Exposure Draft of Proposed

AMENDMENTS TO

IAS 36
IMPAIRMENT OF ASSETS

IAS 38
INTANGIBLE ASSETS

Comments to be received by 4 April 2003

This Exposure Draft together with ED 3 *Business Combinations* is published by the International Accounting Standards Board (IASB) 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 amended International Accounting Standards.

Comments on this Exposure Draft and on ED 3 and its accompanying documents (see separate booklets) should be submitted in writing so as to be received by **4 April 2003**.

All replies will be put on the public record unless confidentiality is requested by the commentator. If commentators respond by fax or email, it would be helpful if they could also send a hard copy of their response by post. Comments should preferably be sent by email to: **CommentLetters@iasb.org.uk** or addressed to:

Annette Kimmitt
Senior Project Manager
International Accounting Standards Board
30 Cannon Street, London EC4M 6XH, United Kingdom

Fax: +44 (0)20 7246 6411

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IASCF Publications Department,
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Introduction

1. This Exposure Draft has been issued by the International Accounting Standards Board as part of its project on business combinations. The Board announced in July 2001 that it would undertake the project as part of its initial agenda. The project's objective is to improve the quality of, and seek international convergence on, the accounting for business combinations and the subsequent accounting for goodwill and intangible assets acquired in business combinations.

2. The project has two phases. The first phase has resulted in the Board publishing simultaneously this Exposure Draft, which proposes changes to IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets*, and ED 3, an Exposure Draft of a proposed International Financial Reporting Standard *Business Combinations*. The Board's deliberations during the first phase of the project focused primarily on the following issues:

   (a) the method of accounting for business combinations;

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

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

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

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

3. Therefore, the Board's intention while developing this Exposure Draft was to reflect only those changes related to its decisions in the Business Combinations project, and *not* to reconsider all of the requirements in IAS 36 and IAS 38. The changes proposed to IAS 36 are primarily concerned with the impairment test for goodwill. The changes proposed to IAS 38 are primarily concerned with clarifying the notion of 'identifiability' as it relates to intangible assets, the useful life and

amortisation of intangible assets, and the accounting for in-process research and development projects acquired in business combinations.

4. The second phase of the Business Combinations project will include consideration of:

   (a) issues arising in respect of the application of the purchase method;

   (b) the accounting for business combinations in which separate entities or operations of entities are brought together to form a joint venture, including possible applications for 'fresh start' accounting; and

   (c) the accounting for business combinations involving entities under common control.

Invitation to comment

5. The Board invites comments on all the changes proposed in the Exposure Draft, and would particularly welcome answers to the questions set out in the 'Invitation to Comment' at the front of each proposed revised Standard. As noted above, the Board is not considering changes to all of the requirements in IAS 36 and IAS 38 at this time. Therefore, the Board is not requesting comments on aspects of these Standards not proposed for change.

6. Comments should be submitted in writing so as to be received no later than **4 April 2003**. Until the revised Standards become effective, the requirements of the current versions of IAS 36 and IAS 38 remain in force.

Presentation of the document

7. This Exposure Draft presents for each of the proposed revised Standards:

   - An invitation to comment. Questions have been limited to the main issues, but the Board would also welcome comments on other changes proposed.

   - A summary of main changes. This section summarises the Board's proposals for changes to the Standard. Minor matters and editorial changes are not mentioned.

   - The revised text presented as a marked-up copy of the full text of the Standard. The amendments to IAS 36 and IAS 38 proposed in the May 2002 Exposure Draft *Improvements to International Accounting Standards* and the November 2002 Exposure Draft 2 *Share-based Payment* also are presented as marked-up text.

   - A basis for conclusions. This section presents the basis for the Board's conclusions on major issues.

   - A summary of the consequential amendments to the Standard proposed in the May 2002 Exposure Draft *Improvements to International Accounting Standards* and the November 2002 Exposure Draft 2 *Share-based Payment*.

   - Alternative views. This section presents the views of Board members who voted against the publication of the Exposure Draft. Those Board members concluded that the proposed revised text for the Standard, taken as a whole, should not be published in its present form. The IASB does not allow partial dissents. Board members' views (including the views of Board members who supported the publication of the Exposure Draft of the Standard) may change as a result of comments received in the exposure process. Alternative views are not attributed to individual Board members.

8. Consequential amendments to other Standards and SIC Interpretations are presented at the end of the Exposure Draft.

Style

9. The Board decided that the Business Combinations project should result in a revised IAS 36 and a revised IAS 38. Therefore, the style changes the Board has agreed to make for new Standards—International Financial Reporting Standards (IFRSs)—have not been reflected in the revised text. These changes are set out in the Preface to International Financial Reporting Standards (issued in May 2002).

10. However, this document does reflect the Board's decision to change certain terminology in existing Standards. Accordingly, the word 'shall' is used instead of 'should' and 'entity' is used instead of 'enterprise'. By replacing 'should' with 'shall', the Board does not intend to change the requirements in the Standards, but to clarify that it interprets 'should' as meaning 'shall'. By replacing 'enterprise' with 'entity', a more neutral term, the Board intends to reflect its objective that Standards should be used by all profit-oriented entities preparing general purpose financial statements.

PROPOSED AMENDMENTS TO

IAS 36
IMPAIRMENT OF ASSETS

[Note: For the purpose of this Exposure Draft, the new text is underlined and the deleted text is struck through. The amendments to IAS 36 proposed in the May 2002 Exposure Draft *Improvements to International Accounting Standards* are also presented in this manner as marked-up text.]

Invitation to Comment (IAS 36)

The Board would particularly welcome answers to the questions set out below. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Question 1 – Frequency of impairment tests

Are the proposals relating to the frequency of impairment testing intangible assets with indefinite useful lives and acquired goodwill appropriate (see proposed paragraphs 8 and 8A and paragraphs C6, C7 and C41 of the Basis for Conclusions)? If not, how often should such assets be tested for impairment, and why?

Question 2 – Intangible assets with indefinite useful lives

The Exposure Draft proposes that the recoverable amount of an intangible asset with an indefinite useful life should be measured, and impairment losses (and reversals of impairment losses) for such assets accounted for, in accordance with the requirements in IAS 36 for assets other than goodwill (see paragraphs C10-C11 of the Basis for Conclusions).

Is this appropriate? If not, how should the recoverable amount be measured, and impairment losses (and reversals of impairment losses) be accounted for?

Question 3 – Measuring value in use

The Exposure Draft proposes additional guidance on measuring the value in use of an asset. Is this additional guidance appropriate? In particular:

(a) should an asset's value in use reflect the elements listed in proposed paragraph 25A? If not, which elements should be excluded or should any additional elements be included? Also, should an entity be permitted to reflect those elements either as adjustments to the future cash flows or adjustments to the discount rate (see proposed paragraph 26A and paragraphs C66 and C67 of the Basis for Conclusions)? If not, which approach should be required?

(b) should the assumptions on which cash flow projections are based take into account both past actual cash flows and management's past ability to forecast cash flows accurately (see proposed paragraph 27(a)(ii) and paragraphs C66 and C67 of the Basis for Conclusions)? If not, why not?

(c) is the additional guidance in proposed Appendix B to [draft] IAS 36 on using present value techniques in measuring an asset's value in use appropriate? If not, why not? Is it sufficient? If not, what should be added?

Question 4 – Allocating goodwill to cash-generating units

The Exposure Draft proposes that for the purpose of impairment testing, acquired goodwill should be allocated to one or more cash-generating units.

(a) Should the allocation of goodwill to one or more cash-generating units result in the goodwill being tested for impairment at a level that is consistent with the lowest level at which management monitors the return on the investment in that goodwill, provided such monitoring is conducted at or below the segment level based on an entity's primary reporting format (see proposed paragraphs 73-77 and paragraphs C18-C20 of the Basis for Conclusions)? If not, at what level should the goodwill be tested for impairment, and why?

(b) If an entity disposes of an operation within a cash-generating unit to which goodwill has been allocated, should the goodwill associated with that operation be included in the carrying amount of the operation when determining the gain or loss on disposal (see proposed paragraph 81 and paragraphs C21-C23 of the Basis for Conclusions)? If not, why not? If so, should the amount of the goodwill be measured on the basis of the relative values of the operation disposed of and the portion of the unit retained or on some other basis?

(c) If an entity reorganises its reporting structure in a manner that changes the composition of one or more cash-generating units to which goodwill has been allocated, should the goodwill be reallocated to the units affected using a relative value approach (see proposed paragraph 82 and paragraphs C24 and C25 of the Basis for Conclusions)? If not, what approach should be used?

Question 5 – Determining whether goodwill is impaired

The Exposure Draft proposes:

(a) that the recoverable amount of a cash-generating unit to which goodwill has been allocated should be measured as the higher of the unit's value in use and net selling price (see proposed paragraphs 5 (definition of recoverable amount) and 85 and paragraph C17 of the Basis for Conclusions).

Is this appropriate? If not, how should the recoverable amount of the unit be measured?

(b) the use of a screening mechanism for identifying potential goodwill impairments, whereby goodwill allocated to a cash-generating unit would be identified as potentially impaired only when the carrying amount of the unit exceeds its recoverable amount (see proposed paragraph 85 and paragraphs C42-C51 of the Basis for Conclusions).

Is this an appropriate method for identifying potential goodwill impairments? If not, what other method should be used?

(c) that if an entity identifies goodwill allocated to a cash-generating unit as potentially impaired, the amount of any impairment loss for that goodwill should be measured as the excess of the goodwill's carrying amount over its implied value measured in accordance with proposed paragraph 86 (see proposed paragraphs 85 and 86 and paragraphs C28-C40 of the Basis for Conclusions).

Is this an appropriate method for measuring impairment losses for goodwill? If not, what method should be used, and why?

Question 6 – Reversals of impairment losses for goodwill

The Exposure Draft proposes that reversals of impairment losses recognised for goodwill should be prohibited (see proposed paragraph 123 and paragraphs C62-C65 of the Basis for Conclusions).

Is this appropriate? If not, what are the circumstances in which reversals of impairment losses for goodwill should be recognised?

Question 7 – Estimates used to measure recoverable amounts of cash-generating units containing goodwill or intangible assets with indefinite useful lives

The Exposure Draft proposes requiring a variety of information to be disclosed for each segment, based on an entity's primary reporting format, that includes within its carrying amount goodwill or intangible assets with indefinite useful lives (see proposed paragraph 134 and paragraphs C69-C82 of the Basis for Conclusions).

(a) Should an entity be required to disclose each of the items in proposed paragraph 134? If not, which items should be removed from the disclosure requirements, and why?

(b) Should the information to be disclosed under proposed paragraph 134 be disclosed separately for a cash-generating unit within a segment when one or more of the criteria in proposed paragraph 137 are satisfied? If not, why not?

Summary of Main Changes (IAS 36)

Frequency of impairment testing

- IAS 36 requires the recoverable amount of an asset to be measured whenever there is an indication that the asset may be impaired. The Exposure Draft proposes:

  - that the recoverable amount of an intangible asset with an indefinite useful life should also be measured at the end of each annual reporting period, irrespective of whether there is any indication that it may be impaired. However, the most recent detailed calculation of recoverable amount made in a preceding reporting period may be used in the impairment test for that asset in the current period, provided specified criteria are met.

  - to relocate from IAS 38 *Intangible Assets* the requirement for the recoverable amount of an intangible asset not yet available for use to also be measured at the end of each annual reporting period, irrespective of whether there is any indication that it may be impaired.

  - that goodwill acquired in a business combination should be tested for impairment annually and whenever there is any indication that it may be impaired.

Measuring value in use

- The Exposure Draft proposes clarifying that the following elements should be reflected in the calculation of an asset's value in use:

  - an estimate of the future cash flows the entity expects to derive from the asset.

  - expectations about possible variations in the amount and/or timing of those future cash flows.

  - the time value of money, represented by the current market risk-free rate of interest.

  - the price for bearing the uncertainty inherent in the asset.

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

  The Exposure Draft also proposes clarifying that the second, fourth and fifth of these elements can be reflected either as adjustments to the future cash flows or adjustments to the discount rate.

- IAS 36 requires cash flow projections used to measure value in use to be based on reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the remaining useful life of the asset. The Exposure Draft proposes requiring those assumptions also to take into account both past actual cash flows and management's past ability to forecast cash flows accurately.

- Additional guidance on using present value techniques in measuring an asset's value in use has been included in proposed Appendix B to [draft] IAS 36. In addition, the guidance in IAS 36 on estimating the discount rate when an asset-specific rate is not directly available from the market has been relocated to Appendix B.

Allocating goodwill to cash-generating units

- IAS 36 requires goodwill to be tested for impairment as part of impairment testing the cash-generating units to which it relates. It employs a 'bottom-up/top-down' approach under which the goodwill is in effect tested for impairment by allocating its carrying amount to each of the smallest cash-generating units to which a portion of that carrying amount can be allocated on a reasonable and consistent basis. Consistently with IAS 36, the Exposure Draft proposes that:

  - goodwill should be tested for impairment as part of impairment testing the cash-generating units to which it relates.

  - the carrying amount of goodwill should be allocated to each of the smallest cash-generating units to which a portion of that carrying amount can be allocated on a reasonable and consistent basis.

However, the Exposure Draft proposes additional guidance clarifying that a portion of the carrying amount of goodwill should be regarded as capable of being allocated to a cash-generating unit on a reasonable and consistent basis only when that cash-generating unit represents the lowest level at which management monitors the return on investment in assets that include the goodwill. That cash-generating unit cannot be larger than a segment based on the entity's primary reporting format determined in accordance with IAS 14 *Segment Reporting*.

- The Exposure Draft proposes clarifying that if the initial allocation of goodwill acquired in a business combination cannot be completed before the end of the annual reporting period in which the business combination occurs, that initial allocation should be completed before the end of the first annual reporting period beginning after the acquisition date.

- The Exposure Draft proposes that when an entity disposes of an operation within a cash-generating unit to which goodwill has been allocated, the goodwill associated with that operation should be:

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

  - measured on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit retained.

- The Exposure Draft proposes that when an entity reorganises its reporting structure in a manner that changes the composition of cash-generating units to which goodwill has been allocated, the goodwill should be reallocated to the units affected using a relative value approach similar to that used when an entity disposes of an operation within a cash-generating unit.

Measuring impairment losses for goodwill

- If the carrying amount of a cash-generating unit to which goodwill has been allocated exceeds its recoverable amount, IAS 36 requires the excess to be recognised as an impairment loss for goodwill. Any excess remaining after the carrying amount of goodwill has been reduced to zero is then recognised by being allocated to the other assets of the unit pro rata with the carrying amount of each asset in the unit. The Exposure Draft proposes amending this approach by requiring the impairment loss

for goodwill to be measured as the excess of the carrying amount of goodwill over its implied value.

- The Exposure Draft proposes that the implied value of goodwill should be measured a s the excess of:

  - the recoverable amount of the cash-generating unit to which the goodwill has been allocated, over

  - the net fair value of the identifiable assets, liabilities and contingent liabilities the entity would recognise if it acquired that cash-generating unit in a business combination on the date of the impairment test. However, an entity should exclude from this net fair value calculation any identifiable asset that was acquired in a business combination but not recognised separately from goodwill at the acquisition date.

Timing of impairment tests for goodwill

- The Exposure Draft proposes that:

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

  - different cash-generating units may be tested for impairment at different times.

  However, if some of the goodwill allocated to a cash-generating unit was acquired in a business combination during the current annual reporting period, the Exposure Draft proposes requiring that unit to be tested for impairment before the end of the current period.

- The Exposure Draft proposes that the most recent detailed calculation made in a preceding reporting period of the recoverable amount of a cash-generating unit to which goodwill has been allocated may be used in the impairment test for that unit in the current period, provided specified criteria are met.

- The Exposure Draft proposes that an entity should recognise its best estimate of any probable impairment loss for goodwill if the carrying amount of a cash-generating unit to which the goodwill has been allocated exceeds its recoverable amount, but the entity has not completed before the financial statements are authorised for issue its determination of whether the goodwill is impaired. The Exposure Draft also proposes requiring any adjustment to that estimated impairment loss as a result of completing the impairment test to be recognised in the immediately succeeding reporting period.

Reversals of impairment losses for goodwill

- IAS 36 requires an impairment loss recognised for goodwill in a previous reporting period to be reversed when the impairment loss was caused by a specific external event of an exceptional nature that is not expected to recur and subsequent external events have occurred that reverse the effect of that event. The Exposure Draft proposes to prohibit the recognition of reversals of impairment losses for goodwill.

Disclosure

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

- The Exposure Draft proposes that if an entity recognises only its best estimate of a probable impairment loss for goodwill, it should disclose the following information in the period in which that estimate is recognised:

  - the fact that the impairment loss recognised for goodwill is an estimate that has not yet been finalised; and

  - the reasons why the amount of the impairment loss has not been finalised.

  The Exposure Draft also proposes that the entity should disclose in the immediately succeeding reporting period the nature and amount of any adjustments recognised to the estimated impairment loss.

- The Exposure Draft proposes requiring disclosure of a range of information for each segment, based on an entity's primary reporting format, that includes within its carrying amount goodwill or intangible assets with indefinite useful lives. That information is concerned primarily with:

  - the key assumptions used to measure the recoverable amounts of the cash-generating units within the segment that include within their carrying amounts goodwill or intangible assets with indefinite useful lives.

  - for each key assumption, the amount by which the value assigned to that assumption must change, incorporating any consequential effects of that change on the other variables used to measure recoverable amount, for the aggregate recoverable amount of the cash-generating units within the segment that include within their carrying amounts goodwill or intangible assets with indefinite useful lives to be equal to their aggregate carrying amount.

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APPENDICES

International Accounting Standard IAS 36
(revised 200X)

Impairment of Assets

[Draft] International Accounting Standard 36 *Impairment of Assets* (IAS 36) is set out in paragraphs 1-139 and Appendix B. All the paragraphs have equal authority but retain the IASC format of the Standard when it was adopted by the IASB. [Draft] IAS 36 should be read in the context of its objective and the Basis for Conclusions, the *Preface to International Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. These provide a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

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

Scope

1. This [draft] Standard ~~should~~ shall be applied in accounting for the impairment of all assets, other than:

(a) inventories (see [draft] IAS 2, Inventories);

(b) assets arising from construction contracts (see IAS 11, Construction Contracts);

(c) deferred tax assets (see IAS 12, Income Taxes);

(d) assets arising from employee benefits (see IAS 19, Employee Benefits);

(e) financial assets that are included in the scope of [draft] IAS ~~32~~ 39, Financial Instruments: ~~Disclosure and Presentation~~ Recognition and Measurement;

(f) investment property that is measured at fair value (see [draft] IAS 40, Investment Property); and

(g) biological assets related to agricultural activity that are measured at fair value less estimated point-of-sale costs (see IAS 41, Agriculture).

2. This [draft] Standard does not apply to inventories, assets arising from construction contracts, deferred tax assets or assets arising from employee benefits because existing ~~International Accounting~~ Standards applicable to these assets already contain specific requirements for recognising and measuring these assets.

3. This [draft] Standard applies to:

   (a) subsidiaries, as defined in [draft] IAS 27, Consolidated and Separate Financial Statements ~~and Accounting for Investments in Subsidiaries~~;

   (b) associates, as defined in [draft] IAS 28, Accounting for Investments in Associates; and

   (c) joint ventures, as defined in IAS 31, Financial Reporting of Interests in Joint Ventures.

   For impairment of other financial assets, refer to [draft] IAS 39, Financial Instruments: Recognition and Measurement.

4. This [draft] Standard does not apply to financial assets included in the scope of [draft] IAS 39, investment property measured at fair value under [draft] IAS 40, or biological assets related to agricultural activity measured at fair value less estimated point-of-sale costs under IAS 41. However, ~~This~~ this [draft] Standard applies to assets that are carried at revalued amount (fair value) under other ~~International Accounting~~

Standards, such as the allowed alternative treatment in [draft] IAS 16, Property, Plant and Equipment. ~~However, identifying~~ Identifying whether such a revalued asset may be impaired depends on the basis used to determine fair value:

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

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

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

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

Definitions

5. The following terms are used in this [draft] Standard with the meanings specified:

The ~~Recoverable~~ recoverable amount of an asset or a cash-generating unit is the higher of ~~an asset's~~ its net selling price and ~~its~~ value in use.

Value in use is the present value of ~~estimated~~ the future cash flows expected to ~~arise~~ be derived from ~~the continuing use of~~ an asset or cash-generating unit ~~and from its disposal at the end of its useful life~~.

Net selling price is the amount obtainable from the sale of an asset or cash-generating unit in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal.

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

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

Carrying amount is the amount at which an asset is recognised 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 life.[1]

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~~ entity; or

[1]In the case of an intangible asset ~~or goodwill~~, the term 'amortisation' is generally used instead of 'depreciation'. Both terms have the same meaning.

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

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

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

An active market is a market where all the following conditions exist:

(a) the items traded within the market are homogeneous;

(b) willing buyers and sellers can normally be found at any time; and

(c) prices are available to the public.

The agreement date for a business combination is the date that a substantive agreement between the combining parties is reached and, in the case of publicly listed entities, announced to the public. In the case of a hostile takeover, the earliest date that a substantive agreement between the combining parties is reached is the date that a sufficient number of the acquiree's owners have accepted the acquirer's offer for the acquirer to obtain control of the acquiree.

Identifying an Asset that may be Impaired

6. Paragraphs 7 to 14 specify when recoverable amount ~~should~~ shall be determined. These requirements use the term 'an asset' but apply equally to an individual asset or a cash-generating unit. The remainder of this [draft] Standard is structured as follows:

   (a) paragraphs 15 to 50 set out the requirements for measuring recoverable amount. These requirements also use the term 'an asset' but apply equally to an individual asset or a cash-generating unit;

   (b) paragraphs 51 to 107 set out the requirements for recognising and measuring impairment losses. Recognition and measurement of impairment losses for individual assets other than goodwill are dealt with in paragraphs 51 to 57. Paragraphs 58 to 107 deal with the recognition and measurement of impairment losses for cash-generating units and goodwill;

   (c) paragraphs 108 to 115 set out the requirements for reversing an impairment loss recognised in prior years for an asset or a cash-generating unit. Again, these requirements use the term 'an asset' but apply equally to an individual asset or a cash-generating unit. Additional requirements are set out for an individual asset in paragraphs 116 to 120, for a cash-generating unit in paragraphs 121 and 122, and for goodwill in paragraphs 123 and 124;

   (d) paragraphs 125 to 133 specify the information to be disclosed about impairment losses and reversals of impairment losses for assets and cash-generating units. Paragraphs 134 to 137 set out additional disclosure requirements for cash-generating units to which goodwill or intangible assets with indefinite useful lives have been allocated for impairment testing purposes.

7. An asset is impaired when the carrying amount of the asset exceeds its recoverable amount. Paragraphs 9 to 11 describe some indications that an impairment loss may have occurred: if any of those indications is present, an ~~enterprise~~ entity is required to make a formal estimate of recoverable amount. ~~If no indication of a potential impairment loss is present,~~ Except as described in paragraphs 8A and 8B, this [draft] Standard does not require an ~~enterprise~~ entity to make a formal estimate

of recoverable amount if no indication of a potential impairment loss is present.

8. An ~~enterprise~~ entity ~~should~~ shall assess at each balance sheet date whether there is any indication that an asset may be impaired. If any such indication exists, the ~~enterprise~~ entity ~~should~~ shall estimate the recoverable amount of the asset.

8A. Irrespective of whether there is any indication of impairment, an entity shall also:

(a) estimate at the end of each annual reporting period the recoverable amount of an intangible asset with an indefinite useful life or an intangible asset not yet available for use; and

(b) test goodwill acquired in a business combination for impairment annually in accordance with paragraphs 73 to 98.

8B. The ability of an intangible asset to generate sufficient future economic benefits to recover its carrying amount is usually subject to greater uncertainty until the asset is available for use. Therefore, this [draft] Standard requires an entity to test for impairment, at least annually, the carrying amount of an intangible asset that is not yet available for use. [2]

9. In assessing whether there is any indication that an asset may be impaired, an ~~enterprise~~ entity ~~should~~ shall 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 passage of time or normal use;

(b) significant changes with an adverse effect on the ~~enterprise~~ entity have taken place during the period, or will take place in the near

[2] The reference in paragraph 8A to ''intangible assets not yet available for use'' and paragraph 8B have been relocated from IAS 38 *Intangible Assets*. For an explanation see paragraph B28 of the Basis for Conclusions to [draft] IAS 38 *Intangible Assets*.

future, in the technological, market, economic or legal environment in which the ~~enterprise~~ entity operates or in the market to which an asset is dedicated;

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

(d) the carrying amount of the net assets of the ~~reporting enterprise~~ entity is more than its market capitalisation;

Internal sources of information

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

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

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

10. The list in paragraph 9 is not exhaustive. An ~~enterprise~~ entity may identify other indications that an asset may be impaired and these would also require the ~~enterprise~~ entity to determine the asset's recoverable amount or, in the case of goodwill, perform an impairment test in accordance with paragraphs 73 to 98.

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

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

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

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

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

12. As indicated in paragraph 8A, this [draft] Standard requires the recoverable amount of an intangible asset with an indefinite useful life or not yet available for use to be estimated, and goodwill to be tested for impairment, at least annually. Apart from when the requirements in paragraph 8A apply, ~~The~~ 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~~ entity need not re-estimate the asset's recoverable amount if no events have occurred that would eliminate that difference. Similarly, previous analysis may show that an asset's recoverable amount is not sensitive to one (or more) of the indications listed in paragraph 9.

13. As an illustration of paragraph 12, if market interest rates or other market rates of return on investments have increased during the period, an ~~enterprise~~ entity is not required to make a formal estimate of an asset's recoverable amount in the following cases:

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

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

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

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

14. If there is an indication that an asset may be impaired, this may indicate that the remaining useful life, the depreciation (amortisation) method or the residual value for the asset need to be reviewed and adjusted under the ~~International Accounting~~ Standard applicable to the asset, even if no impairment loss is recognised for the asset.

Measurement of Recoverable Amount

15. This [draft] Standard defines recoverable amount as the higher of an asset's or cash-generating unit's net selling price and value in use. Paragraphs 16 to ~~56~~ 50 set out the requirements for measuring recoverable amount. These requirements use the term 'an asset' but apply equally to an individual asset or a cash-generating unit.

16. It is not always necessary to determine both an asset's net selling price and its value in use. 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.

17. It may be possible to determine net selling price, even if an asset is not traded in an active market. However, sometimes it will not be possible to determine net selling price because there is no basis for making a reliable estimate of the amount obtainable from the sale of the asset in an arm's length transaction between knowledgeable and willing parties. In this case, the recoverable amount of the asset may be taken to be its value in use.

