphs 67 and 68(f) of the Exposure Draft); and
 - (c) the nature of the changes in assumptions that explain why the amounts disclosed in accordance with (a) and (b) above differ (if this is the case).
101. The Board believes that it is a matter of good management for an enterprise to carry out such an assessment and that this requirement will discourage an enterprise from making recurring over-optimistic (pessimistic) estimates of future cash flows.

Information on Cash-Generating Units

102. Some argue that if an asset's recoverable amount is determined for the asset's cash-generating unit, an enterprise should disclose information on that cash-generating unit such as:
- (a) which items are included in the cash-generating unit. For example, whether, in general, cash-generating units of a retail chain are identified on a store by store basis or at a regional level; and
 - (b) whether there has been any modification in the asset's cash-generating unit since the last estimate of recoverable amount.
103. The aim of such a disclosure would be:
- (a) to provide users with information that will assist them in understanding how assets are grouped when they are tested for impairment. This information is important because the way a cash-generating unit is identified has immediate consequences in the recognition or non-recognition of an impairment loss for an individual asset; and

- (b) to include an additional safeguard to ensure that cash-generating units are determined on a reasonable and consistent basis throughout periods.

104. Opponents of such disclosure argue that:

- (a) the benefits of this disclosure do not justify the cost; and
- (b) it is not the role of users to verify how an enterprise groups assets for recoverability since this is the role of external auditors.

105. The Exposure Draft does not propose to require an enterprise to disclose information about how cash-generating units are formed. Paragraph 49 of the Exposure Draft requires that an asset's cash-generating unit should include all assets that can be directly attributed, or allocated on a reasonable and consistent basis, to the asset's cash-generating unit. The Board believes that this requirement is sufficient.

Scope (Exposure Draft: paragraphs 1-4)

106. IAS 2, Inventories, requires an enterprise to measure the recoverable amount of an inventory at its net realisable value. The Board believes that there is no need to revise this requirement because it is well accepted as an appropriate test for recovery of inventories. No major differences exist between IAS 2 and the requirements included in the Exposure Draft.
107. IAS 11, Construction Contracts, and IAS 12, Income Taxes, already deal with the impairment of assets arising from construction contracts and deferred tax assets. Under both IAS 11 and IAS 12, recoverable amount is, in effect, determined on an undiscounted basis. The Board acknowledges that this is inconsistent with the proposals in the Exposure Draft. However, the Board believes that it is not possible to eliminate that inconsistency without fundamental changes to IAS 11 and IAS 12. The Board has no plans to revise IAS 11 or IAS 12.
108. The IASC Financial Instruments project is due to be completed after the Impairment project. Impairment requirements for financial instruments will be dealt with in that project.
109. E54, Employee Benefits, contains an upper limit on the amount at which an enterprise should recognise an asset arising from employee benefits. That limit is determined on a discounted basis that is broadly compatible with the proposals in the Exposure Draft. Therefore, this Exposure Draft does not deal with such assets.
110. The proposals in the Exposure Draft are applicable to all assets, unless specifically excluded, regardless of their classification as current or non-current. There are, at present, no International Accounting Standards on accounting for the impairment of current assets other than inventories.