18. If there is no reason to believe that an asset's value in use materially exceeds its net selling price, the asset's recoverable amount may be taken to be its net selling price. This will often be the case for an asset that is held for disposal. This is because the value in use of an asset held for disposal will consist mainly of the net disposal proceeds, since the future cash flows from continuing use of the asset until its disposal are likely to be negligible.

19. Recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows from continuing use that are largely independent of those from other assets or groups of assets. If this is the case, recoverable amount is determined for the cash-generating unit to which the asset belongs (see paragraphs ~~64~~ 58 to ~~87~~ 102), unless either:

(a) the asset's net selling price is higher than its carrying amount; or

(b) the asset's value in use can be estimated to be close to its net selling price and net selling price can be determined.

20. In some cases, estimates, averages and computational shortcuts may provide a reasonable approximation of the detailed computations illustrated in this [draft] Standard for determining net selling price or value in use.

Measuring the Recoverable Amount of an Intangible Asset with an Indefinite Useful Life

20A. Paragraph 8A requires the recoverable amount of an intangible asset with an indefinite useful life to be estimated at the end of each annual reporting period, irrespective of whether there is any indication that it may be impaired. However, the most recent detailed calculation of such an asset's recoverable amount made in a preceding period may be used in the impairment test for that asset in the current period provided all of the following criteria are met:

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

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

(c) based on an analysis of events that have occurred and circumstances that have changed since the most recent recoverable amount calculation, the likelihood that a current recoverable amount determination would be less than the asset's carrying amount is remote.

Net Selling Price

21. The best evidence of an asset's net selling price is a price in a binding sale agreement in an arm's length transaction, adjusted for incremental costs that would be directly attributable to the disposal of the asset.

22. If there is no binding sale agreement but an asset is traded in an active market, net selling price is the asset's market price less the costs of disposal. The appropriate market price is usually the current bid price. When current bid prices are unavailable, the price of the most recent transaction may provide a basis from which to estimate 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.

23. If there is no binding sale agreement or active market for an asset, net selling price is based on the best information available to reflect the amount that an ~~enterprise~~ entity could obtain, at the balance sheet date, for the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the costs of disposal. In determining this amount, an ~~enterprise~~ entity considers the outcome of recent transactions for similar assets within the same industry. Net selling price does not reflect a forced sale, unless management is compelled to sell immediately.

24. Costs of disposal, other than those that have already been recognised as liabilities, are deducted in determining net selling price. Examples of such costs are legal costs, stamp duty and similar transaction taxes, costs of removing the asset, and direct incremental costs to bring an asset into condition for its sale. However, termination benefits (as defined in IAS 19, Employee Benefits) and costs associated with reducing or reorganising a business following the disposal of an asset are not direct incremental costs to dispose of the asset.

25. Sometimes, the disposal of an asset would require the buyer to take over a liability and only a single net selling price is available for both the asset and the liability. Paragraph ~~77~~ 71 explains how to deal with such cases.

Value in Use

25A. The following elements shall be reflected in the calculation of an asset's value in use:

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

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

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

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

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

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

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

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

26A. The elements identified in paragraph 25A(b), (d) and (e) can be reflected either as adjustments to the future cash flows or adjustments to the discount rate. Whichever approach an entity adopts to reflect expectations about possible variations in the amount and/or timing of future cash flows, the result shall be to reflect the expected present value of the future cash flows; that is, the weighted average of all possible outcomes. Appendix B provides additional guidance on the use of present value techniques in measuring an asset's value in use.

Basis for Estimates of Future Cash Flows

27. In measuring value in use:

(a) cash flow projections ~~should~~ shall be based on reasonable and supportable assumptions that:

(i) represent management's best estimate of the ~~set~~ range of economic conditions that will exist over the remaining useful life of the asset; and

(ii) take into account both past actual cash flows and management's past ability to forecast cash flows accurately.

Greater weight ~~should~~ shall be given to external evidence;

(b) cash flow projections ~~should~~ shall be based on the most recent financial budgets/forecasts that have been approved by management. Projections based on these budgets/forecasts ~~should~~ shall cover a maximum period of five years, unless a longer period can be justified; and

(c) cash flow projections beyond the period covered by the most recent budgets/forecasts ~~should~~ shall be estimated by extrapolating the projections based on the budgets/forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified. This growth rate ~~should~~ shall not exceed the long-term average growth rate for the products, industries, or country or countries in which the ~~enterprise~~ entity operates, or ~~for~~ the market in which the asset is used, unless a higher rate can be justified.

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

29. Cash flow projections until the end of an asset's useful life are estimated by extrapolating the cash flow projections based on the financial budgets/forecasts using a growth rate for subsequent years. This rate is steady or declining, unless an increase in the rate matches objective information about patterns over a product or industry lifecycle. If appropriate, the growth rate is zero or negative.

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

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

Composition of Estimates of Future Cash Flows

32. Estimates of future cash flows ~~should~~ shall include:

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

(b) projections of cash outflows that are necessarily incurred to generate the cash inflows from continuing use of the asset (including cash outflows to prepare the asset for use) and 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.

33. Estimates of future cash flows and the discount rate reflect consistent assumptions about price increases due to general inflation. Therefore, if the discount rate includes the effect of price increases due to general inflation, future cash flows are estimated in nominal terms. If the discount rate excludes the effect of price increases due to general inflation, future cash flows are estimated in real terms (but include future specific price increases or decreases).

34. Projections of cash outflows include future overheads that can be attributed directly, or allocated on a reasonable and consistent basis, to the use of the asset.

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

36. To avoid double counting, estimates of future cash flows do not include:

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

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

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

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

(b) future capital expenditure that will improve or enhance the asset in excess of its ~~originally assessed~~ standard of performance assessed immediately before the expenditure is made.

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

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

(b) future capital expenditure that will improve or enhance the asset in excess of its ~~originally assessed~~ standard of performance assessed immediately before the expenditure is made or the related future benefits from this future expenditure.

39. A restructuring is a programme that is planned and controlled by management and that materially changes either the scope of the business undertaken by an ~~enterprise~~ entity or the manner in which the business is conducted. IAS 37, Provisions, Contingent Liabilities and Contingent Assets, gives guidance that ~~may clarify~~ clarifies when an ~~enterprise~~ entity is committed to a restructuring.

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

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

    (b) estimates of future cash outflows for the restructuring are dealt with in a restructuring provision under IAS 37, Provisions, Contingent Liabilities and Contingent Assets.

    Appendix A, Example 5, illustrates the effect of a future restructuring on a value in use calculation.

41. Until an ~~enterprise~~ entity incurs capital expenditure that improves or enhances an asset in excess of its ~~originally assessed~~ standard of performance assessed immediately before the expenditure is made, estimates of future cash flows do not include the estimated future cash inflows ~~that are~~ expected to arise from this expenditure (see Appendix A, Example 6).

42. Estimates of future cash flows include future capital expenditure necessary to maintain or sustain an asset at its ~~originally assessed~~ standard of performance assessed immediately before the expenditure is made.

43. Estimates of future cash flows ~~should~~ shall not include:

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

(b) income tax receipts or payments.

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

45. 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~~ shall be the amount that an ~~enterprise~~ entity expects to obtain from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the estimated costs of disposal.

46. 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~~ entity uses prices prevailing at the date of the estimate for similar assets that have reached the end of their 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.

Foreign Currency Future Cash Flows

47. Future cash flows are estimated in the currency in which they will be generated and then discounted using a discount rate appropriate for that currency. An ~~enterprise~~ entity translates the present value obtained using the spot exchange rate at the ~~balance sheet date (described in IAS 21, The Effects of Changes in Foreign Exchange Rates, as the closing rate)~~ date of the value in use calculation.

Discount Rate

48. The discount rate (or rates) ~~should~~ shall be a pre-tax rate (or rates) that reflect(s) current market assessments of:

(a) the time value of money; and

(b) the risks specific to the asset. ~~***The discount rate(s) should not reflect risks***~~ ***for which the future cash flow estimates have not been adjusted.***

49. A rate that reflects current market assessments of the time value of money and the risks specific to the asset is the return that investors would require if they were to choose an investment that would generate cash flows of amounts, timing and risk profile equivalent to those that the ~~enterprise~~ entity expects to derive from the asset. This rate is estimated from the rate implicit in current market transactions for similar assets or from the weighted average cost of capital of a listed ~~enterprise~~ entity that has a single asset (or a portfolio of assets) similar in terms of service potential and risks to the asset under review. However, the discount rate(s) used to measure an asset's value in use should not reflect risks for which the future cash flow estimates have been adjusted. Otherwise, the effect of some assumptions will be double-counted.

50. When an asset-specific rate is not directly available from the market, an ~~enterprise~~ entity uses surrogates to estimate the discount rate. ~~The purpose is to estimate, as far as possible, a market assessment of:~~ Appendix B provides additional guidance on estimating the discount rate in such circumstances.

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

~~(b) the risks that the future cash flows will differ in amount or timing from estimates.~~

~~51. As a starting point, the enterprise may take into account the following rates:~~

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

~~(b) the enterprise's incremental borrowing rate; and~~

~~(c) other market borrowing rates.~~

~~52. These rates are adjusted:~~

~~(a) to reflect the way that the market would assess the specific risks associated with the projected cash flows; and~~

~~(b) to exclude risks that are not relevant to the projected cash flows.~~

~~Consideration is given to risks such as country risk, currency risk, price risk and cash flow risk.~~

~~53. To avoid double counting, the discount rate does not reflect risks for which future cash flow estimates have been adjusted.~~

~~54. The discount rate is independent of the enterprise's capital structure and the way the enterprise financed the purchase of the asset because the future cash flows expected to arise from an asset do not depend on the way in which the enterprise financed the purchase of the asset.~~

~~55. When the basis for the rate is post tax, that basis is adjusted to reflect a pre-tax rate.~~

~~56. 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 value in use is sensitive to a difference in risks for different periods or to the term structure of interest rates.~~

Recognition and Measurement of an Impairment Loss

~~57~~ 51. Paragraphs ~~58~~ 52 to ~~63~~ 57 set out the requirements for recognising and measuring impairment losses for an individual asset other than goodwill. Recognition and measurement of impairment losses for ~~a~~ cash-generating units and goodwill are dealt with in paragraphs ~~88~~ 58 to ~~93~~ 107.

~~58~~ 52. If, and only if, the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset ~~should~~ shall be reduced to its recoverable amount. That reduction is an impairment loss.

~~59~~ 53. An impairment loss ~~should~~ shall be recognised ~~as an expense in the income statement~~ immediately in profit or loss, unless the asset is carried at revalued amount under another ~~International Accounting~~ Standard (for example, under the allowed alternative treatment in [draft] IAS 16, Property, Plant and Equipment). Any impairment loss of a revalued asset ~~should~~ shall be treated as a revaluation decrease under that other ~~International Accounting~~ Standard.

~~60~~ 54. An impairment loss on a non-revalued asset is recognised ~~as an expense in the income statement~~ in profit or loss. However, an impairment loss on a revalued asset is recognised directly against any revaluation surplus for the asset to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset.

~~61~~ 55. When the amount estimated for an impairment loss is greater than the carrying amount of the asset to which it relates, an ~~enterprise~~ entity ~~should~~ shall recognise a liability if, and only if, that is required by another ~~International Accounting~~ Standard.

~~62~~ 56. After the recognition of an impairment loss, the depreciation (amortisation) charge for the asset ~~should~~ shall be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

~~63~~ 57. If an impairment loss is recognised, any related deferred tax assets or liabilities are determined under IAS 12, Income Taxes, by comparing the revised carrying amount of the asset with its tax base (see Appendix A, Example 3).

Cash-Generating Units and Goodwill

~~64~~ 58. Paragraphs ~~65~~ 59 to ~~93~~ 107 set out the requirements for identifying the cash-generating unit to which an asset belongs and determining the carrying amount of, and recognising impairment losses for, cash-generating units and goodwill.

Identification of the Cash-Generating Unit to Which an Asset Belongs

~~65~~ 59. If there is any indication that an asset may be impaired, recoverable amount ~~should~~ shall be estimated for the individual asset. If it is not possible to estimate the recoverable amount of the individual asset, an ~~enterprise~~ entity ~~should~~ shall determine the recoverable amount of the cash-generating unit to which the asset belongs (the asset's cash-generating unit).

~~66~~ 60. The recoverable amount of an individual asset cannot be determined if:

(a) the asset's value in use cannot be estimated to be close to its net selling price (for example, when the future cash flows from continuing use of the asset cannot be estimated to be negligible); and

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

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

Example

A mining ~~enterprise~~ entity owns a private railway to support its mining activities. The private railway could be sold only for scrap value and the private railway does not generate cash inflows from continuing use that are largely independent of the cash inflows from the other assets of the mine.

continued …

It is not possible to estimate the recoverable amount of the private railway because the value in use of the private railway cannot be determined and it is probably different from scrap value. Therefore, the ~~enterprise~~ entity estimates the recoverable amount of the cash-generating unit to which the private railway belongs, that is, the mine as a whole.

~~67~~ 61. As defined in paragraph 5, an asset's cash-generating unit is the smallest group of assets that includes the asset and that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets. Identification of an asset's cash-generating unit involves judgement. If recoverable amount cannot be determined for an individual asset, an ~~enterprise~~ entity identifies the lowest aggregation of assets that generate largely independent cash inflows from continuing use.

Example

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

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

~~68~~ 62. Cash inflows from continuing use are inflows of cash and cash equivalents received from parties outside the ~~reporting enterprise~~ entity. In identifying whether cash inflows from an asset (or group of assets) are largely independent of the cash inflows from other assets (or groups of assets), an ~~enterprise~~ entity considers various factors including how management monitors the ~~enterprise~~ entity's operations (such as by product lines, businesses, individual locations, districts or regional areas or in some other way) or how management makes decisions about continuing or disposing of the ~~enterprise~~ entity's assets and operations. Appendix A, Example 1, gives examples of identification of a cash-generating unit.

~~69~~ ***63. If an active market exists for the output produced by an asset or a group of assets, this asset or group of assets ~~should~~ shall be identified as a cash-generating unit, even if some or all of the output is used internally. If this is the case, management's best estimate of future market prices for the output ~~should~~ shall be used:***

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

(b) in determining the value in use of other cash-generating units of the ~~reporting enterprise~~ entity, when estimating the future cash outflows that relate to the internal use of the output.

~~70~~ 64. Even if part or all of the output produced by an asset or a group of assets is used by other units of the ~~reporting enterprise~~ entity (for example, products at an intermediate stage of a production process), this asset or group of assets forms a separate cash-generating unit if the ~~enterprise~~ entity could sell this output on an active market. This is because this asset or group of assets could generate cash inflows from continuing use that would be largely independent of the cash inflows from other assets or groups of assets. In using information based on financial budgets/forecasts that relates to such a cash-generating unit, an ~~enterprise~~ entity adjusts this information if internal transfer prices do not reflect management's best estimate of future market prices for the cash-generating unit's output.

~~71~~ 65. Cash-generating units ~~should~~ shall be identified consistently from period to period for the same asset or types of assets, unless a change is justified.

~~72~~ 66. If an ~~enterprise~~ entity determines that an asset belongs to a ~~different~~ cash-generating unit ~~than~~ different from that in previous periods, or that the types of assets aggregated for the asset's cash-generating unit have changed, paragraph ~~117~~ 129 requires certain disclosures about the cash-generating unit, if an impairment loss is recognised or reversed for the cash-generating unit and is material to the financial statements of the ~~reporting enterprise~~ entity as a whole.

Recoverable Amount and Carrying Amount of a Cash-Generating Unit

~~73~~ 67. The recoverable amount of a cash-generating unit is the higher of the cash-generating unit's net selling price and value in use. For the purpose of determining the recoverable amount of a cash-generating unit, any reference in paragraphs 16 to ~~56~~ 50 to 'an asset' is read as a reference to 'a cash-generating unit'.

~~74~~ 68. The carrying amount of a cash-generating unit ~~should~~ shall be determined consistently with the way the recoverable amount of the cash-generating unit is determined.

~~75~~ 69. The carrying amount of a cash-generating unit:

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

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

This is because net selling price and value in use of a cash-generating unit are determined excluding cash flows that relate to assets that are not part of the cash-generating unit and liabilities that have already been recognised in the financial statements (see paragraphs 24 and 36).

~~76~~ 70. Where assets are grouped for recoverability assessments, it is important to include in the cash-generating unit all assets that generate the relevant stream of cash inflows from continuing use. Otherwise, the cash-generating unit may appear to be fully recoverable when in fact an impairment loss has occurred. In some cases, although certain assets contribute to the estimated future cash flows of a cash-generating unit, they cannot be allocated to the cash-generating unit on a reasonable and consistent basis. This might be the case for goodwill or corporate assets such as head office assets. Paragraphs ~~79~~ 73 to ~~87~~ 102 explain how to deal with these assets in testing a cash-generating unit for impairment.

~~77~~ 71. It may be necessary to consider certain recognised liabilities in order to determine the recoverable amount of a cash-generating unit. This may occur if the disposal of a cash-generating unit would require the buyer to take over a liability. In this case, the net selling price (or the estimated cash flow from ultimate disposal) of the cash-generating unit is the estimated selling price for the assets of the cash-generating unit and the liability together, less the costs of disposal. 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 is deducted in determining both the cash-generating unit's value in use and its carrying amount.

Example

A company operates a mine in a country where legislation requires that the owner must restore the site on completion of its mining operations. The cost of restoration includes the replacement of the overburden, which must be removed before mining operations commence. A provision for the costs to replace the overburden was recognised as soon as the overburden was removed. The amount provided was recognised as part of the cost of the mine and is being depreciated over the mine's useful life. The carrying amount of the provision for restoration costs is 500, which is equal to the present value of the restoration costs.

The ~~enterprise~~ entity is testing the mine for impairment. The cash-generating unit for the mine is the mine as a whole. The ~~enterprise~~ entity has received various offers to buy the mine at a price of around 800; this price encompasses the fact that the buyer will take over the obligation to restore the overburden. Disposal costs for the mine are negligible. The value in use of the mine is approximately 1,200, excluding restoration costs. The carrying amount of the mine is 1,000.

The net selling price for the cash-generating unit is 800. This amount considers restoration costs that have already been provided for. As a consequence, the value in use for the cash-generating unit is determined after consideration of the restoration costs and is estimated to be 700 (1,200 less 500). The carrying amount of 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). Therefore, the recoverable amount of the cash-generating unit exceeds its carrying amount.

~~78~~ 72. For practical reasons, the recoverable amount of a cash-generating unit is sometimes determined after consideration of assets that are not part of the cash-generating unit (for example, receivables or other financial assets) or liabilities that have already been recognised in the financial statements (for example, payables, pensions and other provisions). In such cases, the carrying amount of the cash-generating unit is increased by the carrying amount of those assets and decreased by the carrying amount of those liabilities.

Goodwill

Allocating Goodwill to Cash-Generating Units

73. For the purpose of impairment testing, goodwill acquired in a business combination shall, from the acquisition date, be allocated to one or more cash-generating units. Each of those cash-generating units shall represent the smallest cash-generating unit to which a portion of the carrying amount of the goodwill can be allocated on a reasonable and consistent basis.

74. A portion of the carrying amount of goodwill shall be regarded as capable of being allocated to a cash-generating unit on a reasonable and consistent basis only when that cash-generating unit represents the lowest level at which management monitors the return on investment in assets that include the goodwill. However, that cash-generating unit shall not be larger than a segment based on the entity's primary reporting format determined in accordance with IAS 14, Segment Reporting.

~~79~~ 75. Goodwill ~~arising on acquisition~~ acquired in a business combination represents a payment made by an acquirer in anticipation of future economic benefits from assets that are not capable of being individually identified and separately recognised. ~~The future economic benefits may result from synergy between the identifiable assets acquired or from assets which, individually, do not qualify for recognition in the financial statements.~~ Goodwill does not generate cash flows independently ~~from~~ of other assets or groups of assets. ~~and, therefore, the recoverable amount of goodwill as an individual asset cannot be determined. As a consequence, if there is an indication that goodwill may be impaired, recoverable amount is determined for the cash-generating unit to which goodwill belongs. This amount is then compared to the carrying amount~~

~~of this cash-generating unit and any impairment loss is recognised in accordance with paragraph 88.~~

76. Goodwill acquired in a business combination often contributes to the cash flows of multiple cash-generating units. However, a cash-generating unit is tested for impairment by including in its carrying amount only those assets that can be allocated to it on a reasonable and consistent basis. Therefore, the smallest cash-generating unit to which a portion of the carrying amount of goodwill can be allocated on a reasonable and consistent basis often comprises a number of smaller cash-generating units to which the goodwill relates but to which it cannot be allocated on a reasonable and consistent basis.

77. Applying the requirements in paragraphs 73 and 74 results in goodwill being tested for impairment at a level that is consistent with the lowest level at which management monitors, whether directly or indirectly, the return on the investment in that goodwill, provided such monitoring is conducted at or below segment level based on the entity's primary reporting format. Therefore, the development of additional reporting systems is typically not necessary.

78. A cash-generating unit to which goodwill is allocated for the purpose of impairment testing may or may not coincide with the level at which goodwill is allocated under [draft] IAS 21, The Effects of Changes in Foreign Exchange Rates, for the purpose of measuring foreign currency gains and losses.

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

80. Under [draft] IFRS X, Business Combinations, if the initial accounting for a business combination can be determined only provisionally by the end of the reporting period in which the combination is effected, the acquirer:

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

(b) recognises any adjustments to those provisional values as a result of completing the initial accounting within twelve months of the acquisition date.

In such circumstances, the initial allocation of the goodwill acquired in the combination might also be unable to be completed before the end of the annual reporting period in which the combination is effected. When this is the case, the entity discloses the information required to be disclosed under paragraph 132.

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

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

(b) measured on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit retained.

Example

An entity sells for 100 an operation that was part of a cash-generating unit to which goodwill has been allocated. The recoverable amount of the portion of the cash-generating unit retained is 300.

25% of the goodwill allocated to the cash-generating unit is included in the carrying amount of the operation that is sold.

82. If an entity reorganises its reporting structure in a way that changes the composition of one or more cash-generating units to which goodwill has been allocated, the goodwill shall be reallocated to the units affected using a relative value approach similar to that used when an entity disposes of an operation within a cash-generating unit.

Example

Goodwill previously had been allocated to cash-generating unit A. However, A is to be divided and integrated into three other cash-generating units, B, C and D.

The goodwill allocated to unit A is reallocated to units B, C and D based on the relative values of the three portions of A before those portions are integrated with B, C and D.

~~***80. In testing a cash-generating unit for impairment, an enterprise should identify whether goodwill that relates to this cash-generating unit is recognised in the financial statements. If this is the case, an enterprise should:***~~

~~***(a) perform a 'bottom-up' test, that is, the enterprise should:***~~

~~***(i) identify whether the carrying amount of goodwill can be allocated on a reasonable and consistent basis to the cash-generating unit under review; and***~~

~~***(ii) then, compare the recoverable amount of the cash-generating unit under review to its carrying amount (including the carrying amount of allocated goodwill, if any) and recognise any impairment loss in accordance with paragraph 88.***~~

~~***The enterprise should perform the second step of the 'bottom-up' test even if none of the carrying amount of goodwill can be allocated on a reasonable and consistent basis to the cash-generating unit under review; and***~~

~~***(b) if, in performing the 'bottom-up' test, the enterprise could not allocate the carrying amount of goodwill on a reasonable and consistent basis to the cash-generating unit under review, the enterprise should also perform a 'top-down' test, that is, the enterprise should:***~~

~~***(i) identify the smallest cash-generating unit that includes the cash-generating unit under review and to which the carrying amount of goodwill can be allocated on a reasonable and consistent basis (the 'larger' cash-generating unit); and***~~

~~***(ii) then, compare the recoverable amount of the larger cash-generating unit to its carrying amount (including the carrying amount of allocated goodwill) and recognise any impairment loss in accordance with paragraph 88.***~~

~~81. Whenever a cash-generating unit is tested for impairment, an enterprise considers any goodwill that is associated with the future cash flows to be generated by the cash-generating unit. If goodwill can be allocated on a reasonable and consistent basis, an enterprise applies the 'bottom-up' test only. If it is not possible to allocate goodwill on a reasonable and consistent basis, an enterprise applies both the 'bottom-up' test and 'top-down' test (see Appendix A, Example 7).~~

~~82. The 'bottom-up' test ensures that an enterprise recognises any impairment loss that exists for a cash-generating unit, including for goodwill that can be allocated on a reasonable and consistent basis. Whenever it is impracticable to allocate goodwill on a reasonable and consistent basis in the 'bottom-up' test, the combination of the 'bottom-up' and the 'top-down' test ensures that an enterprise recognises:~~

~~(a) first, any impairment loss that exists for the cash-generating unit excluding any consideration of goodwill; and~~
~~(b) then, any impairment loss that exists for goodwill. Because an enterprise applies the 'bottom-up' test first to all assets that may be impaired, any impairment loss identified for the larger cash-generating unit in the 'top-down' test relates only to goodwill allocated to the larger unit.~~

~~83. If the 'top-down' test is applied, an enterprise formally determines the recoverable amount of the larger cash-generating unit, unless there is persuasive evidence that there is no risk that the larger cash-generating unit is impaired (see paragraph 12).~~

Testing Cash-Generating Units with Goodwill for Impairment

83. When, as described in paragraph 76, goodwill relates to a cash-generating unit but cannot be allocated to that unit on a reasonable and consistent basis, the unit shall be tested for impairment, whenever there is an indication that it may be impaired, by comparing its carrying amount, excluding any goodwill, with its recoverable amount. Any impairment loss shall be recognised in accordance with paragraph 103.

84. If a cash-generating unit described in paragraph 83 includes in its carrying amount an intangible asset that has an indefinite useful life or is not yet available for use and that asset can be tested for impairment only as part of the cash-generating unit, paragraph 8A requires the unit also to be tested for impairment at the end of each annual reporting period.

85. A cash-generating unit to which goodwill has been allocated shall be tested for impairment annually, and whenever there is an indication that it may be impaired, by comparing its carrying amount, including the goodwill, with its recoverable amount. If the recoverable amount of the unit exceeds its carrying amount, the unit and the goodwill allocated to that unit shall be regarded as not impaired. If the carrying amount of the unit exceeds its recoverable amount, the entity shall:

(a) determine whether the goodwill allocated to that unit is impaired by comparing the implied value of the goodwill, determined in accordance with paragraph 86, with its carrying amount;

(b) recognise any excess of the carrying amount of goodwill over its implied value immediately in profit or loss as an impairment loss; and

(c) recognise any remaining excess of the carrying amount of the unit over its recoverable amount as an impairment loss in accordance with paragraph 103.

Implied Value of Goodwill

86. The implied value of goodwill shall be measured as the excess of:

(a) the recoverable amount of the cash-generating unit to which the goodwill has been allocated, over

(b) the net fair value of the identifiable assets, liabilities and contingent liabilities the entity would recognise if it acquired that cash-generating unit in a business combination on the date of the impairment test. However, an entity shall exclude from this net fair value any identifiable asset acquired in a business combination but not recognised separately from goodwill at the acquisition date.

87. To calculate the implied value of goodwill, an entity determines the net fair value of the identifiable assets, liabilities and contingent liabilities it would recognise if it acquired the cash-generating unit in a business combination on the date of the impairment test. The requirement in paragraph 86(b) to exclude from that net fair value particular identifiable assets ensures that an impairment loss is not recognised for goodwill to the extent that the loss arises because an identifiable asset not recognised separately from goodwill at the acquisition date subsequently meets the criteria for separate recognition.

Minority Interest

88. Under [draft] IFRS X, goodwill recognised in a business combination represents the goodwill acquired by a parent based on the parent's ownership interest, rather than the amount of goodwill controlled by the parent as a result of the business combination. Therefore, goodwill attributable to a minority interest is not recognised in the parent's consolidated financial statements. Accordingly, if there is a minority interest in a cash-generating unit to which goodwill has been allocated, the carrying amount of that unit comprises:

(a) both the parent's interest and the minority interest in the identifiable net assets of the unit; and

(b) the parent's interest in goodwill.

However, part of the recoverable amount of the cash-generating unit determined in accordance with this [draft] Standard will be attributable to the minority interest in goodwill.

89. Consequently, for the purpose of impairment testing a non-wholly-owned cash-generating unit with goodwill, the carrying amount of that unit is notionally adjusted, before being compared with its recoverable amount, by grossing up the carrying amount of goodwill allocated to the unit to include the goodwill attributable to the minority interest. This notionally adjusted carrying amount is then compared with the recoverable amount of the unit to determine whether the cash-generating unit is impaired. If it is, the entity allocates the impairment loss in accordance with paragraph 85 by first determining the amount of any goodwill impairment.

90. The implied value of goodwill allocated to a unit with a minority interest includes goodwill attributable to both the parent and the minority interest. This implied value is compared with the notionally grossed up carrying amount of the goodwill to determine whether the goodwill is impaired. However, because goodwill is recognised only to the extent of the parent's ownership interest, any impairment loss relating to the goodwill is apportioned between that attributable to the parent and that attributable to the minority interest, with only the former being recognised by the entity as a goodwill impairment loss.

91. If the total impairment loss relating to goodwill is less than the amount by which the notionally adjusted carrying amount of the cash-generating unit exceeds its recoverable amount, paragraph 85(c) requires the remaining excess to be accounted for as an impairment loss in accordance with paragraph 103.

92. Example 7 in Appendix A illustrates the impairment testing of a non-wholly-owned cash-generating unit with goodwill.

Timing of Impairment Tests

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

94. If other assets or smaller cash-generating units constituting the cash-generating unit to which goodwill has been allocated are tested for impairment at the same time as that larger unit, they shall be tested for impairment before the larger unit.

95. At the time of impairment testing a cash-generating unit to which goodwill has been allocated, there might, for example, be an indication that a smaller cash-generating unit within that larger unit may be impaired. In such circumstances, the entity tests the smaller cash-generating unit for impairment first, and recognises any impairment

loss for that unit before testing the larger cash-generating unit for impairment.

96. The most recent detailed calculation made in a preceding reporting period of the recoverable amount of a cash-generating unit to which goodwill has been allocated may be used in the impairment test of that cash-generating unit in the current period provided all of the following criteria are met:

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

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

(c) based on an analysis of events that have occurred and circumstances that have changed since the most recent recoverable amount calculation, the likelihood that a current recoverable amount determination would be less than the current carrying amount of the cash-generating unit is remote.

97. If the carrying amount of a cash-generating unit to which goodwill has been allocated exceeds its recoverable amount but the entity has not completed before the financial statements are authorised for issue its determination of whether the goodwill is impaired, the entity shall recognise in those financial statements its best estimate of any probable impairment loss for the goodwill. Any adjustment to that estimated impairment loss as a result of completing the impairment test shall be recognised in the immediately succeeding reporting period.

98. An entity that recognises its best estimate of a probable impairment loss for goodwill in accordance with paragraph 97 might, as a result of completing the impairment test, determine that the estimated impairment loss recognised in the preceding reporting period was overstated. In such circumstances, the recognition of an adjustment to the previously recognised estimated impairment loss for goodwill is not a reversal of an impairment loss.

Corporate Assets

~~84~~ 99. Corporate assets include group or divisional assets such as the building of a headquarters or a division of the ~~enterprise~~ entity, EDP equipment or a research centre. The structure of an ~~enterprise~~ entity determines whether an asset meets this [draft] Standard's definition of corporate assets for a particular cash-generating unit. Key characteristics of corporate assets are that they do not generate cash inflows independently ~~from~~ of other assets or groups of assets and their carrying amount cannot be fully attributed to the cash-generating unit under review.

~~85~~ 100. Because corporate assets do not generate separate cash inflows, the recoverable amount of an individual corporate asset cannot be determined unless management has decided to dispose of the asset. As a consequence, if there is an indication that a corporate asset may be impaired, recoverable amount is determined for the cash-generating unit to which the corporate asset belongs, compared ~~to~~ with the carrying amount of this cash-generating unit and any impairment loss is recognised in accordance with paragraph ~~88~~ 103.

~~86~~ 101. In testing a cash-generating unit for impairment, an ~~enterprise~~ entity ~~should~~ shall identify all the corporate assets that relate to the cash-generating unit under review. ~~For each identified corporate asset, an enterprise should then apply paragraph 80, that is:~~ If a portion of the carrying amount of a corporate asset:

~~(a) if the carrying amount of the corporate asset can be allocated on a reasonable and consistent basis to the cash-generating unit under review, an enterprise should apply the 'bottom-up' test only; and~~

~~(b) if the carrying amount of the corporate asset cannot be allocated on a reasonable and consistent basis to the cash-generating unit under review, an enterprise should apply both the 'bottom-up' and 'top-down' tests.~~

(a) can be allocated on a reasonable and consistent basis to that unit, the entity shall compare the carrying amount of the unit, including the portion of the carrying amount of the corporate asset allocated to the unit, with its recoverable amount. Any impairment loss shall be recognised in accordance with paragraph 103.

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

(i) compare the carrying amount of the unit, excluding the corporate asset, with its recoverable amount and recognise any impairment loss in accordance with paragraph 103;

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

(iii) compare the carrying amount of the larger cash-generating unit, including the portion of the carrying amount of the corporate asset allocated to that unit, with its recoverable amount. Any impairment loss shall be recognised in accordance with paragraph 103.

~~87~~ 102. An example of how to deal with corporate assets can be found in Appendix A, Example 8.

Impairment Loss for a Cash-Generating Unit

~~88~~ 103. An impairment loss ~~should~~ shall be recognised for a cash-generating unit if, and only if, its recoverable amount is less than its carrying amount. The impairment loss ~~should~~ shall be allocated to reduce the carrying amount of the assets of the unit in the following order:

(a) first, to reduce the carrying amount of goodwill allocated to the cash-generating unit (if any) to its implied value in accordance with paragraph 85; and

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

These reductions in carrying amounts ~~should~~ shall be treated as impairment losses on individual assets and recognised in accordance with paragraph ~~59~~ 53.

~~89~~ 104. In allocating an impairment loss under paragraph ~~88~~ 103, the carrying amount of an asset ~~should~~ shall not be reduced below the highest of:

(a) its net selling price (if determinable);

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

(c) zero.

The amount of the impairment loss that would otherwise have been allocated to the asset ~~should~~ shall be allocated to the other assets of the unit on a pro-rata basis.

~~90. The goodwill allocated to a cash-generating unit is reduced before reducing the carrying amount of the other assets of the unit because of its nature.~~

~~91~~ 105. If ~~there is no practical way to estimate~~ the recoverable amount of each individual asset of a cash-generating unit cannot be estimated without undue cost or effort, this [draft] Standard requires an arbitrary allocation of an impairment loss between the assets of that unit, other than goodwill, because all assets of a cash-generating unit work together.

~~92~~ 106. If the recoverable amount of an individual asset cannot be determined (see paragraph ~~66~~ 60):

(a) an impairment loss is recognised for the asset if its carrying amount is greater than the higher of its net selling price and the results of the allocation procedures described in paragraphs ~~88~~ 103 and ~~89~~ 104; and

(b) no impairment loss is recognised for the asset if the related cash-generating unit is not impaired. This applies even if the asset's net selling price is less than its carrying amount.

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 machine does not generate independent cash inflows from continuing use. The smallest identifiable group of assets that includes the machine and generates cash inflows from continuing use that are largely independent of the cash inflows from other assets is the production line to which the machine belongs. The recoverable amount of the production line shows that the production line taken as a whole is not impaired.

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

The recoverable amount of the machine alone cannot be estimated since the machine's value in use:

(a) may differ from its net selling price; and

(b) can be determined only for the cash-generating unit to which the machine belongs (the production line).

The production line is not impaired, therefore, no impairment loss is recognised for the machine. Nevertheless, the ~~enterprise~~ entity may need to reassess the depreciation period or the depreciation method for the machine. Perhaps, a shorter depreciation period or a faster depreciation method is required to reflect the expected remaining useful life of the machine or the pattern in which economic benefits are consumed by the ~~enterprise~~ entity.

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

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

~~93~~ 107. After the requirements in paragraphs ~~88~~ 103 and ~~89~~ 104 have been applied, a liability ~~should~~ shall be recognised for any remaining amount of an impairment loss for a cash-generating unit if, and only if, that is required by other ~~International Accounting~~ Standards.

Reversal of an Impairment Loss

~~94~~ 108. Paragraphs ~~95~~ 109 to ~~101~~ 115 set out the requirements for reversing an impairment loss recognised for an asset or a cash-generating unit in prior ~~years~~ periods. These requirements use the term 'an asset' but apply equally to an individual asset or a cash-generating unit. Additional requirements are set out for an individual asset in paragraphs ~~102~~ 116 to ~~106~~ 120, for a cash-generating unit in paragraphs ~~107 to 108~~ 121 and 122 and for goodwill in paragraphs ~~109 to 112~~ 123 and 124.

~~95~~ 109. An ~~enterprise should~~ entity shall assess at each balance sheet date whether there is any indication that an impairment loss recognised in prior periods for an asset ~~in prior years may~~ other than goodwill may no longer exist or may have decreased. If any such indication exists, the ~~enterprise should~~ entity shall estimate the recoverable amount of that asset.

~~96~~ 110. In assessing whether there is any indication that an impairment loss recognised in prior periods for an asset ~~in prior years~~ other than goodwill may no longer exist or may have decreased, an ~~enterprise should~~ entity shall 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 changes with a favourable effect on the ~~enterprise~~ entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the ~~enterprise~~ entity operates or in the market to which the asset is dedicated;

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

Internal sources of information

(d) significant changes with a favourable effect on the ~~enterprise~~ entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, the asset is used or is expected to be used. These changes include capital expenditure ~~that has been~~ incurred during the period to improve or enhance an asset in excess of its ~~originally assessed~~ standard of performance assessed immediately before the expenditure is made or a commitment to discontinue or restructure the operation to which the asset belongs; and

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

~~97~~ 111. Indications of a potential decrease in an impairment loss in paragraph ~~96~~ 110 mainly mirror the indications of a potential impairment loss in paragraph 9. The concept of materiality applies in identifying whether an impairment loss recognised in prior periods for an asset ~~in prior years~~ other than goodwill may need to be reversed and the recoverable amount of the asset determined.

~~98~~ 112. If there is an indication that an impairment loss recognised for an asset other than goodwill may no longer exist or may have decreased, this may indicate that the remaining useful life, the depreciation (amortisation) method or the residual value may need to be reviewed and adjusted in accordance with the ~~International Accounting~~ Standard applicable to the asset, even if no impairment loss is reversed for the asset.

~~99~~ 113. An impairment loss recognised in prior periods for an asset ~~in prior years~~ other than goodwill ~~should~~ shall be reversed if, and only if, there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If this is the case, the carrying amount of the asset ~~should~~ shall, except as described in paragraph 116, be increased to its recoverable amount. That increase is a reversal of an impairment loss.

~~100~~ 114. 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~~ entity last recognised an impairment loss for that asset.

An ~~enterprise~~ entity is required under paragraph 129 to identify the change in estimates that causes the increase in estimated service potential. Examples of changes in estimates include:

(a) a change in the basis for recoverable amount (i.e., whether recoverable amount is based on net selling price or value in use);

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

(c) if recoverable amount was based on net selling price: a change in estimate of the components of net selling price.

~~101~~ 115. An asset's value in use may become greater than the asset's carrying amount simply because the present value of future cash inflows increases as they become closer. However, the service potential of the asset has not increased. Therefore, an impairment loss is not reversed just because of the passage of time (sometimes called the 'unwinding' of the discount), even if the recoverable amount of the asset becomes higher than its carrying amount.

Reversal of an Impairment Loss for an Individual Asset

~~102~~ 116. The increased carrying amount of an asset other than goodwill due to a reversal of an impairment loss ~~should~~ shall not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years.

~~103~~ 117. Any increase in the carrying amount of an asset other than goodwill above the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years is a revaluation. In accounting for such a revaluation, an ~~enterprise~~ entity applies the ~~International Accounting~~ Standard applicable to the asset.

~~104~~ 118. A reversal of an impairment loss for an asset other than goodwill ~~should~~ shall be recognised ~~as income~~ immediately in ~~the income statement~~ profit or loss, unless the asset is carried at revalued amount under another ~~International Accounting~~ Standard (for example, under

the allowed alternative treatment in [draft] IAS 16, Property, Plant and Equipment). Any reversal of an impairment loss on a revalued asset ~~should~~ shall be treated as a revaluation increase under that other ~~International Accounting~~ Standard.

~~105~~ 119. A reversal of an impairment loss on a revalued asset is credited directly to equity under the heading revaluation surplus. However, to the extent that an impairment loss on the same revalued asset was previously recognised ~~as an expense in the income statement~~ in profit or loss, a reversal of that impairment loss is also recognised ~~as income in the income statement~~ in profit or loss.

~~106~~ 120. After a reversal of an impairment loss is recognised, the depreciation (amortisation) charge for the asset ~~should~~ shall be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

Reversal of an Impairment Loss for a Cash-Generating Unit

~~107~~ 121. A reversal of an impairment loss for a cash-generating unit ~~should~~ shall be allocated to ~~increase the carrying amount of~~ the assets of the unit, ~~in the following order:~~ except for goodwill, pro-rata with the carrying amounts of those assets.

~~(a) first, assets other than goodwill on a pro-rata basis based on the carrying amount of each asset in the unit; and~~

~~(b) then, to goodwill allocated to the cash generating unit (if any), if the requirements in paragraph 109 are met.~~

These increases in carrying amounts ~~should~~ shall be treated as reversals of impairment losses for individual assets and recognised in accordance with paragraph ~~104~~ 118.

~~108~~ 122. In allocating a reversal of an impairment loss for a cash-generating unit under paragraph ~~107~~ 121, the carrying amount of an asset ~~should~~ shall not be increased above the lower of:

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

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

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

Reversal of an Impairment Loss for Goodwill

~~109~~ 123. ~~As an exception to the requirement in paragraph 99, an~~ An impairment loss recognised for goodwill ~~should~~ shall not be reversed in a subsequent period ~~unless:~~.

~~(a) the impairment loss was caused by a specific external event of an exceptional nature that is not expected to recur; and~~

~~(b) subsequent external events have occurred that reverse the effect of that event.~~

~~110~~ 124. [Draft] IAS 38, Intangible Assets, prohibits the recognition of internally generated goodwill. ~~Any subsequent increase in the recoverable amount of goodwill is likely to be an increase in internally generated goodwill, unless the increase relates clearly to the reversal of the effect of a specific external event of an exceptional nature~~. Any increase in the recoverable amount of goodwill in the periods following the recognition of an impairment loss for that goodwill is likely to be an increase in internally generated goodwill, rather than a reversal of the impairment loss recognised for the acquired goodwill.

~~111. This Standard does not permit an impairment loss to be reversed for goodwill because of a change in estimates (for example, a change in the discount rate or in the amount and timing of future cash flows of the cash-generating unit to which goodwill relates).~~

~~112. A specific external event is an event that is outside of the control of the enterprise. Examples of external events of an exceptional nature include new regulations that significantly curtail the operating activities, or decrease the profitability, of the business to which the goodwill relates.~~

Disclosure

~~113~~ 125. ~~For~~ An entity shall disclose the following for each class of assets~~, the financial statements should disclose~~:

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

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

(c) the amount of impairment losses recognised directly in equity during the period; and

(d) the amount of reversals of impairment losses recognised directly in equity during the period.

~~114~~ 126. A class of assets is a grouping of assets of similar nature and use in an ~~enterprise~~ entity's operations.

~~115~~ 127. The information required in paragraph ~~113~~ 125 may be presented with other information disclosed for the class of assets. For example, this information may be included in a reconciliation of the carrying amount of property, plant and equipment, at the beginning and end of the period, as required under [draft] IAS 16, Property, Plant and Equipment.

~~116~~ 128. An ~~enterprise~~ entity that ~~applies~~ reports segment information in accordance with IAS 14, Segment Reporting, ~~should~~ shall disclose the following for each reportable segment based on an ~~enterprise~~ entity's primary reporting format ~~(as defined in IAS 14)~~:

(a) the amount of impairment losses recognised in ~~the income statement~~ profit or loss and directly in equity during the period; and

(b) the amount of reversals of impairment losses recognised in ~~the income statement~~ profit or loss and directly in equity during the period.

~~117~~ 129. ~~If an impairment loss for an individual asset or a cash-generating unit is recognised or reversed during the period and is material to the financial statements of the reporting enterprise as a whole, an enterprise should disclose~~ An entity shall disclose the following for each material impairment loss recognised or reversed during the period for an individual asset, including goodwill, or a cash-generating unit:

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

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

(c) for an individual asset:

(i) the nature of the asset; and

(ii) if the entity reports segment information in accordance with IAS 14, the reportable segment to which the asset belongs, based on the ~~enterprise~~ entity's primary reporting format ~~(as defined in IAS 14, Segment Reporting, if the enterprise applies IAS 14)~~;

(d) for a cash-generating unit:

(i) a description of the cash-generating unit (such as whether it is a product line, a plant, a business operation, a geographical area, a reportable segment as defined in IAS 14 or other);

(ii) the amount of the impairment loss recognised or reversed by class of assets and, if the entity reports segment information in accordance with IAS 14, by reportable segment based on the ~~enterprise~~ entity's primary reporting format ~~(as defined in IAS 14, if the enterprise applies IAS 14)~~; and

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

(e) whether the recoverable amount of the asset (cash-generating unit) is its net selling price or its value in use;

(f) if recoverable amount is net selling price, the basis used to determine net selling price (such as whether selling price was determined by reference to an active market or in some other way); and

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

~~118~~ 130. ~~If impairment losses recognised (reversed) during the period are material in aggregate to the financial statements of the reporting enterprise as a whole, an enterprise should disclose a brief description of the following~~ An entity shall disclose the following information for the aggregate impairment losses and the aggregate reversals of impairment losses recognised during the period for which no information is disclosed under paragraph 129:

(a) the main classes of assets affected by impairment losses and the main classes of assets affected by reversals of impairment losses ~~(reversals of impairment losses) for which no information is disclosed under paragraph 117~~; and

(b) the main events and circumstances that led to the recognition ~~(reversal)~~ of these impairment losses and reversals of impairment losses ~~for which no information is disclosed under paragraph 117~~.

~~119~~ 131. An ~~enterprise~~ entity is encouraged to disclose key assumptions used to determine the recoverable amount of assets (cash-generating units) during the period. However, an entity is required under paragraph 134 to disclose information about the estimates used to measure the recoverable amount of a cash-generating unit when goodwill or an intangible asset

with an indefinite useful life is included in the carrying amount of that unit.

132. If, in accordance with paragraph 79, any portion of the goodwill acquired in a business combination during the reporting period has not been allocated to a cash-generating unit at the reporting date, the amount of the unallocated goodwill shall be disclosed together with the reasons why that amount remains unallocated.

133. An entity that recognises the best estimate of a probable impairment loss for goodwill in accordance with paragraph 97 shall disclose the following in the period in which the estimated impairment loss is recognised:

(a) the fact that the impairment loss recognised for goodwill is an estimate that has not yet been finalised; and

(b) the reasons why the amount of the impairment loss has not been finalised.

The entity shall disclose in the immediately succeeding reporting period the nature and amount of any adjustments recognised to the estimated impairment loss.

Estimates used to Measure Recoverable Amounts of Cash-Generating Units Containing Goodwill or Intangible Assets with Indefinite Useful Lives

134. An entity that reports segment information in accordance with IAS 14 shall disclose the information required under (a) to (f) for each segment, based on the entity's primary reporting format, that includes in its carrying amount goodwill or intangible assets with indefinite useful lives. An entity that does not report segment information shall disclose the information required under (a) to (f) for the entity as a whole. References to 'cash-generating units' should be read as references only to those cash-generating units within the segment or, as the case may be, the entity as a whole, that include in their carrying amounts goodwill or intangible assets with indefinite useful lives:

(a) the carrying amount of goodwill.

(b) the carrying amount of intangible assets with indefinite useful lives.

(c) the basis on which the recoverable amounts of the cash-generating units have been determined (value in use or net selling price).

(d) the amount by which the aggregate of the recoverable amounts of the cash-generating units exceeds the aggregate of their carrying amounts.

(e) if the recoverable amounts of the cash-generating units are based on value in use:

(i) a description of, and the value assigned to, each key assumption on which management has based its cash flow projections for the period covered by the most recent budgets/forecasts, whether those assumptions reflect past experience and, if not, how and why they differ from past experience. Key assumptions are those to which the recoverable amounts of the cash-generating units are most sensitive.

(ii) the period over which management has projected cash flows based on financial budgets/forecasts approved by management and, when a period greater than five years is used for a cash-generating unit, an explanation of why that longer period is justified. This explanation shall include a discussion of management's past experience in accurately forecasting cash flows over equivalent periods. If different periods are used for different cash-generating units, the range of periods used shall be disclosed.

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

cash-generating units, the range of growth rates used shall be disclosed.

(iv) for each key assumption disclosed under (i) above, the amount by which the value assigned to that assumption must change, after incorporating any consequential effects of that change on the other variables used to measure recoverable amount, in order for the aggregate recoverable amount of the cash-generating units to be equal to their aggregate carrying amount.

(v) the change in the weighted average growth rate used to extrapolate cash flow projections beyond the period covered by the most recent budgets/forecasts that would cause the aggregate recoverable amount of the cash-generating units to be equal to their aggregate carrying amount. The weighted average growth rate should be weighted by reference to the amount of goodwill and identifiable intangible assets with indefinite useful lives in each cash-generating unit.

(f) if the recoverable amounts of the cash-generating units are based on net selling price, the methodology used to determine net selling price. If those net selling prices are not determined using observable market prices for the cash-generating units, the following information shall also be disclosed:

(i) a description of, and the value assigned to, each key assumption on which management has based its determination of net selling price, whether the assumptions reflect past experience and, if not, how and why they differ from past experience. Key assumptions are those to which the recoverable amounts of the cash-generating units are most sensitive.

(ii) for each assumption disclosed under (i) above, the amount by which the value assigned to that assumption must change, after incorporating any consequential effects of that change on the other variables used to measure recoverable amount, in order for the aggregate recoverable amount of the cash-generating units to be equal to their aggregate carrying amount.

135. The most recent detailed calculation made in a preceding period of the recoverable amount of a cash-generating unit may, under paragraph 20A or 96, be carried forward and used in the impairment test for that unit in the current period provided specified criteria are met. When this is the case, the information for that cash-generating unit that is incorporated into the disclosures required under paragraph 134 relate to the carried forward calculation of recoverable amount.

136. Example 9 in Appendix A illustrates the disclosures required under paragraph 134.

137. The information required under paragraph 134 shall be disclosed separately for a cash-generating unit within a segment (or, as the case may be, within the entity) when:

(a) the carrying amount of goodwill or intangible assets with indefinite useful lives allocated to that cash-generating unit is significant in relation to the total carrying amount of goodwill or intangible assets with indefinite useful lives; or

(b) the basis for determining the recoverable amount of the cash-generating unit differs from the basis used for the other units within the segment (entity) whose carrying amounts include goodwill or identifiable intangible assets with indefinite useful lives; or

(c) the nature of, or value assigned to, the key assumptions or growth rate on which management has based its determination of recoverable amount for the cash-generating unit differs significantly from that used for the other units within the segment (entity) whose carrying amounts include goodwill or identifiable intangible assets with indefinite useful lives.

Transitional Provisions and Effective Date

~~***120. This Standard should be applied on a prospective basis only. Impairment losses (reversals of impairment losses) that result from adoption of this International Accounting Standard should be recognised in accordance with this Standard (i.e., in the income statement unless an asset is carried at revalued amount. An impairment loss (reversal of impairment loss) on a revalued asset should be treated as a revaluation decrease (increase)).***~~

~~121. Before the adoption of this Standard, various International Accounting Standards included requirements broadly similar to those included in this Standard for the recognition and reversal of impairment losses. However, changes may arise from previous assessments because this Standard details how to measure recoverable amount and how to consider an asset's cash-generating unit. It would be difficult to determine retrospectively what the estimate of recoverable amount would have been. Therefore, on adoption of this Standard, an enterprise does not apply the benchmark or the allowed alternative treatment for other changes in accounting policies in IAS 8, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies.~~

138. This [draft] Standard shall apply:

(a) prospectively from [date the revised Standard is issued] to:

(i) goodwill acquired in business combinations for which the agreement date is after [date the revised Standard is issued]; and

(ii) intangible assets acquired in business combinations for which the agreement date is after [date the revised Standard is issued]; and

(b) to all other assets prospectively from the beginning of the first annual reporting period beginning on or after [date the revised Standard is issued].

139. Entities are encouraged to apply the requirements of this [draft] Standard before the effective dates specified in paragraph 138. However, if an entity applies this [draft] Standard before those effective dates, it also shall apply [draft] IFRS X, Business Combinations, and [draft] IAS 38 (revised 200X), Intangible Assets, at the same time.

~~Effective Date~~

~~122. This International Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 July 1999. Earlier application is encouraged. If an enterprise applies this Standard for financial statements covering periods beginning before 1 July 1999, the enterprise should disclose that fact.~~

Appendix A

Illustrative Examples

Contents

Continued ../..

Appendix A

Illustrative Examples

The appendix is illustrative only and does not form part of the ~~standards~~ [draft] Standard. The purpose of the appendix is to illustrate the application of the ~~standards~~ [draft] Standard to assist in clarifying ~~their~~ its meaning.

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

Example 1 - Identification of Cash-Generating Units

The purpose of this example is:

(a) to give an indication of how cash-generating units are identified in various situations; and

(b) to highlight certain factors that an ~~enterprise~~ entity may consider in identifying the cash-generating unit to which an asset belongs.

A - Retail Store Chain

Background

A1. Store X belongs to a retail store chain M. X makes all its retail purchases through M's purchasing centre. Pricing, marketing, advertising and human resources policies (except for hiring X's cashiers and salesmen) are decided by M. M also owns 5 other stores in the same city as X (although in different neighbourhoods) and 20 other stores in other cities. All stores are managed in the same way as X. X and 4 other stores were purchased 5 years ago and goodwill was recognised.

What is the cash-generating unit for X (X's cash-generating unit)?

Analysis

A2. In identifying X's cash-generating unit, an ~~enterprise~~ entity considers whether, for example:

(a) internal management reporting is organised to measure performance on a store-by-store basis; and

(b) the business is run on a store-by-store profit basis or on a region/city basis.

A3. All M's stores are in different neighbourhoods and probably have different customer bases. So, although X is managed at a corporate level, X generates cash inflows that are largely independent ~~from~~ of those of M's other stores. Therefore, it is likely that X is a cash-generating unit.

A4. If the carrying amount of the goodwill can be allocated on a reasonable and consistent basis to X's cash-generating unit, M applies to that cash-generating unit the ~~'bottom-up'~~ impairment test described in paragraph ~~80~~ 85 of [draft] IAS 36. If the carrying amount of the goodwill cannot be allocated on a reasonable and consistent basis to X's cash-generating unit, M applies to that cash-generating unit the ~~'bottom up' and 'top down'~~ impairment tests described in paragraph 83 of [draft] IAS 36.

B - Plant for an Intermediate Step in a Production Process

Background

A5. A significant raw material used for plant Y's final production is an intermediate product bought from plant X of the same ~~enterprise~~ entity. X's products are sold to Y at a transfer price that passes all margins to X. 80% of Y's final production is sold to customers outside of the ~~reporting enterprise~~ entity. 60% of X's final production is sold to Y and the remaining 40% is sold to customers outside of the ~~reporting enterprise~~ entity.

For each of the following cases, what are the cash-generating units for X and Y?

Case 1: X could sell the products it sells to Y in an active market. Internal transfer prices are higher than market prices.

Case 2: There is no active market for the products X sells to Y.

Analysis

Case 1

A6. X could sell its products ~~on~~ in an active market and, so, generate cash inflows from continuing use that would be largely independent of the cash inflows from Y. Therefore, it is likely that X is a separate cash-generating unit, although part of its production is used by Y (see paragraph ~~69~~ 63 of [draft] IAS 36).

A7. It is likely that Y is also a separate cash-generating unit. Y sells 80% of its products to customers outside of the ~~reporting enterprise~~ entity. Therefore, its cash inflows from continuing use can be considered to be largely independent.

A8. Internal transfer prices do not reflect market prices for X's output. Therefore, in determining value in use of both X and Y, the ~~enterprise~~ entity adjusts financial budgets/forecasts to reflect management's best estimate of future market prices for those of X's products that are used internally (see paragraph ~~69~~ 63 of [draft] IAS 36).

Case 2

A9. It is likely that the recoverable amount of each plant cannot be assessed independently ~~from~~ of the recoverable amount of the other plant because:

(a) the majority of X's production is used internally and could not be sold in an active market. So, cash inflows of X depend on demand for Y's products. Therefore, X cannot be considered to generate cash inflows that are largely independent ~~from~~ of those of Y; and

(b) the two plants are managed together.

A10. As a consequence, it is likely that X and Y together is the smallest group of assets that generates cash inflows from continuing use that are largely independent.

C - Single Product ~~Enterprise~~ Entity

Background

A11. ~~Enterprise~~ Entity M produces a single product and owns plants A, B and C. Each plant is located in a different continent. A produces a component that is assembled in either B or C. The combined capacity of B and C is not fully utilised. M's products are sold world-wide from either B or C. For example, B's production can be sold in C's continent if the products can be delivered faster from B than from C. Utilisation levels of B and C depend on the allocation of sales between the two sites.

For each of the following cases, what are the cash-generating units for A, B and C?

Case 1: There is an active market for A's products.

Case 2: There is no active market for A's products.

Analysis

Case 1

A12. It is likely that A is a separate cash-generating unit because there is an active market for its products (see Example B - Plant for an Intermediate Step in a Production Process, Case 1).

A13. Although there is an active market for the products assembled by B and C, cash inflows for B and C depend on the allocation of production across the two sites. It is unlikely that the future cash inflows for B and C can be determined individually. Therefore, it is likely that B and C together is the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent.

A14. In determining the value in use of A and B plus C, M adjusts financial budgets/forecasts to reflect its best estimate of future market prices for A's products (see paragraph ~~69~~ 63 of [draft] IAS 36).

Case 2

A15. It is likely that the recoverable amount of each plant cannot be assessed independently because:

(a) there is no active market for A's products. Therefore, A's cash inflows depend on sales of the final product by B and C; and

(b) although there is an active market for the products assembled by B and C, cash inflows for B and C depend on the allocation of production across the two sites. It is unlikely that the future cash inflows for B and C can be determined individually.

A16. As a consequence, it is likely that A, B and C together (i.e., M as a whole) is the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent.

D - Magazine Titles

Background

A17. A publisher owns 150 magazine titles of which 70 were purchased and 80 were self-created. The price paid for a purchased magazine title is recognised as an intangible asset. The costs of creating magazine titles and maintaining the existing titles are recognised as an expense when incurred. Cash inflows from direct sales and advertising are identifiable for each magazine title. Titles are managed by customer segments. The level of advertising income for a magazine title depends on the range of titles in the customer segment to which the magazine title relates. Management has a policy to abandon old titles before the end of their economic lives and replace them immediately with new titles for the same customer segment.

What is the cash-generating unit for an individual magazine title?

Analysis

A18. It is likely that the recoverable amount of an individual magazine title can be assessed. Even though the level of advertising income for a title is influenced, to a certain extent, by the other titles in the customer segment, cash inflows from direct sales and advertising are identifiable

for each title. In addition, although titles are managed by customer segments, decisions to abandon titles are made on an individual title basis.

A19. Therefore, it is likely that individual magazine titles generate cash inflows that are largely independent ~~one from another~~ of each other and that each magazine title is a separate cash-generating unit.

E - Building Half-Rented to Others and Half-Occupied for Own Use

Background

A20. M is a manufacturing company. It owns a headquarters building that used to be fully occupied for internal use. After down-sizing, half of the building is now used internally and half rented to third parties. The lease agreement with the tenant is for five years.

What is the cash-generating unit of the building?

Analysis

A21. The primary purpose of the building is to serve as a corporate asset, supporting M's manufacturing activities. Therefore, the building as a whole cannot be considered to generate cash inflows that are largely independent of the cash inflows from the ~~enterprise~~ entity as a whole. So, it is likely that the cash-generating unit for the building is M as a whole.

A22. The building is not held as an investment. Therefore, it would not be appropriate to determine the value in use of the building based on projections of future market related rents.

Example 2 - Calculation of Value in Use and Recognition of an Impairment Loss

In this example, tax effects are ignored.

Background and Calculation of Value in Use

A23. At the end of 20X0, ~~enterprise~~ entity T acquires ~~enterprise~~ entity M for 10,000. M has manufacturing plants in 3 countries. ~~The anticipated useful life of the resulting merged activities is 15 years.~~

Schedule 1. Data at the end of 20X0

End of 20X0	*Allocation of purchase price*	*Fair value of identifiable assets*	*Goodwill*[(1)]
Activities in Country A	3,000	2,000	1,000
Activities in Country B	2,000	1,500	500
Activities in Country C	5,000	3,500	1,500
Total	10,000	7,000	3,000

(1) Activities in each country are the smallest cash-generating units to which goodwill can be allocated on a reasonable and consistent basis (~~allocation based on~~ determined as the difference between the purchase price of the activities in each country, as specified in the purchase agreement, and the fair value of the identifiable assets).

A23A. Because goodwill has been allocated to the activities in each country, each of those activities must be tested for impairment annually or more frequently if there is any indication that they may be impaired (see paragraph 85 of [draft] IAS 36).

A24. The net selling price of each cash-generating unit is not determinable because it is unlikely that a ready buyer exists for all the assets of each country's activities. Therefore, the recoverable amount of each unit is based on its value in use. At the end of 20X0 and 20X1, the value in use of each cash-generating unit exceeds its carrying amount. Therefore the activities in each country and the goodwill allocated to those activities are regarded as not impaired.

~~A24. T uses straight-line depreciation and amortisation over a 15-year life for the Country A assets and no residual value is anticipated.~~

A25. ~~In 20X4,~~ At the beginning of 20X2, a new government is elected in Country A. It passes legislation significantly restricting exports of T's main product. As a result, and for the foreseeable future, T's production in Country A will be cut by 40%.

A26. The significant export restriction and the resulting production decrease require T also to estimate the recoverable amount of the ~~goodwill and net assets of the~~ Country A operations at the beginning of 20X2. ~~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.~~

A27. ~~The net selling price of the Country A cash-generating unit is not determinable, as it is unlikely that a ready buyer exists for all the assets of that unit.~~ T uses straight-line depreciation over a 12-year life for the Country A identifiable assets and anticipates no residual value.

A28. To determine the value in use for the Country A cash-generating unit (see Schedule 2), T:

(a) prepares cash flow forecasts derived from the most recent financial budgets/forecasts for the next five years (years ~~20X5-20X9~~ 20X2-20X6) approved by management;

(b) estimates subsequent cash flows (years ~~20X10-20X15~~ 20X7-20Y2) based on declining growth rates. The growth rate for ~~20X10~~ 20X7 is estimated to be 3%. This rate is lower than the average long-term growth rate for the market in Country A; and

(c) selects a 15% discount rate, which represents a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the Country A cash-generating unit.

Recognition and Measurement of Impairment Loss

A29. The recoverable amount of the Country A cash-generating unit is 1,360: the higher of the net selling price of the Country A cash-generating unit (not determinable) and its value in use (1,360).

A30. T compares the recoverable amount of the Country A cash-generating unit to its carrying amount (see Schedule 3). Because the carrying amount exceeds the recoverable amount by 1,473, T first determines whether the goodwill allocated to Country A cash-generating unit is impaired by comparing its implied value with its carrying amount. If T determines that the net fair value of the identifiable assets it would recognise if it acquired Country A cash-generating unit at the date of this impairment test is 1,000, the implied value of the goodwill is 360 (see paragraph 86 of [draft] IAS 36).

A31. T recognises an impairment loss of ~~840~~ 1,473 immediately in ~~the income statement~~ profit or loss. The carrying amount of the goodwill that relates to the Country A operations is ~~eliminated~~ reduced by 640 to its implied value of 360. ~~before reducing the~~ The carrying amount of other identifiable assets within the Country A cash-generating unit is reduced by the remaining impairment loss of 833 (see paragraph ~~88~~ 103 of [draft] IAS 36).

A32. Tax effects are accounted for separately in accordance with IAS 12, Income Taxes (see Example 3A).

Schedule 2. Calculation of the value in use of the Country A cash-generating unit at the ~~end~~ beginning of ~~20X4~~ 20X2

Year	*Long-term growth rates*	*Future cash flows*	*Present value factor at 15% discount rate*[3]	*Discounted future cash flows*
~~20X5~~ 20X2 (n=1)		230[1]	0.86957	200
~~20X6~~ 20X3		253[1]	0.75614	191
~~20X7~~ 20X4		273[1]	0.65752	180
~~20X8~~ 20X5		290[1]	0.57175	166
~~20X9~~ 20X6		304[1]	0.49718	151
~~20X10~~ 20X7	3%	313[2]	0.43233	135
~~20X11~~ 20X8	-2%	307[2]	0.37594	115
~~20X12~~ 20X9	-6%	289[2]	0.32690	94
~~20X13~~ 20Y0	-15%	245[2]	0.28426	70
~~20X14~~ 20Y1	-25%	184[2]	0.24719	45
~~20X15~~ 20Y2	-67%	61[2]	0.21494	13
Value in use				1,360

[1] Based on management's best estimate of net cash flow projections (after the 40% cut).
[2] Based on an extrapolation from preceding year 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 3. Calculation and allocation of the impairment loss for the Country A cash-generating unit at the ~~end~~ beginning of ~~20X4~~ 20X2

~~*End of 20X4*~~ *Beginning of 20X2*	*Goodwill*	*Identifiable assets*	*Total*
Historical cost	1,000	2,000	3,000
Accumulated depreciation ~~/ amortisation~~ (20X1~~–20X4~~)	~~(267)~~ -	~~(533)~~ (167)	~~(800)~~ (167)
Carrying amount	~~733~~ 1,000	~~1,467~~ 1,833	~~2,200~~ 2,833
Impairment Loss	~~(733)~~ (640)	~~(107)~~ (833)	~~(840)~~ (1,473)
Carrying amount after impairment loss	~~0~~ 360	~~1,360~~ 1,000	1,360

Example 3 - Deferred Tax Effects

A - Deferred Tax Effects of the Recognition of an Impairment Loss

Use the data for ~~enterprise~~ entity T as presented in Example 2, with supplementary information as provided in this example.

A33. At the ~~end~~ beginning of ~~20X4~~ 20X2, the tax base of the identifiable assets of the Country A cash-generating unit is ~~1,100~~ 900. Impairment losses are not deductible for tax purposes. The tax rate is 40%.

A34. The recognition of an impairment loss on the assets of the Country A cash-generating unit reduces the taxable temporary difference related to those assets. The deferred tax liability is reduced accordingly.

~~*End*~~ *Beginning of ~~20X4~~ 20X2*	*Identifiable assets before impairment loss*	*Impairment loss*	*Identifiable assets after impairment loss*
Carrying amount (Example 2)	~~1,467~~ 1,833	~~(107)~~ (833)	~~1,360~~ 1,000
Tax base	~~1,100~~ 900	-	~~1,100~~ 900
Taxable temporary difference	~~367~~ 933	~~(107)~~ (833)	~~260~~ 100
Deferred tax liability at 40%	~~146~~ 373	~~(42)~~ (333)	~~104~~ 40

A35. In accordance with IAS 12, Income Taxes, no deferred tax relating to the goodwill was recognised initially. Therefore, the impairment loss relating to the goodwill does not give rise to a deferred tax adjustment.

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

A36. An ~~enterprise~~ entity has an identifiable asset with a carrying amount of 1,000. Its recoverable amount is 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:

	Before impairment	*Effect of impairment*	*After impairment*
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)

A37. In accordance with IAS 12, Income Taxes, the ~~enterprise~~ entity 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 4 - Reversal of an Impairment Loss

Use the data for ~~enterprise~~ entity T as presented in Example 2, with supplementary information as provided in this example. In this example, tax effects are ignored.

Background

A38. In ~~20X6~~ 20X3, the government 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, management estimates that production will increase by 30%. This favourable change requires T to re-estimate the recoverable amount of the net assets of the Country A operations (see paragraphs ~~95-96~~ 109 and 110 of [draft] IAS 36). The cash-generating unit for the net assets of the Country A operations is still the Country A operations.

A39. Calculations similar to those in Example 2 show that the recoverable amount of the Country A cash-generating unit is now ~~1,710~~ 1,910.

Reversal of Impairment Loss

A40. T compares the recoverable amount and the net carrying amount of the Country A cash-generating unit.

Schedule 1. Calculation of the carrying amount of the Country A cash-generating unit at the end of ~~20X6~~ 20X3

	Goodwill	*Identifiable assets*	*Total*
~~*End*~~ *Beginning of ~~20X4~~ 20X2 (Example 2)*			
Historical cost	1,000	2,000	3,000
Accumulated depreciation~~/ amortisation (4 years)~~	~~(267)~~ -	~~(533)~~ (167)	~~(800)~~ (167)
Impairment loss	~~(733)~~ (640)	~~(107)~~ (833)	~~(840)~~ (1,473)
Carrying amount after impairment loss	360	~~1,360~~ 1,000	1,360
End of ~~20X6~~ 20X3			
Additional depreciation (2 years) [1]	-	~~(247)~~ (182)	~~(247)~~ (182)
Carrying amount	360	~~1,113~~ 818	~~1,113~~ 1,178
Recoverable amount			~~1,710~~ 1,910
Excess of recoverable amount over carrying amount			~~597~~ 732

[1] After recognition of the impairment loss at the ~~end~~ beginning of ~~20X4~~ 20X2, T revised the depreciation charge for the Country A identifiable assets (from ~~133.3~~ 166.7 per year to ~~123.7~~ 90.9 per year), based on the revised carrying amount and remaining useful life (11 years).

A41. There has been a favourable change in the estimates used to determine the recoverable amount of the Country A net assets since the last impairment loss was recognised. Therefore, in accordance with paragraph ~~99~~ 113 of [draft] IAS 36, T recognises a reversal of the impairment loss recognised in ~~20X4~~ 20X2.

A42. In accordance with paragraphs ~~107~~ 121 and ~~108~~ 122 of [draft] IAS 36, T increases the carrying amount of the Country A identifiable assets by ~~87~~ 682 (see Schedule 3), i.e. up to the lower of recoverable amount (~~1,710~~ 1,910) and the identifiable assets' depreciated historical cost (~~1,200~~ 1,500) (see Schedule 2). This increase is recognised ~~in the income statement~~ immediately in profit or loss.

A43. In accordance with paragraph 109 123 of [draft] IAS 36, the impairment loss on goodwill is not reversed ~~because the external event that led to the recognition of the impairment loss on goodwill has not reversed. The legislation that significantly restricts exports of T's product is still in place, even though its effect is not as severe as expected~~.

Schedule 2. Determination of the depreciated historical cost of the Country A identifiable assets at the end of ~~20X6~~ 20X3

End of ~~20X6~~ 20X3	*Identifiable assets*
Historical cost	2,000
Accumulated depreciation *(~~133.3~~ 166.7 * ~~6~~ 3 years)*	~~(800)~~ (500)
Depreciated historical cost	~~1,200~~ 1,500
Carrying amount (Schedule 1)	~~1,113~~ 818
Difference	~~87~~ 682

Schedule 3. Carrying amount of the Country A assets at the end of ~~20X6~~ 20X3

End of ~~20X6~~ 20X3	*Goodwill*	*Identifiable assets*	*Total*
Gross carrying amount	1,000	2,000	3,000
Accumulated amortisation	~~(267)~~ -	~~(780)~~ (349)	~~(1,047)~~ (349)
Accumulated impairment loss	~~(733)~~ (640)	~~(107)~~ (833)	~~(840)~~ (1,478)
Carrying amount	360	~~1,113~~ 818	~~1,113~~ 1,178
Reversal of impairment loss	0	~~87~~ 682	~~87~~ 682
Carrying amount after reversal of impairment loss	360	~~1,200~~ 1,500	~~1,200~~ 1,860

Example 5 - Treatment of a Future Restructuring

In this example, tax effects are ignored.

Background

A44. At the end of 20X0, ~~enterprise~~ entity K tests a plant for impairment. The plant is a cash-generating unit. The plant's assets are carried at depreciated historical cost. The plant has a carrying amount of 3,000 and a remaining useful life of 10 years.

A45. The plant is so specialised that it is not possible to determine its net selling price. Therefore, the plant's recoverable amount is its value in use. Value in use is calculated using a pre-tax discount rate of 14%.

A46. Management approved budgets reflect that:

(a) at the end of 20X3, the plant will be restructured at an estimated cost of 100. Since K is not yet committed to the restructuring, a provision has not been recognised for the future restructuring costs; and

(b) there will be future benefits from this restructuring in the form of reduced future cash outflows.

A47. At the end of 20X2, K becomes committed to the restructuring. The costs are still estimated to be 100 and a provision is recognised accordingly. The plant's estimated future cash flows reflected in the most recent management approved budgets are given in paragraph A51 and a current discount rate is the same as at the end of 20X0.

A48. At the end of 20X3, actual restructuring costs of 100 are incurred and paid. Again, the plant's estimated future cash flows reflected in the most recent management approved budgets and a current discount rate are the same as those estimated at the end of 20X2.

At the End of 20X0

Schedule 1. Calculation of the plant's value in use at the end of 20X0

Year	*Future cash flows*	*Discounted at 14%*
20X1	300	263
20X2	280	215
20X3	420(1)	283
20X4	520(2)	308
20X5	350(2)	182
20X6	420(2)	191
20X7	480(2)	192
20X8	480(2)	168
20X9	460(2)	141
20X10	400(2)	108
Value in use		2,051

(1) Excludes estimated restructuring costs reflected in management budgets.
(2) Excludes estimated benefits expected from the restructuring reflected in management budgets.

A49. The plant's recoverable amount (value in use) is less than its carrying amount. Therefore, K recognises an impairment loss for the plant.

Schedule 2. Calculation of the impairment loss at the end of 20X0

	Plant
Carrying amount before impairment loss	3,000
Recoverable amount (Schedule 1)	2,051
Impairment loss	(949)
Carrying amount after impairment loss	2,051

At the End of 20X1

A50. No event occurs that requires the plant's recoverable amount to be re-estimated. Therefore, no calculation of the recoverable amount is required to be performed.

At the End of 20X2

A51. The ~~enterprise~~ entity is now committed to the restructuring. Therefore, in determining the plant's value in use, the benefits expected from the restructuring are considered in forecasting cash flows. This results in an increase in the estimated future cash flows used to determine value in use at the end of 20X0. In accordance with paragraphs ~~95-96~~ 109 and 110 of [draft] IAS 36, the recoverable amount of the plant is re-determined at the end of 20X2.

Schedule 3. Calculation of the plant's value in use at the end of 20X2

Year	*Future cash flows*	*Discounted at 14%*
20X3	420(1)	368
20X4	570(2)	439
20X5	380(2)	256
20X6	450(2)	266
20X7	510(2)	265
20X8	510(2)	232
20X9	480(2)	192
20X10	410(2)	144
Value in use		2,162

(1) Excludes estimated restructuring costs because a liability has already been recognised.
(2) Includes estimated benefits expected from the restructuring reflected in management budgets.

A52. The plant's recoverable amount (value in use) is higher than its carrying amount (see Schedule 4). Therefore, K reverses the impairment loss recognised for the plant at the end of 20X0.

Schedule 4. Calculation of the reversal of the impairment loss at the end of 20X2

	Plant
Carrying amount at the end of 20X0 (Schedule 2)	2,051
End of 20X2	
Depreciation charge (for 20X1 and 20X2 – Schedule 5)	(410)
Carrying amount before reversal	1,641
Recoverable amount (Schedule 3)	2,162
Reversal of the impairment loss	521
Carrying amount after reversal	2,162
Carrying amount: depreciated historical cost (Schedule 5)	2,400[1]

[1] The reversal does not result in the carrying amount of the plant exceeding what its carrying amount would have been at depreciated historical cost. Therefore, the full reversal of the impairment loss is recognised.

At the End of 20X3

A53. There is a cash outflow of 100 when the restructuring costs are paid. Even though a cash outflow has taken place, there is no change in the estimated future cash flows used to determine value in use at the end of 20X2. Therefore, the plant's recoverable amount is not calculated at the end of 20X3.

Schedule 5. Summary of the carrying amount of the plant

End of year	*Depreciated historical cost*	*Recoverable amount*	*Adjusted depreciation charge*	*Impairment loss*	*Carrying amount after impairment*
20X0	3,000	2,051	0	(949)	2,051
20X1	2,700	n.c.	(205)	0	1,846
20X2	2,400	2,162	(205)	521	2,162
20X3	2,100	n.c.	(270)	0	1,892

n.c. = not calculated as there is no indication that the impairment loss may have increased/decreased.

Example 6 - Treatment of Future Capital Expenditure

In this example, tax effects are ignored.

Background

A54. At the end of 20X0, ~~enterprise~~ entity F tests ~~a plane~~ an aircraft for impairment. The ~~plane~~ aircraft is a cash-generating unit. It is carried at depreciated historical cost and its carrying amount is 150,000. It has an estimated remaining useful life of 10 years.

A55. For the purpose of this example, it is assumed that the ~~plane~~ aircraft's net selling price is not determinable. Therefore, the ~~plane~~ aircraft's recoverable amount is its value in use. Value in use is calculated using a pre-tax discount rate of 14%.

A56. Management approved budgets reflect that:

(a) in 20X4, capital expenditure of 25,000 will be incurred to renew the engine of the ~~plane~~ aircraft; and

(b) this capital expenditure will improve the performance of the ~~plane~~ aircraft by decreasing fuel consumption.

A57. At the end of 20X4, renewal costs are incurred. The ~~plane~~ aircraft's estimated future cash flows reflected in the most recent management approved budgets are given in paragraph A60 and a current discount rate is the same as at the end of 20X0.

At the End of 20X0

Schedule 1. Calculation of the ~~plane~~ aircraft's value in use at the end of 20X0

Year	*Future cash flows*	*Discounted at 14%*
20X1	22,165	19,443
20X2	21,450	16,505
20X3	20,550	13,871
20X4	24,725[1]	14,639
20X5	25,325[2]	13,153
20X6	24,825[2]	11,310
20X7	24,123[2]	9,640
20X8	25,533[2]	8,951
20X9	24,234[2]	7,452
20X10	22,850[2]	6,164
Value in use		121,128

[1] Excludes estimated renewal costs reflected in management budgets.
[2] Excludes estimated benefits expected from the renewal of the engine reflected in management budgets.

A58. The ~~plane~~ aircraft's recoverable amount (value in use) is less than its carrying amount. Therefore, F recognises an impairment loss for the ~~plane~~ aircraft.

Schedule 2. Calculation of the impairment loss at the end of 20X0

	~~*Plane*~~ *Aircraft*
Carrying amount before impairment loss	150,000
Recoverable amount (Schedule 1)	121,128
Impairment loss	(28,872)
Carrying amount after impairment loss	121,128

Years 20X1 - 20X3

A59. No event occurs that requires the ~~plane~~ aircraft's recoverable amount to be re-estimated. Therefore, no calculation of recoverable amount is required to be performed.

At the End of 20X4

A60. The capital expenditure is incurred. Therefore, in determining the ~~plane~~ aircraft's value in use, the future benefits expected from the renewal of the engine are considered in forecasting cash flows. This results in an increase in the estimated future cash flows used to determine value in use at the end of 20X0. As a consequence, in accordance with paragraphs ~~95-96~~ 109 and 110 of [draft] IAS 36, the recoverable amount of the ~~plane~~ aircraft is recalculated at the end of 20X4.

Schedule 3. Calculation of the ~~plane~~ aircraft's value in use at the end of 20X4

Year	*Future cash flows*[1]	*Discounted at 14%*
20X5	30,321	26,597
20X6	32,750	25,200
20X7	31,721	21,411
20X8	31,950	18,917
20X9	33,100	17,191
20X10	27,999	12,756
Value in use		122,072

[1] Includes estimated benefits expected from the renewal of the engine reflected in management budgets.

A61. The ~~plane~~ aircraft's recoverable amount (value in use) is higher than the ~~plane~~ aircraft's carrying amount and depreciated historical cost (see Schedule 4). Therefore, K reverses the impairment loss recognised for the ~~plane~~ aircraft at the end of 20X0 so that the ~~plane~~ aircraft is carried at depreciated historical cost.

Schedule 4. Calculation of the reversal of the impairment loss at the end of 20X4

	~~*Plane*~~ *Aircraft*
Carrying amount at the end of 20X0 (Schedule 2)	121,128
End of 20X4	
Depreciation charge (20X1 to 20X4 – Schedule 5)	(48,452)
Renewal expenditure	25,000
Carrying amount before reversal	97,676
Recoverable amount (Schedule 3)	122,072
Reversal of the impairment loss	17,324
Carrying amount after reversal	115,000
Carrying amount: depreciated historical cost (Schedule 5)	115,000[(1)]

[(1)] The value in use of the ~~plane~~ aircraft exceeds what its carrying amount would have been at depreciated historical cost. Therefore, the reversal is limited to an amount that does not result in the carrying amount of the ~~plane~~ aircraft exceeding depreciated historical cost.

Schedule 5. Summary of the carrying amount of the ~~plane~~ aircraft

Year	*Depreciated historical cost*	*Recoverable amount*	*Adjusted depreciation charge*	*Impairment loss*	*Carrying amount after impairment*
20X0	150,000	121,128	0	(28,872)	121,128
20X1	135,000	n.c.	(12,113)	0	109,015
20X2	120,000	n.c.	(12,113)	0	96,902
20X3	105,000	n.c.	(12,113)	0	84,789
20X4	90,000		(12,113)		
renewal	25,000		-		
	115,000	122,072	(12,113)	17,324	115,000
20X5	95,833	n.c.	(19,167)	0	95,833

n.c. = not calculated as there is no indication that the impairment loss may have increased/decreased.

~~Example 7 – Application of the 'Bottom-Up' and 'Top-Down' Tests to Goodwill~~

~~*In this example, tax effects are ignored.*~~

~~A62. At the end of 20X0, enterprise M acquired 100% of enterprise Z for 3,000. Z has 3 cash-generating units A, B and C with net fair values of 1,200, 800 and 400 respectively. M recognises goodwill of 600 (3,000 less 2,400) that relates to Z.~~

~~A63. At the end of 20X5, A makes significant losses. Its recoverable amount is estimated to be 1,400. Carrying amounts are detailed below.~~

~~Schedule 1. Carrying amounts at the end of 20X5~~

~~*End of 20X5*~~	~~*A*~~	~~*B*~~	~~*C*~~	~~*Goodwill*~~	~~*Total*~~
~~Net carrying amount~~	~~1,300~~	~~1,200~~	~~800~~	~~450~~	~~3,750~~

~~A - Goodwill Can be Allocated on a Reasonable and Consistent Basis~~

~~A64. At the date of acquisition of Z, the net fair values of A, B and C are considered a reasonable basis for a pro rata allocation of the goodwill to A, B and C.~~

~~Schedule 2. Allocation of goodwill at the end of 20X5~~

	~~*A*~~	~~*B*~~	~~*C*~~	~~*Total*~~
~~*End of 20X0*~~				
~~Net fair values~~	~~1,200~~	~~800~~	~~400~~	~~2,400~~
~~Pro rata~~	~~50%~~	~~33%~~	~~17%~~	~~100%~~
~~*End of 20X5*~~				
~~Net carrying amount~~	~~1,300~~	~~1,200~~	~~800~~	~~3,300~~
~~Allocation of goodwill (using the pro rata above)~~	~~225~~	~~150~~	~~75~~	~~450~~
~~Net carrying amount (after allocation of goodwill)~~	~~1,525~~	~~1,350~~	~~875~~	~~3,750~~

A65. In accordance with the 'bottom-up' test in paragraph 80(a) of IAS 36, M compares A's recoverable amount to its carrying amount after the allocation of the carrying amount of goodwill.

Schedule 3. Application of 'bottom-up' test

End of 20X5	*A*
Carrying amount after allocation of goodwill (Schedule 2)	1,525
Recoverable amount	1,400
Impairment loss	125

A66. M recognises an impairment loss of 125 for A. The impairment loss is fully allocated to the goodwill in accordance with paragraph 88 of IAS 36.

B - Goodwill Cannot Be Allocated on a Reasonable and Consistent Basis

A67. There is no reasonable way to allocate the goodwill that arose on the acquisition of Z to A, B and C. At the end of 20X5, Z's recoverable amount is estimated to be 3,500.

A68. At the end of 20X5, M first applies the 'bottom-up' test in accordance with paragraph 80(a) of IAS 36. It compares A's recoverable amount to its carrying amount excluding the goodwill.

Schedule 4. Application of 'bottom-up' test

End of 20X5	*A*
Carrying amount	1,300
Recoverable amount	1,400
Impairment loss	0

A69. Therefore, no impairment loss is recognised for A as a result of the 'bottom-up' test.

A70. Since the goodwill could not be allocated on a reasonable and consistent basis to A, M also performs a 'top-down' test in accordance with paragraph 80(b) of IAS 36. It compares the carrying amount of Z as a whole to its recoverable amount (Z as a whole is the smallest cash-generating unit that includes A and to which goodwill can be allocated on a reasonable and consistent basis).

Schedule 5. Application of the 'top-down' test

End of 20X5	*A*	*B*	*C*	*Goodwill*	*Z*
Carrying amount	1,300	1,200	800	450	3,750
Impairment loss arising from the 'bottom-up' test	0	-	-	-	0
Carrying amount after the 'bottom-up' test	1,300	1,200	800	450	3,750
Recoverable amount					3,500
Impairment loss arising from 'top-down' test					(250)

A71. Therefore, M recognises an impairment loss of 250 that it allocates fully to goodwill in accordance with paragraph 88 of IAS 36.

Example 7 – Impairment Testing Cash-Generating Units with Goodwill and Minority Interests

In this example, tax effects are ignored.

Background

A62. Entity X acquires an 80 per cent ownership interest in Entity Y for 1,600 on 1 January 20X3. At that date, Y's identifiable net assets have a fair value of 1,500. Y has no contingent liabilities. Therefore, X recognises in its consolidated financial statements:

(a) goodwill of 400, being the difference between the cost of the business combination of 1,600 and X's 80 per cent interest in Y's identifiable net assets;

(b) Y's identifiable net assets at their fair value of 1,500; and

(c) a minority interest of 300, being the 20 per cent interest in Y's identifiable net assets held by parties outside X.

A63. The assets of Y together are the smallest group of assets that generate cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets. Therefore Y is a cash-generating unit. Because this cash-generating unit includes goodwill within its carrying amount, it must be tested for impairment annually, or more frequently if there is an indication that it may be impaired (see paragraph 85 of [draft] IAS 36).

A64. At the end of 20X3, X determines that the recoverable amount of cash-generating unit Y is 1,000. X uses straight-line depreciation over a 10-year life for Y's identifiable assets and anticipates no residual value.

Testing Y for Impairment

A65. A portion of Y's recoverable amount of 1,000 is attributable to the unrecognised minority interest in goodwill. Therefore, in accordance with paragraph 89 of [draft] IAS 36, the carrying amount of Y must be

notionally adjusted to include goodwill attributable to the minority interest, before being compared with the recoverable amount of 1,000.

Schedule 1. Testing Y for impairment at the end of 20X3

End of 20X3	*Goodwill*	*Identifiable net assets*	*Total*
Gross carrying amount	400	1,500	1,900
Accumulated depreciation	-	(150)	(150)
Carrying amount	400	1,350	1,750
Unrecognised minority interest	100[(1)]	-	100
Notionally adjusted carrying amount	500	1,350	1,850
Recoverable amount			1,000
Impairment loss			850

[(1)] Goodwill attributable to X's 80% interest in Y at the acquisition date is 400. Therefore, goodwill notionally attributable to the 20% minority interest in Y at the acquisition date is 100.

A66. The impairment loss of 850 is allocated to the assets in the unit by first determining whether the goodwill is impaired. In accordance with paragraph 85 of [draft] IAS 36, the goodwill is impaired if its carrying amount exceeds its implied value. If X determines that the fair value of the identifiable net assets it would recognise if it had acquired Y at the date of this impairment test is 800, the implied value of the goodwill is 200 (see paragraph 86 of [draft] IAS 36). This implied value includes the goodwill attributable to both X and the minority interest.

A67. Therefore, 300 of the 850 impairment loss for the unit is attributable to the goodwill (being the excess of the notional carrying amount of the goodwill of 500 over its implied value of 200). However, because the goodwill is recognised only to the extent of X's 80 per cent ownership interest in Y, X recognises only 80 per cent of that goodwill impairment loss (i.e. 240).

A68. The remaining impairment loss of 550 is, in accordance with paragraph 103 of [draft] IAS 36, recognised by reducing the carrying amounts of Y's identifiable assets (see Schedule 2).

Schedule 2. Allocation of the impairment loss for Y at the end of 20X3

End of 20X3	*Goodwill*	*Identifiable net assets*	*Total*
Gross carrying amount	400	1,500	1,900
Accumulated depreciation	-	(150)	(150)
Carrying amount	400	1,350	1,750
Impairment Loss	(240)	(550)	(790)
Carrying amount after impairment loss	160	800	960

Example 8 - Allocation of Corporate Assets

In this example, tax effects are ignored.

Background

~~A72~~ A69. ~~Enterprise~~ Entity M has three cash-generating units: A, B and C. The carrying amounts of those units do not include goodwill. There are adverse changes in the technological environment in which M operates. Therefore, M conducts impairment tests of each of its cash-generating units. At the end of 20X0, the carrying amounts of A, B and C are 100, 150 and 200 respectively.

~~A73~~ A70. The operations are conducted from a headquarters. The carrying amount of the headquarters ~~assets~~ is 200: a headquarters building of 150 and a research centre of 50. The relative carrying amounts of the cash-generating units are a reasonable indication of the proportion of the headquarters building devoted to each cash-generating unit. The carrying amount of the research centre cannot be allocated on a reasonable basis to the individual cash-generating units.

~~A74~~ A71. The remaining estimated useful life of cash-generating unit A is 10 years. The remaining useful lives of B, C and the headquarters ~~assets~~ are 20 years. The headquarters ~~assets~~ are depreciated on a straight-line basis.

~~A75~~ A72. There is no basis on which to calculate a net selling price for each cash-generating unit. Therefore, the recoverable amount of each cash-generating unit is based on its value in use. Value in use is calculated using a pre-tax discount rate of 15%.

Identification of Corporate Assets

~~A76~~ A73. In accordance with paragraph ~~86~~ 101 of [draft] IAS 36, M first identifies all the corporate assets that relate to the individual cash-generating units under review. The corporate assets are the headquarters building and the research centre.

~~A77~~ A74. M then decides how to deal with each of the corporate assets:

(a) the carrying amount of the headquarters building can be allocated on a reasonable and consistent basis to the cash-generating units under review~~. Therefore, only a 'bottom-up' test is necessary~~; and

(b) the carrying amount of the research centre cannot be allocated on a reasonable and consistent basis to the individual cash-generating units under review. ~~Therefore, a 'top-down' test will be applied in addition to the 'bottom-up' test.~~

Allocation of Corporate Assets

~~A78~~ A75. The carrying amount of the headquarters building is allocated to the carrying amount of each individual cash-generating unit. A weighted allocation basis is used because the estimated remaining useful life of A's cash-generating unit is 10 years, whereas the estimated remaining useful lives of B and C's cash-generating units are 20 years.

Schedule 1. Calculation of a weighted allocation of the carrying amount of the headquarters building

End of 20X0	*A*	*B*	*C*	*Total*
Carrying amount	100	150	200	450
Useful life	10 years	20 years	20 years	
Weighting based on useful life	1	2	2	
Carrying amount after weighting	100	300	400	800
Pro-rata allocation of the building	12% *(100/800)*	38% *(300/800)*	50% *(400/800)*	100%
Allocation of the carrying amount of the building (based on pro-rata above)	19	56	75	~~(~~150~~)~~
Carrying amount (after allocation of the building)	119	206	275	600

Determination of Recoverable Amount and Calculation of Impairment Losses

~~A79~~ A76. ~~The 'bottom up' test~~ Paragraph 101 of [draft] IAS 36 requires ~~calculation of~~ first that the recoverable amount of each individual cash-generating unit be compared with its carrying amount, including the portion of the carrying amount of the headquarters building allocated to the unit, and any resulting impairment loss recognised. ~~The 'top down' test~~ Paragraph 101 of [draft] IAS 36 then requires ~~calculation of~~ the recoverable amount of M as a whole (the smallest cash-generating unit that includes the research centre) to be compared with its carrying amount, including both the headquarters building and the research centre.

Schedule 2. Calculation of A, B, C and M's value in use at the end of 20X0

	A		*B*		*C*		*M*	
Year	*Future cash flows*	*Discount at 15%*	*Future cash flows*	*Discount at 15%*	*Future cash flows*	*Discount at 15%*	*Future cash flows*	*Discount at 15%*
1	18	16	9	8	10	9	39	34
2	31	23	16	12	20	15	72	54
3	37	24	24	16	34	22	105	69
4	42	24	29	17	44	25	128	73
5	47	24	32	16	51	25	143	71
6	52	22	33	14	56	24	155	67
7	55	21	34	13	60	22	162	61
8	55	18	35	11	63	21	166	54
9	53	15	35	10	65	18	167	48
10	48	12	35	9	66	16	169	42
11			36	8	66	14	132	28
12			35	7	66	12	131	25
13			35	6	66	11	131	21
14			33	5	65	9	128	18
15			30	4	62	8	122	15
16			26	3	60	6	115	12
17			22	2	57	5	108	10
18			18	1	51	4	97	8
19			14	1	43	3	85	6
20			10	1	35	2	71	4
Value in use		199		164		271		720[(1)]

[(1)] It is assumed that the research centre generates additional future cash flows for the ~~enterprise~~ entity as a whole. Therefore, the sum of the value in use of each individual cash-generating unit is less than the value in use of the business as a whole. The additional cash flows are not attributable to the headquarters building.

~~Calculation of Impairment Losses~~

~~A80. In accordance with the 'bottom-up' test, M compares the carrying amount of each cash-generating unit (after allocation of the carrying amount of the building) to its recoverable amount.~~

Schedule 3. ~~Application of 'bottom-up' test~~ Impairment testing A, B and C

End of 20X0	*A*	*B*	*C*
Carrying amount (after allocation of the building) (Schedule 1)	119	206	275
Recoverable amount (Schedule 2)	199	164	271
Impairment loss	0	(42)	(4)

~~A81~~ A77. The next step is to allocate the impairment losses between the assets of the cash-generating units and the headquarters building.

Schedule 4. Allocation of the impairment losses for cash-generating units B and C

Cash-generating unit	*B*		*C*	
To headquarters building	(12)	*(42*56/206)*	(1)	*(4*75/275)*
To assets in cash-generating unit	(30)	*(42*150/206)*	(3)	*(4*200/275)*
	(42)		(4)	

~~A82~~ A78. ~~In accordance with the 'top-down' test, since~~ Because the research centre could not be allocated on a reasonable and consistent basis to A, B and C's cash-generating units, M compares the carrying amount of the smallest cash-generating unit to which the carrying amount of the research centre can be allocated (i.e., M as a whole) to its recoverable amount.

Schedule 5. ~~Application of the 'top-down' test~~ Impairment testing the 'larger' cash-generating unit (i.e., M as a whole)

End of 20X0	*A*	*B*	*C*	*Building*	*Research centre*	*M*
Carrying amount	100	150	200	150	50	650
Impairment loss arising from the ~~'bottom up' test~~ first step of the test	-	(30)	(3)	(13)	-	(46)
Carrying amount after the ~~'bottom up' test~~ first step of the test	100	120	197	137	50	604
Recoverable amount (Schedule 2)						720
Impairment loss ~~arising from 'top down' test~~ for the 'larger' cash-generating unit						0

~~A83~~ A79. Therefore, no additional impairment loss results from the application of the ~~'top down' test~~ impairment test to the 'larger' cash-generating unit. Only an impairment loss of 46 is recognised as a result of the application of the ~~'bottom up'~~ first step of the test to A, B and C.

Example 9 – Disclosures about Cash-Generating Units with Goodwill or Intangible Assets with Indefinite Useful Lives

The purpose of this example is to illustrate the disclosures required by paragraphs 134 and 137 of [draft] IAS 36.

Background

A80. Entity XYZ is a multinational manufacturing firm that uses geographical segments as its primary format for reporting segment information. XYZ's three reportable segments based on its primary reporting format are Europe, North America and Asia. Goodwill has been allocated for impairment testing purposes to cash-generating units in Europe and North America.

A81. XYZ acquired unit C, a manufacturing operation in North America, in December 20X2. Unlike XYZ's other North American operations, C operates in an industry with high-margins and high-growth rates, and with the benefit of a 10-year patent on its primary product. The patent was granted to C just before XYZ's acquisition of C. As part of accounting for the acquisition of C, XYZ recognised, in addition to the patent, goodwill of 3,000 and a brand name of 1,000. XYZ's management has determined that the brand name has an indefinite useful life. XYZ has no other intangible assets with indefinite useful lives.

A82. During the year ending 31 December 20X3, XYZ determines that there is no impairment of any of its cash-generating units containing goodwill or intangible assets with indefinite useful lives. The recoverable amounts of those units, including unit C, are determined on the basis of value in use calculations. XYZ has determined that the recoverable amount calculations are most sensitive to changes in the following assumptions:

European units containing goodwill	*North American units containing goodwill (excluding Unit C)*	*Unit C*
Gross margin during the budget period (budget period is 4 years)	5-year government bond rate during the budget period (budget period is 5 years)	Gross margin during the budget period (budget period is 5 years)
Market share during the budget period	Market share during the budget period	Market share during the budget period
Euro/US dollar exchange rate during the budget period	Raw material price inflation during the budget period	Raw material price inflation during the budget period
Growth rate used to extrapolate cash flows beyond the budget period	Growth rate used to extrapolate cash flows beyond the budget period	Growth rate used to extrapolate cash flows beyond the budget period

A83. XYZ includes the following disclosure in the notes to its financial statements for the year ending 31 December 20X3.

Impairment Tests for Goodwill and Intangible Assets with Indefinite Lives

Goodwill has been allocated for impairment testing purposes to cash-generating units in two geographical segments: Europe and North America. Also allocated to one of the North American units, unit C, is a valuable brand name that management has determined to have an indefinite useful life. The information in the table below for Europe reflects all of the units within that segment that contain goodwill. The information provided in the table below for North America excludes unit C. Information for C is provided separately because:

- the amount of goodwill allocated to C is significant in relation to the total carrying amount of goodwill;

- the carrying amount of C's brand name represents the total carrying amount of identifiable intangible assets with indefinite useful lives; and

- the key assumptions and growth rate used to determine the recoverable amount of C differ from those used for the other North American units containing goodwill.

Europe

The recoverable amounts of the European units containing goodwill are determined based on value in use calculations. Those calculations use cash flow projections based on financial budgets approved by management covering a four-year period. Cash flows beyond that four-year period are extrapolated using growth rates ranging from 4 to 6 per cent (weighted average 5.2 per cent). Those growth rates do not exceed the long-term average growth rates for the products, industries or countries in which XYZ's European units operate.

North America

The recoverable amounts of the North American units containing goodwill, including unit C, are determined based on value in use calculations. Those calculations use cash flow projections based on financial budgets approved by management covering a five-year period. In the case of units other than C, cash flows beyond the five-year period are extrapolated using growth rates ranging from 5 to 7 per cent (weighted average 6.3 per cent). These growth rates do not exceed the long-term average growth rates for the products, industries or countries in which XYZ's North American units operate.

C's cash flows beyond the five-year period are extrapolated using a 12 per cent growth rate. This growth rate exceeds by 4 percentage points the long-term average growth rate for the market in which C operates. However, C benefits from the protection of a 10-year patent on its primary product, granted in December 20X2. Management is of the opinion that a 12 per cent growth rate is reasonable in the light of that patent.

	Europe	*North America (excluding unit C)*	*Unit C*
Carrying amount of goodwill	1,000	1,000	3,000
Carrying amount of brand name with indefinite useful life	-	-	1,000
Amount by which the aggregate recoverable amount of the units containing goodwill (and indefinite life brand name) exceeds their aggregate carrying amount	4,000	3,000	2,000

Key assumptions used in value in use calculations

• Key assumption	• budgeted gross margin of 25% *	• 5-year government bond rate of 3.57% [1]	• budgeted gross margin of 45% [2]
• Change in key assumption, after incorporating consequential effects of that change on other variables used to measure value in use, that would cause the aggregate recoverable amount of the units containing goodwill (and indefinite life brand name) to equal their aggregate carrying amount	• 5 percentage point drop to 20%	• 1.45 percentage point increase to 5.02%	• 10 percentage point drop to 35%
• Key assumption	• budgeted market share of 20% *	• budgeted market share of 15% *	• budgeted market share of 60% *
• Change in key assumption, after incorporating consequential effects of that change on other variables used to measure value in use, that would cause the aggregate recoverable amount of the units containing goodwill (and indefinite life brand name) to equal their aggregate carrying amount	• 5 percentage point drop to 15%	• 5 percentage point drop to 10%	• 20 percentage point drop to 40%
• Key assumption	• Average exchange rate of €1 = US$0.993[3]	• raw material price inflation of 3% *	• raw material price inflation of 3%*
• Change in key assumption, after incorporating consequential effects of that change on other variables used to measure value in use, that would cause the aggregate recoverable amount of the units containing goodwill (and indefinite life brand name) to equal their aggregate carrying amount	• $0.22 drop to US$0.773	• 3 percentage point increase to 6%	• 1.25 percentage point increase to| 4.25%
• Weighted average growth rate used to extrapolate cash flows beyond the budget period	• 5.2%	• 6.3%	• 12%
• Change in weighted average growth rate that would cause the aggregate recoverable amount of the units containing goodwill (and indefinite life brand name) to equal their aggregate carrying amount	• 0.75 percentage point drop to 4.45%	• 2.4 percentage point drop to 3.9%	• 3.6 percentage point drop to 8.4%

* Assumption is consistent with actual results in previous reporting period.

[1] The rate on 5-year US government bonds during the preceding annual reporting period ranged from 3.91% to 4.76%, with a 12-month average of 4.37%. However, a rate of 3.57% has been used for the budget period because this rate reflects the yield on such bonds at the commencement of the budget period.

[2] Actual gross margins for the preceding two annual reporting periods were 35% and 36%, respectively. However, management believes that a 45% gross margin for the budget period is reasonable in the light of the patent protection over C's primary product and the expected synergies to be achieved from operating C as part of XYZ's North American segment.

[3] The exchange rate during the preceding annual reporting period ranged from US$0.8344 to US$0.9997, with a 12-month average rate of US$0.896. However, an average exchange rate for the budget period of US$0.993 has been used as this rate reflects the average market forward exchange rate over the budget period.

Appendix B

Using Present Value Techniques in Measuring the Value in Use of an Asset

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

The Components of a Present Value Measurement

B1. The following elements together capture the economic differences among assets:

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

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

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

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

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

B2. This appendix contrasts two approaches to computing present value, either of which may be used to estimate the value in use of an asset, depending on the circumstances. Under the 'traditional' approach, adjustments for factors (b)-(e) described in paragraph B1 are embedded in the discount rate. Under the 'expected cash flow' approach, factors (b), (d) and (e) cause adjustments in arriving at risk-adjusted expected cash flows. Whichever approach an entity adopts to reflect expectations about possible variations in the amount and/or timing of future cash

flows, the result should be to reflect the expected present value of the future cash flows, ie the weighted average of all possible outcomes.

General Principles

B3. The techniques used to estimate future cash flows and interest rates will vary from one situation to another depending on the circumstances surrounding the asset in question. However, the following general principles govern any application of present value techniques in measuring assets:

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

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

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

Traditional and Expected Cash Flow Approaches to Present Value

Traditional Approach

B4. Accounting applications of present value have traditionally used a single set of estimated cash flows and a single discount rate, often described as 'the rate commensurate with the risk'. In effect, the traditional approach assumes that a single discount rate convention can incorporate all the

expectations about the future cash flows and the appropriate risk premium. Therefore, the traditional approach places most of the emphasis on selection of the discount rate.

B5. In some circumstances, such as those in which comparable assets can be observed in the marketplace, a traditional approach is relatively easy to apply. For assets with contractual cash flows, it is consistent with the manner in which marketplace participants describe assets, as in 'a 12 per cent bond'.

B6. However, the traditional approach may not appropriately address some complex measurement problems, such as the measurement of non-financial assets for which no market for the item or a comparable item exists. A proper search for 'the rate commensurate with the risk' requires analysis of at least two items—an asset that exists in the marketplace and has an observed interest rate and the asset being measured. The appropriate discount rate for the cash flows being measured must be inferred from the observable rate of interest in that other asset. To draw that inference, the characteristics of the other asset's cash flows must be similar to those of the asset being measured. Therefore, the measurer must do the following:

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

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

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

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

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

Expected Cash Flow Approach

B7. The expected cash flow approach is, in some situations, a more effective measurement tool than the traditional approach. In developing a measurement, the expected cash flow approach uses all expectations about possible cash flows instead of the single most likely cash flow. For example, a cash flow might be 100, 200 or 300 with probabilities of

10 per cent, 60 per cent and 30 per cent, respectively. The expected cash flow is 220. The expected cash flow approach thus differs from the traditional approach by focusing on direct analysis of the cash flows in question and on more explicit statements of the assumptions used in the measurement.

B8. The expected cash flow approach also allows use of present value techniques when the timing of cash flows is uncertain. For example, a cash flow of 1,000 may be received in one year, two years or three years with probabilities of 10 per cent, 60 per cent and 30 per cent, respectively. The example below shows the computation of expected present value in that situation.

Present value of 1,000 in 1 year at 5%	952.38	
Probability	10.00%	95.24
Present value of 1,000 in 2 years at 5.25%	902.73	
Probability	60.00%	541.64
Present value of 1,000 in 3 years at 5.50%	851.61	
Probability	30.00%	255.48
Expected present value		892.36

B9. The expected present value of 892.36 differs from the traditional notion of a best estimate of 902.73 (the 60 per cent probability). A traditional present value computation applied to this example requires a decision about which of the possible timings of cash flows to use and, accordingly, would not reflect the probabilities of other timings. This is because the discount rate in a traditional present value computation cannot reflect uncertainties in timing.

B10. The use of probabilities is an essential element of the expected cash flow approach. Some question whether assigning probabilities to highly subjective estimates suggests greater precision than, in fact, exists. However, the proper application of the traditional approach (as described

in paragraph B6) requires the same estimates and subjectivity without providing the computational transparency of the expected cash flow approach.

B11. Many estimates developed in current practice already incorporate the elements of expected cash flows informally. In addition, accountants often face the need to measure an asset using limited information about the probabilities of possible cash flows. For example, an accountant might be confronted with the following situations:

(a) the estimated amount falls somewhere between 50 and 250, but no amount in the range is more likely than any other amount. Based on that limited information, the estimated expected cash flow is 150 [(50 + 250)/2].

(b) the estimated amount falls somewhere between 50 and 250, and the most likely amount is 100. However, the probabilities attached to each amount are unknown. Based on that limited information, the estimated expected cash flow is 133.33 [(50 + 100 + 250)/3].

(c) the estimated amount will be 50 (10 per cent probability), 250 (30 per cent probability), or 100 (60 per cent probability). Based on that limited information, the estimated expected cash flow is 140 [(50 x .10) + (250 x .30) + (100 x .60)].

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

B12. The application of an expected cash flow approach is subject to a cost-benefit constraint. In some cases, an entity may have access to extensive data and may be able to develop many cash flow scenarios. In other cases, an entity may not be able to develop more than general statements about the variability of cash flows without incurring substantial cost. The entity needs to balance the cost of obtaining additional information against the additional reliability that information will bring to the measurement.

B13. Some maintain that expected cash flow techniques are inappropriate for measuring a single item or an item with a limited number of possible outcomes. They offer an example of an asset with two possible

outcomes: a 90 per cent probability that the cash flow will be 10 and a 10 per cent probability that the cash flow will be 1,000. They observe that the expected cash flow in that example is 109 and criticise that result as not representing either of the amounts that may ultimately be paid.

B14. Assertions like the one just outlined reflect underlying disagreement with the measurement objective. If the objective is accumulation of costs to be incurred, expected cash flows may not produce a representationally faithful estimate of the expected cost. However, [draft] IAS 36 is concerned with measuring the recoverable amount of an asset. The recoverable amount of the asset in this example is not likely to be 10, even though that is the most likely cash flow. This is because a measurement of 10 does not incorporate the uncertainty of the cash flow in the measurement of the asset. Instead, the uncertain cash flow is presented as if it were a certain cash flow. No rational entity would sell an asset with these characteristics for 10.

Discount Rate

B15. Whichever approach an entity adopts for measuring the value in use of an asset, interest rates used to discount cash flows should not reflect risks for which the estimated cash flows have been adjusted. Otherwise, the effect of some assumptions will be double-counted.

B16. When an asset-specific rate is not directly available from the market, an entity uses surrogates to estimate the discount rate. The purpose is to estimate, as far as possible, a market assessment of:

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

(b) factors (b), (d) and (e) described in paragraph B1, to the extent those factors have not caused adjustments in arriving at estimated cash flows.

B17. As a starting point in making such an estimate, the entity might take into account the following rates:

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

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

(c) other market borrowing rates.

B18. However, these rates must be adjusted to:

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

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

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

B19. The discount rate is independent of the entity's capital structure and the way the entity financed the purchase of the asset because the future cash flows expected to arise from an asset do not depend on the way in which the entity financed the purchase of the asset.

B20. Paragraph 48 requires the discount rate used to be a pre-tax rate. Therefore, when the basis used to estimate the discount rate is post-tax, that basis is adjusted to reflect a pre-tax rate.

B21. An entity normally uses a single discount rate for the estimate of an asset's value in use. However, an entity uses separate discount rates for different future periods where value in use is sensitive to a difference in risks for different periods or to the term structure of interest rates.

Appendix C

Basis for Conclusions

Contents

Basis for Conclusions

Introduction

C1. This Basis for Conclusions summarises the Board's considerations in reaching the conclusions in the Exposure Draft for proposed amendments to IAS 36 *Impairment of Assets*. Individual Board members gave greater weight to some factors than to others.

C2. The Exposure Draft has been issued by the Board as part of its project on business combinations. That project has two phases. The first has resulted in the Board issuing simultaneously an Exposure Draft (ED 3) of a proposed IFRS *Business Combinations*, and this Exposure Draft, which proposes changes to IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets*. The Board's intention in developing its proposals to amend IAS 36 as part of the first phase of the project was not to reconsider all of the requirements in IAS 36. The changes proposed to IAS 36 are primarily concerned with the impairment tests for intangible assets with indefinite useful lives (hereafter referred to as 'indefinite life intangibles') and goodwill. The Board has not deliberated the other requirements in IAS 36. Those other requirements will be considered by the Board as part of a future project on impairments of assets.

C3. The amendments to IAS 36 proposed in the May 2002 Exposure Draft *Improvements to International Accounting Standards* are also presented in the Exposure Draft as marked-up text. This Basis for Conclusions does not outline the Board's deliberations on the changes to IAS 36 proposed in the May 2002 Exposure Draft. A list of those proposed changes is provided in Appendix D.

Testing intangible assets with indefinite useful lives for impairment

C4. As part of the first phase of its Business Combinations project, the Board concluded that:

(a) an intangible asset should be regarded as having an indefinite useful life when, based on an analysis of all relevant factors (legal,

regulatory, contractual, competitive, economic and other), there is no foreseeable limit on the period over which the asset is expected to generate net cash inflows for the entity; and

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

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

C5. Having reached these conclusions, the Board then considered the form that the impairment test for indefinite life intangibles should take. The Board concluded, and this Exposure Draft proposes, that:

(a) an indefinite life intangible should be tested for impairment at the end of each annual reporting period, or more frequently if there is any indication that it may be impaired; and

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

Paragraphs C6-C9 outline the Board's deliberations in reaching its conclusion about the frequency of impairment testing indefinite life intangibles. Paragraphs C10 and C11 outline the Board's deliberations in reaching its conclusions about measuring the recoverable amount of such assets and accounting for impairment losses and reversals of impairment losses.

Frequency of impairment testing (paragraphs 8 and 8A)

C6. The Board observed that requiring assets to be remeasured when they are impaired is a valuation concept rather than one of cost allocation. This concept, which some have termed 'the recoverable cost concept', focuses on the benefits to be derived from the asset in the future, rather than on the process by which the cost or other carrying amount of the asset should be allocated to particular accounting periods. Therefore, the purpose of an impairment test is to assess whether the carrying amount of an asset will be recovered through use or sale of the asset. Nevertheless,

allocating the depreciable amount of an asset with a limited useful life on a systematic basis over that life provides some assurance against the asset's carrying amount exceeding its recoverable amount. The Board agreed that non-amortisation of an intangible asset increases the reliance that must be placed on impairment reviews of that asset to ensure that its carrying amount does not exceed its recoverable amount.

C7. Accordingly, the Board decided that indefinite life intangibles should be tested for impairment at the end of each annual reporting period. The Board agreed, however, that testing such assets annually for impairment is not a substitute for management being aware of events occurring or circumstances changing between annual tests that indicate a possible impairment. Therefore, the Board decided that an entity should also be required to test such assets for impairment whenever there is an indication of possible impairment, and not wait until the next annual test.

Carrying forward a recoverable amount calculation (paragraph 20A)

C8. The Exposure Draft proposes permitting the most recent detailed calculation of the recoverable amount of an indefinite life intangible to be carried forward from a preceding reporting period for use in the current period's impairment test, provided all of the criteria in paragraph 20A of the draft Standard are met.

C9. Integral to the Board's decision that indefinite life intangibles should be tested for impairment annually was the view that many entities should be able to conclude that the recoverable amount of such an asset is greater than its carrying amount without actually recomputing recoverable amount. However, the Board agreed that this would be the case only if the last recoverable amount determination exceeded the carrying amount by a substantial margin, and nothing had happened since that last recoverable amount determination to make the likelihood of an impairment loss other than remote. The Board concluded that, in such circumstances, permitting a detailed calculation of the recoverable amount of an indefinite life intangible to be carried forward from the preceding reporting period for use in the current period's impairment test would significantly reduce the costs of applying the impairment test, without compromising its integrity.

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

C10. The Board could see no compelling reason why the measurement basis adopted for determining recoverable amount and the treatment of impairment losses and reversals of impairment losses for one group of identifiable assets should differ from those applying to other identifiable assets. Adopting different methods would impair the usefulness of the information provided to users about an entity's identifiable assets, because both comparability and reliability, which rest on the notion that similar transactions are accounted for in the same way, would be diminished. Therefore, the Board concluded that the recoverable amounts of indefinite life intangibles should be measured, and impairment losses and reversals of impairment losses in respect of those assets should be accounted for, consistently with other identifiable assets covered by IAS 36.

C11. Some Board members expressed concerns over the measurement basis adopted in IAS 36 for determining recoverable amount (higher of value in use and net selling price) and the treatment under IAS 36 of impairment losses and reversals of impairment losses for assets other than goodwill. However, the Board's intention in developing this Exposure Draft was *not* to reconsider the general approach to impairment testing in IAS 36. Accordingly, the Board agreed that it should address concerns over that general approach as part of its future re-examination of IAS 36 in its entirety, rather than as part of its Business Combinations project.

Testing goodwill for impairment
(paragraphs 73-98)

C12. The Board concluded that if a rigorous and operational impairment test could be devised, more useful information would be provided to users of an entity's financial statements under an approach in which goodwill is not amortised, but is instead tested for impairment annually or more frequently if events or changes in circumstances indicate that the goodwill might be impaired. An outline of the Board's deliberations in reaching this conclusion is provided in the Basis for Conclusions to ED 3 *Business Combinations*.

C13. Paragraphs C14-C61 outline the Board's deliberations on the form that the impairment test for goodwill should take:

(a) paragraphs C18-C25 discuss the proposals in the Exposure Draft relating to the allocation of goodwill to cash-generating units and the level at which goodwill is tested for impairment.

(b) paragraphs C26-C51 discuss the proposals in the Exposure Draft relating to the recognition and measurement of impairment losses for goodwill, including the frequency of impairment testing.

(c) paragraphs C52-C61 discuss the proposals in the Exposure Draft relating to the timing of goodwill impairment tests.

C14. As a first step in its deliberations, the Board considered the objective of the goodwill impairment test and the measure of recoverable amount that should be adopted for such a test. The Board observed that recent North American standards use fair value as the basis for impairment testing goodwill, whereas IAS 36 and the United Kingdom standard are based on an approach under which recoverable amount is measured as the higher of value in use and net selling price.

C15. The Board also observed that goodwill acquired in a business combination represents a payment made by an acquirer in anticipation of future economic benefits from assets that are not capable of being individually identified and separately recognised. Goodwill does not generate cash flows independently of other assets or groups of assets and therefore cannot be measured directly—instead it is measured as a residual amount, being the excess of the cost of a business combination over the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities. Moreover, goodwill acquired in a business combination and goodwill generated after that business combination cannot be separately identified, because they contribute jointly to the same cash flows.

C16. The Board concluded that because it is not possible to measure separately goodwill generated internally after a business combination and factor that measure into the impairment test for acquired goodwill, the carrying amount of goodwill will always be shielded from impairment by that internally generated goodwill. The Board therefore took the view that the objective of the goodwill impairment test could at best be to

ensure that the carrying amount of goodwill is recoverable from future cash flows expected to be generated by both acquired goodwill and goodwill generated internally after the business combination.

C17. The Board noted that because goodwill is measured as a residual amount, the starting point in any goodwill impairment test would have to be the recoverable amount of the operation or unit to which the goodwill relates, regardless of the measurement basis adopted for determining recoverable amount. Board members agreed that until the Board considers and resolves the issue of the appropriate measurement objective(s) in accounting more broadly, identifying the appropriate measure of recoverable amount for that unit would be problematic. Therefore, although some Board members expressed concerns over the measurement basis adopted in IAS 36 for determining recoverable amount, the Board agreed that it should not depart from that basis when measuring the recoverable amount of a unit whose carrying amount includes acquired goodwill. The Board noted that this would have the added advantage of allowing the impairment test for goodwill to be integrated with the impairment test in IAS 36 for other assets and cash-generating units that include goodwill.

Allocating goodwill to cash-generating units (paragraphs 73-82)

C18. IAS 36 requires goodwill to be tested for impairment as part of impairment testing the cash-generating units to which it relates. It employs a 'bottom-up/top-down' approach under which the goodwill is in effect tested for impairment by allocating its carrying amount to each of the smallest cash-generating units to which a portion of that carrying amount can be allocated on a reasonable and consistent basis.

C19. Consistently with IAS 36, the Exposure Draft proposes that:

(a) goodwill should be tested for impairment as part of impairment testing the cash-generating units to which it relates; and

(b) the carrying amount of goodwill should be allocated to each of the smallest cash-generating units to which a portion of that carrying amount can be allocated on a reasonable and consistent basis.

However, the Exposure Draft proposes additional guidance clarifying that a portion of the carrying amount of goodwill is to be regarded as capable of being allocated to a cash-generating unit on a reasonable and consistent basis only when that unit represents the lowest level at which management monitors the return on investment in assets that include the goodwill. That cash-generating unit cannot, however, be larger than a segment based on the entity's primary reporting format determined in accordance with IAS 14 *Segment Reporting*.

C20. The Board noted that because acquired goodwill does not generate cash flows independently of other assets or groups of assets, it can be tested for impairment only as part of impairment testing the cash-generating units to which it relates. However, the Board was concerned that in the absence of any guidance on the precise meaning of 'allocated on a reasonable and consistent basis', some might conclude that when a business combination enhances the value of all of the acquirer's pre-existing cash-generating units, any goodwill acquired in that business combination should be tested for impairment only at the level of the entity itself. The Board agreed that this should not be the case. Rather, there should be a link between the level at which goodwill is tested for impairment and the level of internal reporting that reflects the way an entity manages its operations and to which the goodwill naturally would be associated. Therefore, it was important to the Board that goodwill should be tested for impairment at a level at which information about the operations of an entity and the assets that support them is provided for internal reporting purposes.

Disposal of a portion of a cash-generating unit containing goodwill (paragraph 81)

C21. The Exposure Draft proposes that when an entity disposes of an operation within a cash-generating unit to which goodwill has been allocated, the goodwill associated with that operation should be:

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

(b) measured on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit retained.

C22. Each cash-generating unit to which a portion of the carrying amount of goodwill is allocated for impairment testing purposes represents the smallest cash-generating unit to which a portion of that carrying amount can be allocated on a reasonable and consistent basis. Therefore, the Board agreed that goodwill cannot be identified or associated with an asset group at a level lower than that cash-generating unit, except arbitrarily.

C23. However, the Board also agreed that when an *operation* within that cash-generating unit is being disposed of, it is appropriate to presume that some amount of goodwill is associated with that operation. Thus, an allocation of the goodwill should be required when the part of the cash-generating unit being disposed of constitutes an operation. The Board noted that this is consistent with the proposed requirement in ED 3 *Business Combinations* to recognise goodwill when an operation is acquired.

Reorganisation of reporting structure (paragraph 82)

C24. The Exposure Draft proposes that when an entity reorganises its reporting structure in a way that changes the composition of cash-generating units to which goodwill has been allocated, the goodwill should be reallocated to the units affected using a relative value approach similar to that used when an entity disposes of an operation within a cash-generating unit.

C25. The Board concluded that a reorganisation that changes the composition of a cash-generating unit to which goodwill has been allocated gives rise to the same allocation problem as disposing of an operation within that unit: the goodwill cannot be identified or associated with an asset group at a level lower than the cash-generating unit, other than arbitrarily. Therefore, the Board agreed that the same allocation methodology should be used in both cases.

Recognition and measurement of impairment losses (paragraphs 83-92)

C26. The Exposure Draft proposes that if the recoverable amount of a cash-generating unit to which goodwill has been allocated exceeds its carrying amount, both the unit and the goodwill allocated to that unit should be regarded as not impaired. If the carrying amount of the unit exceeds its

recoverable amount, an entity should then determine whether the goodwill allocated to the unit is impaired by comparing its recoverable amount, measured as the 'implied value' of the goodwill, with its carrying amount.

C27. As outlined in paragraphs C49-C51, the Board is proposing that the comparison of recoverable amount and carrying amount of the cash-generating unit be used as a screening mechanism for identifying potential goodwill impairments to reduce the cost of impairment testing goodwill. However, the Board reached its decision to include this screening mechanism after having first decided upon an 'implied value' approach to measuring the recoverable amount of, and thus impairment losses relating to, goodwill and how often goodwill should be required to be tested for impairment. The discussion below is structured to reflect the sequence of the Board's deliberations:

(a) paragraphs C28-C40 outline the Board's deliberations on measuring the recoverable amount (implied value) of goodwill.

(b) paragraphs C41-C51 outline the Board's deliberations on the frequency of goodwill impairment testing and the use of the screening mechanism to identify potential goodwill impairments to reduce the cost of the impairment test.

Measuring the recoverable amount of goodwill (paragraph 86)

C28. The Exposure Draft proposes that an impairment loss for goodwill should be measured as the excess of the carrying amount of goodwill over its implied value. The Exposure Draft also proposes that the implied value of goodwill should be measured as a residual, being the excess of:

(a) the recoverable amount (higher of value in use and net selling price) of the cash-generating unit to which the goodwill has been allocated, over

(b) the net fair value of the identifiable assets, liabilities and contingent liabilities the entity would recognise if it acquired the cash-generating unit in a business combination on the date of the impairment test (excluding any identifiable asset that was acquired

in a business combination but not recognised separately from goodwill at the acquisition date).

C29. As discussed in paragraph C17, the Board had concluded that:

(a) because goodwill is measured as a residual amount, the starting point in any goodwill impairment test, and therefore in measuring the recoverable amount of goodwill, must be the recoverable amount of the unit to which the goodwill relates. As outlined in paragraphs C19 and C20, the Board agreed that this unit should represent the smallest cash-generating unit to which a portion of the carrying amount of goodwill can be allocated on a reasonable and consistent basis.

(b) the recoverable amount of such a unit should be measured consistently with the requirements in IAS 36 as the higher of value in use and net selling price.

C30. Therefore, the Board's discussion focused on how the recoverable amount of goodwill allocated to a cash-generating unit could be separated from the recoverable amount of the unit as a whole, allowing that goodwill generated internally after a business combination could not be measured separately. The Board concluded that a method similar to the method an acquirer uses to allocate the cost of a business combination to the net assets acquired could be used to measure the recoverable amount of goodwill after its initial recognition. Thus, the Board decided that some measure of the net assets of a cash-generating unit to which goodwill has been allocated should be subtracted from the recoverable amount of that unit to determine a current implied value for the goodwill.

C31. The Board considered the following issues in arriving at the measure of the net assets of a cash-generating unit described in paragraph C28(b):

(a) whether the measure should include unrecognised value attributable to the recognised identifiable net assets within the unit (discussed in paragraphs C33 and C34).

(b) whether the measure should include the value of unrecognised identifiable net assets within the unit (discussed in paragraphs C33-C36).

(c) if all or part of an acquiree is integrated with an entity's existing units, whether the measure should include the value of unrecognised internally generated goodwill within a unit immediately before the business combination (pre-existing internally generated goodwill) (discussed in paragraphs C37-C40).

C32. The Board concluded that the measure of the net assets of a cash-generating unit described in paragraph C28(b) would result in the best estimate of the current implied value of the goodwill, given that goodwill generated internally after a business combination could not be measured separately.

Unrecognised value

C33. The Board noted that excluding from the measure of a unit's net assets any unrecognised value attributable to the unit's recognised identifiable net assets would cause that unrecognised value to be included within the implied value of goodwill. Similarly, excluding from the measure of a unit's net assets the value of the unit's unrecognised identifiable net assets would cause the value of those items also to be included within the implied value of goodwill. The Board referred to this as providing 'cushions' against the recognition of impairment losses for goodwill.

C34. The Board agreed that providing such cushions confuses different types of assets. If the unrecognised values are included within the implied value of goodwill, that implied value could not be said to be an estimate of the current value of goodwill. Therefore, the Board concluded that those unrecognised values should be *excluded* from the implied value of goodwill by being *included* in the measure of the net assets of the unit for the purpose of impairment testing goodwill.

C35. However, Board members noted that if an asset acquired in a business combination did not, at the time of accounting for the combination, satisfy the criteria proposed in ED 3 *Business Combinations* for recognition separately from goodwill, that asset would be included within the carrying amount of goodwill. The Board observed that it might be possible for such an asset subsequently to meet those criteria. Nonetheless, ED 3 prohibits any adjustment being made to the carrying amount of goodwill to recognise the asset separately—it would remain within the carrying amount of goodwill.

C36. The Board agreed that including the value of such an asset within the measure of the net assets of the unit, and thus excluding it from the implied value of goodwill, would be inappropriate because it:

(a) confuses different types of assets; and

(b) could result in the entity recognising an impairment loss for goodwill when no such impairment exists.

Therefore, the Board agreed that the Exposure Draft should propose excluding the value of such assets from the measure of the net assets of the unit.

Pre-existing internally generated goodwill

C37. The Board considered whether, if all or part of an acquiree is integrated with an entity's existing units, the measure of the net assets of those units should include the value of any unrecognised internally generated goodwill that existed within the units immediately before the business combination (pre-existing internally generated goodwill). If the measure of the net assets *excludes* pre-existing internally generated goodwill, that internally generated goodwill will be *included* within the implied value of goodwill, thereby providing a cushion against the recognition of impairment losses for the acquired goodwill.

C38. The Board agreed that it might be theoretically possible to remove the cushion created by pre-existing internally generated goodwill by including it within the measure of the unit's net assets. However, even if this were done, it does not ensure that the impairment test will capture only changes in the value of acquired goodwill. Because all goodwill operates jointly with other assets to generate cash flows, it is not possible for any impairment test to discern whether the pre-existing internally generated goodwill, rather than the acquired goodwill, has been impaired and replaced by goodwill generated after the business combination. In addition, a requirement to remove the cushion created by pre-existing internally generated goodwill would prove unworkable in practice for entities that regularly reorganise or restructure their operations. This is because when a reorganisation changes the composition of cash-generating units, it is unlikely that pre-existing internally generated goodwill could be traced to the reorganised units except arbitrarily.

C39. The Board was not as concerned about the cushion arising from pre-existing internally generated goodwill as it was about the cushions arising from other unrecognised identifiable assets or from unrecognised value attributable to recognised identifiable assets. Whereas the latter two cushions confuse different types of assets, the first does not. Therefore, the Board agreed that the revised Standard should not require an entity to attempt to identify, track and exclude from the implied value of goodwill any pre-existing internally generated goodwill.

C40. The Board observed that, as a result of this decision and its decision about the treatment of unrecognised identifiable assets and unrecognised value attributable to recognised identifiable assets, the impairment test for goodwill would ensure that the carrying amount of acquired goodwill is recoverable from the future cash flows expected to be generated by goodwill.

Frequency of testing and the screening mechanism (paragraphs 8, 8A and 85)

C41. Having agreed on the most appropriate measure of the recoverable amount of goodwill, the Board then considered how often an entity should be required to test goodwill for impairment. Consistently with its conclusions about indefinite life intangibles (see paragraphs C6 and C7), the Board agreed that non-amortisation of goodwill increases the reliance that must be placed on impairment tests to ensure that the carrying amount of goodwill does not exceed its recoverable amount. Accordingly, the Board decided that goodwill should be tested for impairment annually. However, the Board also agreed that the annual test is not a substitute for management being aware of events occurring or circumstances changing between annual tests indicating a possible impairment of goodwill. Therefore, the Board decided that an entity should also be required to test goodwill for impairment whenever there is an indication of possible impairment.

C42. After the Board had decided on the frequency of impairment testing, some Board members expressed concern that the proposed test would not be cost-effective. Their concerns related primarily to the requirement to determine the fair value of each identifiable asset, liability and contingent liability within a cash-generating unit that would be recognised by the entity if it had acquired the cash-generating unit in a business

combination on the date of the impairment test (in order to estimate the implied value of goodwill).

C43. The Board considered the following alternatives for addressing these concerns:

(a) retaining the one-step approach to impairment testing goodwill in IAS 36. Under that approach, if the recoverable amount of a cash-generating unit to which goodwill has been allocated exceeds its carrying amount, the unit and the goodwill allocated to that unit should be regarded as not impaired. If the carrying amount of the unit exceeds its recoverable amount, the excess is recognised as an impairment loss by first being allocated to reduce the carrying amount of goodwill. If, after reducing the carrying amount of goodwill to zero, an excess remains, it is allocated to reduce the carrying amount of the other assets within the unit pro-rata with the carrying amount of each asset.

(b) including as a first step in the impairment test for goodwill a screening mechanism similar to that in US Financial Accounting Standards Board Statement of Financial Accounting Standards No. 142 *Goodwill and Other Intangible Assets* (SFAS 142). Under SFAS 142, goodwill is tested for impairment by first comparing the fair value of the reporting unit to which the goodwill has been allocated for impairment testing purposes with the carrying amount of that unit. If the fair value of the unit exceeds its carrying amount, the goodwill is regarded as not impaired. An entity need estimate the implied fair value of goodwill (using an approach consistent with that described in paragraph C28) only if the fair value of the unit is less than its carrying amount.

C44. The Board agreed that the Exposure Draft should propose a screening mechanism similar to that in SFAS 142. The Board's deliberations of each of the above alternatives are outlined below.

Retaining the one-step approach in IAS 36

C45. IAS 36 is premised on the notion that if a series of independent cash flows can be generated only by a group of assets operating together as a unit, impairment losses should be considered only for that unit as a whole—individual assets within the unit should not be considered

separately. Therefore, IAS 36 adopts the view that it is acceptable to offset unrealised losses on some assets by unrealised gains on other assets.

C46. The Board noted the following arguments in support of retaining the one-step approach to impairment testing goodwill in IAS 36:

(a) it is less costly and simpler to apply than an approach involving an implied value calculation.

(b) it is consistent with the approach in IAS 36 for impairment testing assets other than goodwill. It would be inconsistent to consider goodwill separately for impairment testing purposes when other assets within a unit are not considered separately but instead considered as part of the unit as a whole, particularly given that goodwill, unlike many other assets, cannot generate cash inflows independently of other assets.

(c) if goodwill is considered separately for impairment testing purposes using an implied value calculation when other assets within a unit are considered only as part of the unit as a whole:

(i) there will be asymmetry: unrecognised goodwill will shield the carrying value of other assets from impairment, but the unrecognised value of other assets will not shield the carrying amount of goodwill from impairment. This seems unreasonable given that the unrecognised value of those other assets cannot then be recognised.

(ii) the carrying amount of a unit will be less than its recoverable amount whenever an impairment loss for goodwill exceeds the unrecognised value of the other assets in the unit.

C47. The Board acknowledged that the one-step approach would be less costly and simpler to apply than the implied value approach, and would ensure consistency with the approach in IAS 36 for impairment testing other assets. However, the Board agreed that given the nature of goodwill and the fact that its non-amortisation increases the reliance that must be placed on impairment testing, a more rigorous impairment test is justified for goodwill than for other assets.

C48. The Board reconfirmed its view that the best measure of goodwill impairment would be based on a purchase price allocation approach in which the measure of the net assets of a cash-generating unit described in paragraph C28(b) is subtracted from the recoverable amount of the unit to determine the implied value of goodwill. Because that method is the same as the method used to measure goodwill initially, the resulting reported amount of goodwill after any impairment charge would be the best available estimate consistent with the initial measurement of goodwill upon its acquisition.

Using a screening mechanism

C49. The Board considered the extent to which significant impairments of goodwill might go unrecognised if a comparison of a unit's carrying amount with its recoverable amount were added as a screen to identify potential goodwill impairments. The Board noted that the use of such a device would provide a cushion against recognising impairment losses for goodwill equal to the unrecognised value attributable to the identifiable assets in the unit. That cushion would, however, exist only if the value of those identifiable assets were being maintained or increased. The Board agreed that in this situation, it is likely that the value of goodwill is also being maintained because there is likely to be, to some extent, a correlation between appreciation in the value of the identifiable assets in a unit and appreciation in the value of goodwill in that unit. The converse is also likely to be true to some extent. For example, if the value of goodwill is *not* being maintained, the value of identifiable intangible assets in the unit also is probably not being maintained. Therefore, the unrecognised value attributable to those identifiable intangible assets would provide little or no cushion against recognising impairment losses for goodwill.

C50. Therefore, the Board concluded that using a comparison of a unit's carrying amount with its recoverable amount as a screen to identify potential goodwill impairments would be likely to:

(a) not result in as many impairments of goodwill going unrecognised as might first have been thought; and

(b) reduce significantly the costs of applying the goodwill impairment test without unduly compromising its integrity.

C51. The Board agreed that if the measurement of goodwill impairment were preceded by a less costly screening mechanism, the cost of measuring goodwill impairment by calculating the implied value of the goodwill would be justifiable. The measurement process would be required relatively infrequently, and would produce better information in situations where there was clearly a potential goodwill impairment.

Timing of impairment tests (paragraphs 93-98)

C52. To reduce the costs of applying the test, the Exposure Draft proposes to permit the annual impairment test for cash-generating units to which goodwill has been allocated to be performed at any time during an annual reporting period, provided the test is performed at the same time every year. However, if some or all of the goodwill allocated to a unit was acquired in a business combination during the current annual reporting period, that unit must be tested for impairment before the end of the current period.

C53. The Board observed that acquirers can sometimes 'overpay' for an acquiree, resulting in the amount initially recognised for the business combination and the resulting goodwill exceeding the recoverable amount of the investment. The Board agreed that the users of an entity's financial statements are provided with representationally faithful, and therefore useful, information about a business combination if such an impairment loss is recognised by the acquirer in the annual period in which the business combination occurs.

C54. The Board was concerned that it might be possible for entities to delay recognising such an impairment loss to the annual reporting period after the business combination if the revised Standard included only a requirement to impairment test cash-generating units to which goodwill has been allocated on an annual basis at any time during a reporting period. Therefore, the Board decided to propose in the Exposure Draft the added requirement that if some or all of the goodwill allocated to a unit was acquired in a business combination during the current annual reporting period, the unit should be tested for impairment before the end of that period.

Sequence of impairment tests (paragraph 94)

C55. The Exposure Draft proposes that if other assets or smaller cash-generating units constituting a larger cash-generating unit to which goodwill has been allocated are tested for impairment at the same time as that larger unit, the other assets or smaller units should be tested for impairment before the larger unit.

C56. The Board observed that assets or smaller cash-generating units making up a larger cash-generating unit to which goodwill has been allocated might need to be tested for impairment at the same time as that larger unit when there is an indication of a possible impairment of the asset or smaller unit. The Board agreed that to assess whether the larger unit and the goodwill within that unit are impaired, the carrying amount of the larger unit would need first to be adjusted by recognising any impairment losses relating to the assets or smaller units within that larger unit.

Carrying forward a recoverable amount calculation (paragraph 96)

C57. Consistently with the proposals for indefinite life intangibles, the Exposure Draft proposes to permit the most recent detailed calculation of the recoverable amount of a cash-generating unit to which goodwill has been allocated to be carried forward from a preceding reporting period for use in the current reporting period's impairment test, provided all of the criteria in paragraph 96 are met.

C58. Integral to the Board's decision that goodwill should be tested for impairment annually was the view that many entities should be able to conclude that the recoverable amount of a cash-generating unit to which goodwill has been allocated is greater than its carrying amount without actually recomputing recoverable amount. However, again consistently with the proposals for indefinite life intangibles, the Board agreed that this would be the case only if the last recoverable amount determination exceeded the carrying amount of the unit by a substantial margin, and nothing had happened since that last determination to make the likelihood of an impairment loss other than remote. The Board concluded that in such circumstances, permitting a detailed calculation of the recoverable amount of a cash-generating unit to which goodwill has been allocated to be carried forward from the preceding reporting period for use in the current period's impairment test would significantly reduce

the costs of applying the impairment test, without compromising its integrity.

Second step of the impairment test not completed by year-end (paragraphs 97, 98 and 133)

C59. The Exposure Draft proposes that an entity should recognise its best estimate of any probable impairment loss for goodwill when the carrying amount of a cash-generating unit to which goodwill has been allocated has been determined to exceed its recoverable amount, but the entity has not completed its determination of whether the goodwill is impaired before the financial statements are authorised for issue.

C60. The Board observed that if an entity tests for impairment a cash-generating unit to which goodwill has been allocated towards the end of the annual reporting period and discovers that the unit's carrying amount exceeds its recoverable amount, the entity might not be able to complete the goodwill impairment test before its financial statements are authorised for issue. The Board concluded that, in these circumstances, users of the entity's financial statements are provided with the most relevant information about the value of the goodwill if the entity recognises its best estimate of any probable impairment loss and discloses the information required under proposed paragraph 133.

C61. The Board also agreed that the entity should be able to complete the goodwill impairment test during the next reporting period. Therefore, the Exposure Draft also proposes that any adjustment to the previously recognised estimated impairment loss should be recognised in the immediately succeeding reporting period.

Reversing goodwill impairment losses (paragraph 123)

C62. The Exposure Draft proposes to prohibit the recognition of reversals of impairment losses for goodwill. IAS 36 requires an impairment loss for goodwill recognised in a previous reporting period to be reversed when the impairment loss was caused by a specific external event of an exceptional nature that is not expected to recur, and subsequent external events have occurred that reverse the effect of that event.

C63. The Board noted that IAS 38 *Intangible Assets* prohibits the recognition of internally generated goodwill. Therefore, if reversals of impairment losses for goodwill were permitted, an entity would need to establish the extent to which a subsequent increase in the recoverable amount of goodwill is attributable to the recovery of the acquired goodwill within a cash-generating unit, rather than an increase in the internally generated goodwill within the unit. The Board concluded that this will seldom, if ever, be possible. Because the acquired goodwill and internally generated goodwill contribute jointly to the same cash flows, any subsequent increase in the recoverable amount of the acquired goodwill is indistinguishable from an increase in the internally generated goodwill. Even if the specific external event that caused the recognition of the impairment loss is reversed, it will seldom, if ever, be possible to determine that the effect of that reversal is a corresponding increase in the recoverable amount of the acquired goodwill. Therefore, the Board concluded that reversals of impairment losses for goodwill should be prohibited.

C64. Some Board members expressed concern that prohibiting the recognition of reversals of impairment losses for goodwill so as to avoid recognising internally generated goodwill might be viewed by some as inconsistent with the impairment test for goodwill being proposed by the Board. This is because the impairment test results in the carrying amount of goodwill being shielded from impairment by internally generated goodwill. This has been described by some as 'backdoor' capitalisation of internally generated goodwill.

C65. However, the Board was not as concerned about goodwill being shielded from the recognition of impairment losses by internally generated goodwill as it was about the direct recognition of internally generated goodwill that might occur if reversals of impairment losses for goodwill were permitted. As discussed in paragraphs C16 and C38, the Board is of the view that:

(a) it is not possible to devise an impairment test for acquired goodwill that removes the cushion against the recognition of impairment losses provided by goodwill generated internally after a business combination; and

(b) an impairment test in which the cushion created by pre-existing internally generated goodwill is removed would not be possible or practicable.

Other proposed amendments to IAS 36

Value in use (paragraphs 25A, 26A and 27, and Appendix B)

C66. The Exposure Draft proposes:

(a) additional guidance to clarify the elements that are reflected in an asset's value in use and that those elements can be reflected either as adjustments to the future cash flows or as adjustments to the discount rate.

(b) to clarify that cash flow projections used in measuring value in use must be based on reasonable and supportable assumptions that take into account both past actual cash flows and management's past ability to forecast cash flows accurately.

(c) additional application guidance (in Appendix B) on using present value techniques in measuring value in use.

(d) relocating to Appendix B the guidance in IAS 36 on estimating the discount rate used to measure value in use when an asset-specific rate is not directly available from the market.

C67. The Board agreed to include this additional guidance in the Exposure Draft in response to a number of requests from its constituents for clarification of the existing requirements in IAS 36 on measuring value in use. The Board believes that the additional guidance clarifies those requirements and will help to ensure their consistent application.

Corporate assets (paragraph 101)

C68. The Exposure Draft proposes a redrafting of the paragraph dealing with impairment testing cash-generating units to which corporate assets relate. The Board's intention in redrafting that paragraph was not to amend the requirements for impairment testing cash-generating units to which corporate assets relate. Rather, the redrafting is intended merely to

adjust for removing the 'top-down/bottom-up' test from the impairment test for goodwill.

Disclosures for cash-generating units containing goodwill or indefinite life intangibles (paragraphs 134-137)

C69. The Exposure Draft proposes requiring an entity to disclose a range of information about cash-generating units whose carrying amounts include goodwill or indefinite life intangibles. That information includes:

(a) the carrying amount of goodwill and the carrying amount of indefinite life intangibles.

(b) the basis on which the unit's recoverable amount has been determined (value in use or net selling price).

(c) the amount by which the unit's recoverable amount exceeds its carrying amount.

(d) the key assumptions and estimates used to measure the unit's recoverable amount and information about the sensitivity of that recoverable amount to changes in the key assumptions and estimates.

C70. If an entity reports segment information in accordance with IAS 14 *Segment Reporting*, the Exposure Draft proposes that this information should be disclosed in aggregate for each segment based on the entity's primary reporting format. If an entity does not report segment information, the information would be disclosed in aggregate for the entity as a whole. However, the Exposure Draft also proposes that the information would be disclosed separately for a cash-generating unit when:

(a) the carrying amount of the goodwill or indefinite life intangibles allocated to the unit is significant in relation to the total carrying amount of goodwill or indefinite life intangibles; or

(b) the basis for determining the unit's recoverable amount differs from the basis used for the other units within the segment (or, as the case may be, the entity) whose carrying amounts include goodwill or indefinite life intangibles; or

(c) the nature of, or value assigned to the key assumptions or growth rate on which management has based its determination of the unit's recoverable amount differs significantly from that used for the other units within the segment (or, as the case may be, the entity) whose carrying amounts include goodwill or indefinite life intangibles.

C71. In deciding to include these disclosure requirements in the Exposure Draft, the Board observed that non-amortisation of goodwill and indefinite life intangibles increases the reliance that must be placed on impairment tests of those assets to ensure that their carrying amounts do not exceed their recoverable amounts. However, the nature of impairment tests means that the carrying amounts of such assets and the related assertion that those carrying amounts are recoverable will normally be supported only by management's projections. The Board therefore agreed it should consider ways in which the reliability of the impairment tests for goodwill and indefinite life intangibles could be improved. As a first step, the Board considered including a 'subsequent cash flow test' in the revised Standard, similar to that included in UK Financial Reporting Standard 11 *Impairment of Fixed Assets and Goodwill* (FRS 11).

Subsequent cash flow test

C72. FRS 11 requires an entity to perform a 'subsequent cash flow test' to confirm, ex post, the cash flow projections used to measure a unit's value in use when testing goodwill for impairment. Under FRS 11, for five years following each impairment test for goodwill in which recoverable amount has been based on value in use, the actual cash flows achieved must be compared with those forecast. If the actual cash flows are so much less than those forecast that use of the actual cash flows in the value in use calculation could have required recognition of an impairment in previous periods, the original impairment calculations must be re-performed using the actual cash flows, but without revising any other cash flows or assumptions (except those that change as a direct consequence of the occurrence of the actual cash flows, for example where a major cash inflow has been delayed for a year). Any impairment

identified must then be recognised in the current period, unless the impairment has reversed and the reversal of the loss satisfies certain criteria in FRS 11 regarding reversals of impairment losses for goodwill.

C73. The Board noted the following arguments in support of including a similar test in the revised Standard:

(a) it would enhance the reliability of the goodwill impairment test by preventing the possibility of entities avoiding the recognition of impairment losses by using over-optimistic cash flow projections in the value in use calculations.

(b) it would provide useful information to users of an entity's financial statements because a record of actual cash flows continually falling short of forecast cash flows will tend to cast doubt on the reliability of current estimates.

C74. However, the subsequent cash flow test is designed only to prevent entities from avoiding goodwill write-downs. The Board observed that, given current trends in 'big bath' restructuring charges, the greater risk to quality financial reporting might be from entities trying to write off goodwill without adequate justification in an attempt to 'manage' the balance sheet. The Board also observed that:

(a) the focus of the test on cash flows ignores other elements in the measurement of value in use. As a result, it does not produce representationally faithful results in a present value measurement system. The Board considered incorporating into the recalculation performed under the test corrections of estimates of other elements in the measurement of value in use. However, the Board concluded that specifying which elements to include would be problematic. Moreover, adding corrections of estimates of those other elements to the test would effectively transform the test into a requirement to perform a comprehensive recalculation of value in use for each of the five annual reporting periods following an impairment test.

(b) the amount recognised as an impairment loss under the test is the amount of the impairment that would have been recognised, provided changes in estimates of remaining cash flows and changes in discount and growth rates are ignored. Therefore, it is a hypothetical amount that does not provide decision-useful

information—it is neither an estimate of a current amount nor a prediction of ultimate cash flows.

(c) the requirement to perform the test for each of the five annual reporting periods following an impairment test could result in an entity having to maintain as many as five sets of 5-year computations for each cash generating unit to which goodwill has been allocated. Therefore, the test is likely to be extremely burdensome, particularly if an entity has a large number of such units, without producing understandable or decision-useful information.

C75. The Board therefore decided not to include a subsequent cash flow test in the revised Standard. However, the Board remained committed to finding some way of improving the reliability of the impairment tests for goodwill and indefinite life intangibles, and decided to explore improving that reliability through disclosure requirements.

Including disclosure requirements in the revised Standard

C76. The Board observed that the *Framework* identifies 'reliability' as one of the key qualitative characteristics that information must possess to be useful to users in making economic decisions. To be reliable, information must be free from material error and bias and be able to be depended upon to represent faithfully that which it purports to represent. The *Framework* identifies 'relevance' as another key qualitative characteristic that information must possess to be useful to users in making economic decisions. To be relevant, information must help users to evaluate past, present or future events, or confirm or correct their past evaluations.

C77. The Board agreed that information that assists users in evaluating the reliability of other information included in the financial statements is itself relevant, increasing in relevance as the reliability of that other information decreases. For example, information that assists users in evaluating the reliability of the amount recognised for a provision is relevant because it helps users to evaluate the effect of both a past event (the economic consequences of the past event giving rise to the present obligation) and a future event (the amount of the expected future outflow of economic benefits required to settle the obligation). Accordingly, an entity is required under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* to disclose, for each class of provision, information

about the uncertainties surrounding the amount and timing of expected outflows of economic benefits, and the major assumptions concerning future events that may affect the amount required to settle the obligation and that have been reflected in the amount of the provision.

C78. The Board concluded that because information that assists users in evaluating the reliability of other information is itself relevant, an entity should disclose information that assists users in evaluating the reliability of the estimates used by management to support the carrying amounts of goodwill and indefinite life intangibles. Consistently with this objective, the Board concluded that disclosures about the following would be of particular importance to users:

(a) the key assumptions and estimates used to measure the recoverable amounts of cash-generating units whose carrying amounts include goodwill or indefinite life intangibles.

(b) the link between those key assumptions and estimates and past experience.

(c) the sensitivity of the recoverable amounts of the units to changes in the key assumptions and estimates.

C79. The Board agreed that such disclosures would provide users with more useful information for evaluating the reliability of the impairment tests for goodwill and indefinite life intangibles than the information that would be provided by a subsequent cash flow test.

Level of aggregation for disclosures

C80. The Board considered how some balance might be achieved between the objective of providing users with useful information for evaluating the reliability of the estimates used by management to support the carrying amounts of goodwill and indefinite life intangibles, and the potential magnitude of those disclosures. The Board agreed that the most appropriate way to deal with this issue would be to require the information to be disclosed on some aggregated basis.

C81. In considering the appropriate level of aggregation, the Board observed that each cash-generating unit within an aggregated level would need to have its recoverable amount calculated on the same basis (net selling

price or value in use), using the same methodology, and dependent on the same key assumptions as the other units in the level. The Board concluded that the requirements in IAS 14 for identifying segments are such that this is likely to be the case for each of the cash-generating units within a given segment based on the entity's primary reporting format.

C82. The Board therefore decided that a reasonable balance could be achieved between the objective of the disclosures and their potential magnitude by requiring:

(a) information to be disclosed on an aggregate basis for each segment based on the entity's primary reporting format that includes in its carrying amount goodwill or indefinite life intangibles; but

(b) information for a particular cash-generating unit within that segment to be excluded from the aggregate information and disclosed separately when either:

(i) the basis (net selling price or value in use), methodology or key assumptions used to measure its recoverable amount differ from those used to measure the recoverable amounts of the other units in the segment; or

(ii) the carrying amount of the goodwill or indefinite life intangibles in the unit is significant in relation to the total carrying amount of goodwill or indefinite life intangibles.

Transitional provisions (paragraphs 138 and 139)

C83. The Exposure Draft proposes that the revised Standard should apply prospectively.

C84. In developing this proposal, the Board first considered whether entities should be required to:

(a) apply retrospectively the proposed impairment test for goodwill; and

(b) apply retrospectively the proposed requirement prohibiting reversals of impairment losses for goodwill and therefore eliminate any reversals recognised before the date the revised Standard is issued.

C85. The Board agreed that retrospective application of the proposed impairment test for goodwill would be problematic for the following reasons:

(a) it is likely to be impossible in many cases because the information needed may not exist, may no longer be obtainable, or may be obtainable only if the entity incurs undue cost and effort.

(b) it requires the determination of estimates that would have been made at a prior date, and therefore raises problems in relation to how the effect of hindsight can be separated from the factors existing at the date of the impairment test.

C86. The Board also noted that the proposal in the Exposure Draft to require goodwill to be tested for impairment annually, irrespective of whether there is any indication that it may be impaired, will ensure that by the end of the first period in which the revised Standard is effective, all recognised goodwill acquired before the effective date of the revised Standard would be tested for impairment by applying the proposed new impairment test.

C87. In the case of reversals of impairment losses for goodwill, the Board acknowledged that requiring the elimination of reversals recognised before the date the revised Standard is issued might seem appropriate, particularly given the Board's reasons for proposing to prohibit reversals of impairment losses for goodwill (see paragraphs C62-C65). The Board concluded, however, that the previous amortisation of that goodwill, combined with the proposed requirement in the Exposure Draft for goodwill to be tested for impairment at least annually, would ensure that the carrying amount of the goodwill does not exceed its recoverable amount at the end of the reporting period in which the revised Standard is effective. Therefore, the Board concluded that the revised Standard should, in all respects, apply on a prospective basis from the date it is issued.

Transitional impairment test for goodwill

C88. Given that one of the objectives of the first phase of the Business Combinations project is to seek international convergence on the accounting for goodwill, the Board considered whether the revised Standard should include a transitional goodwill impairment test similar to that included in SFAS 142. Under SFAS 142, goodwill is required to be

tested for impairment annually, and between annual tests if an event occurs or circumstances change and would be more likely than not to reduce the fair value of a reporting unit below its carrying amount. The transitional provisions in SFAS 142 require the impairment test for goodwill to be applied prospectively. However, a transitional goodwill impairment test must be performed as of the *beginning* of the fiscal year in which SFAS 142 is applied in its entirety. An impairment loss recognised as a result of a transitional test is recognised as the effect of a change in accounting principle, rather than as an impairment loss. In addition to the transitional test, SFAS 142 requires an entity to perform the required annual goodwill impairment test in the year that SFAS 142 is initially applied in its entirety. In other words, the transitional goodwill impairment test may not be regarded as the initial year's annual test unless an entity designates the beginning of its fiscal year as the date for its annual goodwill impairment test.

C89. The FASB concluded that goodwill that was not regarded as impaired under US generally accepted accounting principles (GAAP) before SFAS 142 was issued could be determined to be impaired if the SFAS 142 impairment test were applied to that goodwill at the date an entity initially applied SFAS 142. This is because under previous US GAAP, entities typically tested goodwill for impairment using undiscounted estimates of future cash flows. The FASB further concluded that:

(a) the preponderance of any transitional impairment losses was likely to result from the change in methods and treating those losses as stemming from changes in accounting principles would therefore be more representationally faithful.

(b) given that a transitional impairment loss should be reported as a change in accounting principle, the transitional goodwill impairment test should ideally apply as of the date SFAS 142 is initially applied.

Should the revised IAS 36 include a transitional goodwill impairment test?

C90. The Board observed that currently under IAS 36, goodwill being amortised over a period exceeding 20 years must be tested for impairment at least at each financial year-end. Goodwill being amortised over a period not exceeding 20 years must be tested for impairment at the

balance sheet date if there is an indication it might be impaired. This Exposure Draft proposes requiring goodwill to be tested for impairment annually or more frequently if there is an indication the goodwill might be impaired. It also proposes to carry forward to the revised Standard (a) the indicators of impairment in IAS 36, and (b) the measure of recoverable amount (higher of value in use and net selling price).

C91. Therefore, goodwill tested for impairment under IAS 36 immediately before the beginning of the reporting period in which the revised Standard becomes effective (because it is being amortised over a period exceeding 20 years or because there is an indicator of impairment) could not be identified as impaired under the revised Standard at the beginning of the period in which it becomes effective. This is because an impairment loss will be identified for goodwill under the revised Standard only if the carrying amount of the cash-generating unit to which the goodwill has been allocated exceeds its recoverable amount, and the IAS 36 impairment test ensures that this will not be the case.

C92. The Board concluded that there would be only one possible circumstance in which a transitional impairment test might give rise to the recognition of an impairment loss for goodwill. This would be when goodwill being amortised over a period not exceeding 20 years is, immediately before the beginning of the period in which the revised Standard becomes effective, impaired in the absence of any indicator of impairment that ought reasonably to have been considered by the entity. Board members generally agreed that this is likely to be a rare occurrence.

C93. The Board observed that any such impairment loss would nonetheless be recognised as a consequence of applying the requirement proposed in the Exposure Draft to test goodwill for impairment at least annually. Therefore, the only benefit of applying a transitional impairment test would be, in those rare cases, to separate the impairment loss arising before the period in which the revised Standard is issued from any impairment loss arising after the beginning of that period.

C94. The Board concluded that given the rare circumstances in which this issue arises, the benefit of applying a transitional goodwill impairment test is outweighed by the added costs of the test. Therefore, the Board decided that the revised Standard should not require a transitional goodwill impairment test.

Transitional impairment test for indefinite life intangibles

C95. SFAS 142 also requires a transitional impairment test to be applied, as of the beginning of the fiscal year in which that Standard is initially applied, to intangible assets recognised before the effective date of SFAS 142 that are reassessed as having indefinite useful lives. An impairment loss arising from that transitional impairment test is recognised as the effect of a change in accounting principle rather than as an impairment loss. As with goodwill:

(a) intangible assets that cease being amortised upon initial application of SFAS 142 are tested for impairment under SFAS 142 using a different method from what had previously applied to those assets. Therefore, it is possible that such an intangible asset not previously regarded as impaired might be determined to be impaired under SFAS 142.

(b) the FASB concluded that the preponderance of any transitional impairment losses would be likely to result from the change in impairment testing methods. Treating those losses as stemming from changes in accounting principles is therefore more representationally faithful.

C96. The Board considered whether the revised IAS 36 should include a transitional impairment test for indefinite life intangibles similar to that in SFAS 142.

C97. The Board observed that IAS 38 *Intangible Assets* requires an intangible asset being amortised over a period exceeding 20 years to be tested for impairment at least at each financial year-end in accordance with IAS 36. An intangible asset being amortised over a period not exceeding 20 years must, under IAS 36, be tested for impairment at the balance sheet date only if there is an indication the asset might be impaired. This Exposure Draft proposes requiring an indefinite life intangible to be tested for impairment at least at the end of each annual reporting period. However, it also proposes that the recoverable amount of such an asset should continue to be measured in accordance with IAS 36.

C98. As with goodwill, the Board concluded that the revised Standard should not require a transitional impairment test for indefinite life intangibles because:

(a) the only circumstance in which a transitional impairment test might give rise to the recognition of an impairment loss would be when an indefinite life intangible previously being amortised over a period not exceeding 20 years is, immediately before the beginning of the period in which the revised Standard is issued, impaired in the absence of any indicator of impairment that ought reasonably to have been considered by the entity.

(b) any such impairment loss would nonetheless be recognised as a consequence of applying the requirement proposed in the Exposure Draft to test such assets for impairment at least at the end of each annual reporting period. Therefore, the only benefit of such a test would be to separate the impairment loss arising before the period in which the revised Standard is issued from any impairment loss arising after the beginning of that period.

(c) given the extremely rare circumstances in which this issue is likely to arise, the benefit of applying a transitional impairment test is outweighed by the added costs of the test.

Early application (paragraph 139)

C99. The Board noted that the issue of any revised Standard demonstrates its opinion that application of the revised Standard will result in more useful information being provided to users about an entity's financial position, performance or cash flows. On that basis, a case exists for permitting, and indeed encouraging, entities to apply the revised IAS 36 before its effective date. However, the Board also considered the assertion that permitting a revised Standard to be applied before its effective date potentially diminishes comparability between entities in the period(s) leading up to that effective date, and has the effect of providing entities with an option.

C100. The Board concluded that the benefit of providing users with more useful information about an entity's financial position, performance and cash flows by permitting early application of the revised IAS 36 outweighs the disadvantages of potentially diminished comparability. Therefore, the draft Standard proposes to encourage entities to apply the requirements of the revised Standard before its effective date. However, given that these proposals are part of an integrated package, the draft

Standard proposes to require all of the resulting new and revised Standards to be applied simultaneously.

Appendix D

Amendments to IAS 36 proposed in the May 2002 Exposure Draft *Improvements to International Accounting Standards*

D1. In May 2002 the IASB issued an Exposure Draft *Improvements to International Accounting Standards*. The changes proposed in that Exposure Draft will, if made, lead to a number of consequential amendments to IAS 36 *Impairment of Assets*.

D2. The consequential amendments to IAS 36 proposed in the May 2002 Exposure Draft are presented in this Exposure Draft as marked-up text as follows:

(a) an amendment to paragraph 3 of [draft] IAS 36, which relates to a proposed title change for IAS 27 *Consolidated and Separate Financial Statements*.

(b) an amendment to paragraph 9(f) of [draft] IAS 36, which relates to whether an asset becoming idle should be regarded as an indication that the asset may be impaired.

(c) amendments to paragraphs 37, 38, 41 and 42 of [draft] IAS 36. These changes relate to the treatment of future capital expenditure that will enhance an asset in excess of its standard of performance assessed immediately before the expenditure is made.

(d) an amendment to paragraph 105 of [draft] IAS 36, which relates to allocating an impairment loss to the individual assets within a cash-generating unit when the individual recoverable amounts of those assets cannot be estimated without undue cost or effort.

(e) an amendment to paragraph 110(d) of [draft] IAS 36, which relates to capital expenditure incurred during the period to improve or enhance an asset in excess of its standard of performance assessed immediately before the expenditure is made.

Appendix E

Alternative views on ED 3 *Business Combinations* and associated proposed amendments to IAS 36 and IAS 38

E1. Two Board members voted against the publication of ED 3 *Business Combinations* and the Exposure Draft of Proposed Amendments to IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets*. Their alternative views are set out in the appendix to the Basis for Conclusions on ED 3.

PROPOSED AMENDMENTS TO

IAS 38
INTANGIBLE ASSETS

[Note: For the purpose of this Exposure Draft, the new text is underlined and the deleted text is struck through.
The amendments to IAS 38 proposed in the May 2002 Exposure Draft *Improvements to International Accounting Standards* and the November 2002 Exposure Draft 2 *Share-based Payment* are also presented in this manner as marked-up text.]

Invitation to Comment (IAS 38)

The Board would particularly welcome answers to the questions set out below. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Question 1 – Identifiability

The Exposure Draft proposes that an asset should be treated as meeting the identifiability criterion in the definition of an intangible asset when it is separable or arises from contractual or other legal rights (see proposed paragraphs 10 and 11 and paragraphs B6-B10 of the Basis for Conclusions).

Are the separability and contractual/other legal rights criteria appropriate for determining whether an asset meets the identifiability criterion in the definition of an intangible asset? If not, what criteria are appropriate, and why?

Question 2 – Criteria for recognising intangible assets acquired in a business combination separately from goodwill

This Exposure Draft proposes clarifying that for an intangible asset acquired in a business combination, the probability recognition criterion will always be satisfied and, with the exception of an assembled workforce, sufficient information should always exist to measure its fair value reliably (see proposed paragraphs 29-32 and paragraphs B11-B15 of the Basis for Conclusions). Therefore, as proposed in ED 3, an Exposure Draft of a proposed International Financial Reporting Standard *Business Combinations*, an acquirer should recognise, at the acquisition date and separately from goodwill, all of the acquiree's intangible assets, excluding an assembled workforce, that meet the definition of an intangible asset (see proposed paragraphs 36, 43 and 44 of ED 3).

Do you agree that, with the exception of an assembled workforce, sufficient information can reasonably be expected to exist to measure reliably the fair value of an intangible asset acquired in a business combination? If not, why not? The Board would appreciate respondents outlining the specific

circumstances in which the fair value of an intangible asset acquired in a business combination could not be measured reliably.

Question 3 – Indefinite useful life

The Exposure Draft proposes to remove from IAS 38 the rebuttable presumption that an intangible asset's useful life cannot exceed twenty years, and to require its useful life to be regarded as indefinite when, based on an analysis of all of the relevant factors, there is no foreseeable limit on the period of time over which the asset is expected to generate net cash inflows for the entity (see proposed paragraphs 85-88 and paragraphs B29-B32 of the Basis for Conclusions).

Is this appropriate? If not, under what circumstances, if any, should an intangible asset be regarded as having an indefinite useful life?

Question 4 – Useful life of intangible asset arising from contractual or other legal rights

The Exposure Draft proposes that if an intangible asset arises from contractual or other legal rights that are conveyed for a limited term that can be renewed, the useful life shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost (see proposed paragraphs 91 and 92 and paragraphs B33-B35 of the Basis for Conclusions).

Is this an appropriate basis for determining the useful life of an intangible asset arising from contractual or other legal rights that are conveyed for a limited term that can be renewed? If not, under what circumstances should the useful life include the renewal period(s)?

Question 5 – Non-amortisation of intangible assets with indefinite useful lives

The Exposure Draft proposes that an intangible asset with an indefinite useful life should not be amortised (see proposed paragraphs 103 and 104 and paragraphs B36-B38 of the Basis for Conclusions).

Is this appropriate? If not, how should such assets be accounted for after their initial recognition?

Summary of Main Changes (IAS 38)

Definition of an intangible asset

- IAS 38 defines an intangible asset as an identifiable non-monetary asset without physical substance held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. The Exposure Draft proposes amending this definition by removing from it the requirement for the asset to be held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.

- IAS 38 does not define 'identifiability', but states that an intangible asset can be distinguished clearly from goodwill if the asset is separable, but that separability is not a necessary condition for identifiability. The Exposure Draft proposes that an asset should be treated as meeting the identifiability criterion in the definition of an intangible asset when it:

  - is separable, ie capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability; or

  - arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

Criteria for initial recognition

- IAS 38 requires an intangible asset to be recognised if, and only if, it is probable that the future economic benefits attributable to the asset will flow to the entity, and its cost can be measured reliably. The Exposure Draft proposes additional guidance to clarify that:

  - the probability recognition criterion will always be satisfied for separately acquired intangible assets.

  - the probability recognition criterion will always be satisfied for intangible assets acquired in a business combination. In addition, with the exception of an assembled workforce, sufficient information should always exist to measure reliably the fair value of an intangible

asset acquired in a business combination. Therefore, an acquirer recognises at the acquisition date separately from goodwill all of the acquiree's intangible assets, excluding any assembled workforce that meets the definition of an intangible asset, but including any of the acquiree's in-process research and development projects that meet the definition of an intangible asset.

Subsequent expenditure

- The treatment under IAS 38 of subsequent expenditure on an in-process research and development project acquired in a business combination and recognised as an asset separately from goodwill is unclear. The Exposure Draft proposes requiring such expenditure to be:

  - recognised as an expense when incurred if it is in the nature of research expenditure;

  - recognised as an expense when incurred if it is in the nature of development expenditure but does not satisfy the criteria in IAS 38 for recognising such expenditure as an intangible asset; and

  - recognised as an intangible asset if it is in the nature of development expenditure that satisfies the criteria in IAS 38 for recognising such expenditure as an intangible asset.

Useful life

- IAS 38 is based on the assumption that the useful life of an intangible asset will always be finite, and includes a rebuttable presumption that the useful life cannot exceed twenty years from the date the asset is available for use. The Exposure Draft proposes:

  - to remove the rebuttable presumption; and

  - to require an intangible asset to be regarded as having an indefinite useful life when, based on an analysis of all of the relevant factors, there is no foreseeable limit on the period over which the asset is expected to generate net cash inflows for the entity.

- IAS 38 requires that if control over the future economic benefits from an intangible asset is achieved through legal rights granted for a finite

period, the useful life of the intangible asset cannot exceed the period of those rights, unless the rights are renewable and renewal is virtually certain. The Exposure Draft proposes that:

- the useful life of an intangible asset arising from contractual or other legal rights should not exceed the period of those rights, but may be shorter depending on the period over which the asset is expected to be used by the entity; and

- if the rights are conveyed for a limited term that can be renewed, the useful life should include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost.

Intangible assets with indefinite useful lives

- The Exposure Draft proposes that:

  - an intangible asset with an indefinite useful life should not be amortised.

  - the useful life of such an asset should be reviewed each reporting period to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. If they do not, the change in the useful life assessment from indefinite to finite should be accounted for as a change in an accounting estimate.

Impairment testing intangible assets

- IAS 38 requires the recoverable amount of an intangible asset not yet available for use to be estimated at least at each financial year-end, even if there is no indication that the asset is impaired. The Exposure Draft proposes to relocate this requirement to IAS 36 *Impairment of Assets*.

- IAS 38 requires the recoverable amount of an intangible asset that is amortised over a period exceeding twenty years from the date it is available for use to be estimated at least at each financial year-end, even if there is no indication that the asset is impaired. The Exposure Draft proposes to remove this requirement. Therefore, an entity need determine the recoverable amount of an intangible asset with a finite useful life that is amortised over a period exceeding twenty years from the date it is

available for use only when, in accordance with IAS 36, there is an indication that the asset may be impaired.

Disclosure

- If an intangible asset is amortised over more than twenty years, IAS 38 requires disclosure of the reasons why the presumption that the useful life of an intangible asset will not exceed twenty years from the date the asset is available for use is rebutted. The Exposure Draft proposes to remove this disclosure requirement.

- If an intangible asset is assessed as having an indefinite useful life, the Exposure Draft proposes requiring disclosure of the carrying amount of that asset and the reasons supporting the indefinite useful life assessment.

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International Accounting Standard IAS 38 (revised 200X)

Intangible Assets

[Draft] International Accounting Standard 38 *Intangible Assets* (IAS 38) is set out in paragraphs 1-127. All the paragraphs have equal authority but retain the IASC format of the Standard when it was adopted by the IASB. [Draft] IAS 38 should be read in the context of its objective and the Basis for Conclusions, the *Preface to International Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. These provide a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

The objective of this [draft] Standard is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another ~~International Accounting~~ Standard. This [draft] Standard requires an ~~enterprise~~ entity to recognise an intangible asset if, and only if, certain criteria are met. The [draft] Standard also specifies how to measure the carrying amount of intangible assets and requires certain disclosures about intangible assets.

Scope

1. This [draft] Standard ~~should~~ shall be applied ~~by all enterprises~~ in accounting for intangible assets, except:

(a) intangible assets that are covered by another ~~International Accounting~~ Standard;

(b) financial assets, as defined in [draft] IAS ~~32~~ 39, Financial Instruments: ~~Disclosure and Presentation~~ Recognition and Measurement;

(c) mineral rights and expenditure on the exploration for, or development and extraction of, minerals, oil, natural gas and similar non-regenerative resources; and

(d) intangible assets arising in insurance ~~enterprises~~ entities from contracts with policyholders.

2. If another ~~International Accounting~~ Standard deals with a specific type of intangible asset, an ~~enterprise~~ entity applies that Standard instead of this [draft] Standard. For example, this [draft] Standard does not apply to:

   (a) intangible assets held by an ~~enterprise~~ entity for sale in the ordinary course of business (see [draft] IAS 2, Inventories, and IAS 11, Construction Contracts);

   (b) deferred tax assets (see IAS 12, Income Taxes);

   (c) leases that fall within the scope of [draft] IAS 17, Leases;

   (d) assets arising from employee benefits (see IAS 19, Employee Benefits);

   (e) goodwill ~~arising on~~ acquired in a business combination (see ~~IAS 22~~ [draft] IFRS X, Business Combinations); and

   (f) financial assets as defined in [draft] IAS 32, Financial Instruments: Disclosure and Presentation. The recognition and measurement of some financial assets are covered by: [draft] IAS 27, Consolidated and Separate Financial Statements ~~and Accounting for Investments in Subsidiaries~~; [draft] IAS 28, Accounting for Investments in Associates; IAS 31, Financial Reporting of Interests in Joint Ventures; and [draft] IAS 39, Financial Instruments: Recognition and Measurement.

3. Some intangible assets may be contained in or on a physical substance such as a compact ~~disk~~ disc (in the case of computer software), legal documentation (in the case of a licence or patent) or film. In determining whether an asset that incorporates both intangible and tangible elements should be treated under [draft] IAS 16, Property, Plant and Equipment, or as an intangible asset under this [draft] Standard, judgement is required to assess which element is more significant. For example, computer software for a computer controlled machine tool that cannot operate without that specific software is an integral part of the related hardware and it is treated as property, plant and equipment. The same applies to the operating system of a computer. Where the software is not an integral part of the related hardware, computer software is treated as an intangible asset.

4. This [draft] Standard applies to, among other things, expenditure on advertising, training, start-up, research and development activities. Research and development activities are directed to the development of knowledge. Therefore, although these activities may result in an asset with physical substance (for example, a prototype), the physical element of the asset is secondary to its intangible component, that is the knowledge embodied in it.

5. In the case of a finance lease, the underlying asset may be either tangible or intangible. After initial recognition, a lessee deals with an intangible asset held under a finance lease under this [draft] Standard. Rights under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights are excluded from the scope of [draft] IAS 17 and fall within the scope of this [draft] Standard.

6. Exclusions from the scope of ~~an International Accounting~~ a Standard may occur if certain activities or transactions are so specialised that they give rise to accounting issues that may need to be dealt with in a different way. Such issues arise in the expenditure on the exploration for, or development and extraction of, oil, gas and mineral deposits in extractive industries and in the case of contracts between insurance ~~enterprises~~ entities and their policyholders. Therefore, this [draft] Standard does not apply to expenditure on such activities. However, this [draft] Standard applies to other intangible assets used (such as computer software), and other expenditure (such as start-up costs), in extractive industries or by insurance ~~companies~~ entities.

Definitions

7. The following terms are used in this [draft] Standard with the meanings specified:

An intangible asset is an identifiable non-monetary asset without physical substance ~~held for use in the production or supply of goods or services, for rental to others, or for administrative purposes~~.

An asset is a resource:

(a) controlled by an ~~enterprise~~ entity as a result of past events; and

(b) from which future economic benefits are expected to flow to the ~~enterprise~~ entity.

Monetary assets are money held and assets to be received in fixed or determinable amounts of money.

Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use.

Amortisation is the systematic allocation of the depreciable amount of an intangible 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~~ entity; or

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

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 ~~production~~ construction, except that if an asset is received as consideration for equity instruments of the entity in a share-based payment transaction to which [draft] IFRS X, Share-based Payment, applies, the cost of the asset shall be determined in accordance with the measurement requirements in that [draft] IFRS.

The ~~R~~residual value of an intangible asset is the ~~net~~ estimated amount ~~which~~ that ~~an enterprise~~ the entity would currently expect~~s~~ to obtain ~~for~~ from disposal of ~~an~~ the asset ~~at the end of its useful life~~, after deducting the ~~expected~~ estimated costs of disposal, if the asset were of the age and in the condition expected at the end of its estimated useful life.

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

An active market is a market where all the following conditions exist:

(a) the items traded within the market are homogeneous;

(b) willing buyers and sellers can normally be found at any time; and

(c) prices are available to the public.

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

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

The agreement date for a business combination is the date that a substantive agreement between the combining parties is reached and, in the case of publicly listed entities, announced to the public. In the case of a hostile takeover, the earliest date that a substantive agreement between the combining parties is reached is the date that a sufficient number of the acquiree's owners have accepted the acquirer's offer for the acquirer to obtain control of the acquiree.

Intangible Assets

8. ~~Enterprises~~ Entities frequently expend resources, or incur liabilities, on the acquisition, development, maintenance or enhancement of intangible resources such as scientific or technical knowledge, design and implementation of new processes or systems, licences, intellectual property, market knowledge and trademarks (including brand names and publishing titles). Common examples of items encompassed by these broad headings are computer software, patents, copyrights, motion picture films, customer lists, mortgage servicing rights, fishing licences, import quotas, franchises, customer or supplier relationships, customer loyalty, market share and marketing rights.

9. Not all the items described in paragraph 8 will meet the definition of an intangible asset, that is, identifiability, control over a resource and existence of future economic benefits. If an item covered by this [draft] Standard does not meet the definition of an intangible asset, expenditure to acquire it or generate it internally is recognised as an expense when it is incurred. However, if the item is acquired in a business combination ~~that is an acquisition~~, it forms part of the goodwill recognised at the acquisition date ~~of acquisition~~ (see paragraph ~~56~~ 60).

Identifiability

10. The definition of an intangible asset requires that an intangible asset be identifiable to distinguish it clearly from goodwill. Goodwill ~~arising on~~ acquired in a business combination ~~that is an acquisition~~ represents a payment made by the acquirer in anticipation of future economic benefits from assets that are not capable of being individually identified and separately recognised. The future economic benefits may result from synergy between the identifiable assets acquired or from assets which, individually, do not qualify for recognition in the financial statements but for which the acquirer is prepared to make a payment in the ~~acquisition~~ business combination.

~~11. An intangible asset can be clearly distinguished from goodwill if the asset is separable. An asset is separable if the enterprise could rent, sell, exchange or distribute the specific future economic benefits attributable to the asset without also disposing of future economic benefits that flow from other assets used in the same revenue earning activity.~~

11. An asset meets the identifiability criterion in the definition of an intangible asset when it:

(a) is separable, ie is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability; or

(b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

~~12. Separability is not a necessary condition for identifiability since an enterprise may be able to identify an asset in some other way. For example, if an intangible asset is acquired with a group of assets, the transaction may involve the transfer of legal rights that enable an enterprise to identify the intangible asset. Similarly, if an internal project aims to create legal rights for the enterprise, the nature of these rights may assist the enterprise in identifying an underlying internally generated intangible asset. Also, even if an asset generates future economic benefits only in combination with other assets, the asset is identifiable if the enterprise can identify the future economic benefits that will flow from the asset.~~

Control

~~13~~ 12. An ~~enterprise~~ entity controls an asset if the ~~enterprise~~ entity has the power to obtain the future economic benefits flowing from the underlying resource and also can restrict the access of others to those benefits. The capacity of an ~~enterprise~~ entity to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control since an ~~enterprise~~ entity may be able to control the future economic benefits in some other way.

~~14~~ 13. Market and technical knowledge may give rise to future economic benefits. An ~~enterprise~~ entity controls those benefits if, for example, the knowledge is protected by legal rights such as copyrights, a restraint of

trade agreement (where permitted) or by a legal duty on employees to maintain confidentiality.

~~15~~ 14. An ~~enterprise~~ entity may have a team of skilled staff and may be able to identify incremental staff skills leading to future economic benefits from training. The ~~enterprise~~ entity may also expect that the staff will continue to make their skills available to the ~~enterprise~~ entity. However, usually an ~~enterprise~~ entity has insufficient control over the expected future economic benefits arising from a team of skilled staff and from training to consider that these items meet the definition of an intangible asset. For a similar reason, specific management or technical talent is unlikely to meet the definition of an intangible asset, unless it is protected by legal rights to use it and to obtain the future economic benefits expected from it, and it also meets the other parts of the definition.

~~16~~ 15. An ~~enterprise~~ entity may have a portfolio of customers or a market share and expect that, due to its efforts in building customer relationships and loyalty, the customers will continue to trade with the ~~enterprise~~ entity. However, in the absence of legal rights to protect, or other ways to control, the relationships with customers or the loyalty of the customers to the ~~enterprise~~ entity, the ~~enterprise~~ entity usually has insufficient control over the economic benefits from customer relationships and loyalty to consider that such items (portfolio of customers, market shares, customer relationships, customer loyalty) meet the definition of intangible assets.

Future Economic Benefits

~~17~~ 16. The future economic benefits flowing from an intangible asset may include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the ~~enterprise~~ entity. For example, the use of intellectual property in a production process may reduce future production costs rather than increase future revenues.

Recognition and Initial Measurement of an Intangible Asset

~~18~~ 17. The recognition of an item as an intangible asset requires an ~~enterprise~~ entity to demonstrate that the item meets the:

(a) definition of an intangible asset (see paragraphs 7- ~~17~~ 16); and

(b) recognition criteria set out in this [draft] Standard (see paragraphs ~~19-55~~ 18-21).

Paragraphs 22-28 deal with the application of those recognition criteria to separately acquired intangible assets, and paragraphs 29-35 deal with their application to intangible assets acquired in a business combination. Paragraph 36 deals with the initial measurement of intangible assets acquired by way of a government grant, paragraphs 37-39 with exchanges of intangible assets, and paragraphs 40-42 with the treatment of internally generated goodwill. Paragraphs 43-59 deal with the initial recognition and measurement of internally generated intangible assets.

~~19~~ 18. An intangible asset ~~should~~ shall be recognised if, and only if:

(a) it is probable that the future economic benefits that are attributable to the asset will flow to the ~~enterprise~~ entity; and

(b) the cost of the asset can be measured reliably.

~~20~~ 19. An ~~enterprise should~~ entity shall assess the probability of future economic benefits using reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the useful life of the asset.

~~21~~ 20. An ~~enterprise~~ entity uses judgement to assess the degree of certainty attached to the flow of future economic benefits that are attributable to the use of the asset on the basis of the evidence available at the time of initial recognition, giving greater weight to external evidence.

~~22~~ 21. An intangible asset ~~should~~ shall be measured initially at cost.

Separate Acquisition

22. The price an entity pays to acquire separately an intangible asset normally reflects expectations about the probability that the future economic benefits embodied in the asset will flow to the entity. In other words, the effect of probability is reflected in the cost of the asset. Therefore, the probability recognition criterion in paragraph 18(a) is always satisfied for separately acquired intangible assets.

23. In addition, ~~If an intangible asset is acquired separately,~~ the cost of ~~the~~ a separately acquired intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.

24. The cost of ~~an~~ a separately acquired intangible asset comprises:

(a) its purchase price, including any import duties and non-refundable purchase taxes, after deducting any trade discounts and rebates; and

(b) any directly attributable expenditure on preparing the asset for its intended use.

25. Directly attributable expenditure includes, for example~~,~~:

(a) costs of employee benefits (as defined in IAS 19, Employee Benefits) arising directly from bringing the asset to its working condition; and

(b) professional fees ~~for legal services. Any trade discounts and rebates are deducted in arriving at the cost~~.

26. Because capitalisation of costs ceases when an intangible asset is in the working condition necessary for it to be capable of operating in the manner intended by management, costs incurred in using or redeploying intangible assets (as distinct from improving the assets' standard of performance) are excluded from the cost of those assets. For example, the following costs are excluded from the cost of an intangible asset:

(a) costs incurred while the asset is capable of operating in the manner intended by management, but has yet to be brought into use;

(b) initial operating losses, such as those incurred while demand for the asset's outputs builds up.

27. Some operations occur in connection with the development of an intangible asset, but are not necessary to bring the asset to the working condition necessary for it to be capable of operating in the manner intended by management. These incidental operations may occur before or during the development activities. Because incidental operations are not necessary to bring an asset to the working condition necessary for it to be capable of operating in the manner intended by management, the income and related expenses of incidental operations are recognised in profit or loss for the period, and included in their respective classifications of income and expense in the income statement.

~~25~~ 28. If payment for an intangible asset is deferred beyond normal credit terms, its cost is the cash price equivalent; the difference between this amount and the total payments is recognised as interest expense over the period of credit unless it is capitalised under the allowed alternative treatment in IAS 23, Borrowing Costs.

~~26. If an intangible asset is acquired in exchange for equity instruments of the reporting enterprise, the cost of the asset is the fair value of the equity instruments issued, which is equal to the fair value of the asset.~~

Acquisition as Part of a Business Combination

~~27~~ 29. Under ~~IAS 22 (revised 1998)~~ [draft] IFRS X, Business Combinations, if an intangible asset is acquired in a business combination ~~that is an acquisition~~, the cost of that intangible asset is ~~based on~~ its fair value at the acquisition date ~~of acquisition~~. The fair value of an intangible asset reflects market expectations about the probability that the future economic benefits embodied in the asset will flow to the entity. In other words, the effect of probability is reflected in the fair value measurement of the intangible asset. Therefore, the probability recognition criterion in paragraph 18(a) is always satisfied for intangible assets acquired in business combinations.

30. A non-monetary asset without physical substance must be identifiable to meet the definition of an intangible asset. As outlined in paragraph 11, this will be the case when the asset is separable or arises from contractual or other legal rights. With one possible exception discussed

in paragraph 31, sufficient information should always exist to measure reliably the fair value of an asset that has an underlying contractual or legal basis or is capable of being separated from the entity.

31. As discussed in paragraph 14, an entity usually has insufficient control over the expected future economic benefits arising from a team of skilled staff and from training to conclude that these items meet the definition of an asset. However, even in the unlikely event that an entity could demonstrate:

(a) control over the future economic benefits arising from an assembled workforce acquired in a business combination; and

(b) that the workforce meets one of the criteria in paragraph 11 for identifiability,

it is highly unlikely that the fair value of that workforce and the related intellectual capital could be measured with sufficient reliability. Accordingly, an acquirer is prohibited under [draft] IFRS X from recognising an assembled workforce as an asset separately from goodwill.

32. Therefore, in accordance with this [draft] Standard and [draft] IFRS X, an acquirer recognises at the acquisition date separately from goodwill all of the acquiree's intangible assets, excluding assembled workforces, irrespective of whether those assets had been recognised in the acquiree's financial statements before the business combination. This means that the acquirer recognises as an asset separately from goodwill any of the acquiree's in-process research and development projects that meet the definition of an intangible asset. This will be the case when the project:

(a) meets the definition of an asset; and

(b) is identifiable, ie is separable or arises from contractual or other legal rights.

Measuring the Fair Value of an Intangible Asset Acquired in a Business Combination

~~28~~ 33. ~~Judgement is required to determine whether the cost (i.e. fair value) of an intangible asset acquired in a business combination can be measured with sufficient reliability for the purpose of separate recognition.~~ Quoted market prices in an active market provide the most reliable ~~measurement~~ estimate of the fair value of an intangible asset (see also paragraph ~~67~~ 73). The appropriate market price is usually the current bid price. If current bid prices are unavailable, the price of the most recent similar transaction may provide a basis from which to estimate fair value, provided that there has not been a significant change in economic circumstances between the transaction date and the date at which the asset's fair value is estimated.

~~29~~ 34. If no active market exists for an intangible asset, its ~~cost~~ fair value ~~reflects~~ is the amount that the ~~enterprise~~ entity would have paid for the asset, at the acquisition date, ~~of the acquisition, for the asset~~ in an arm's length transaction between knowledgeable and willing parties, based on the best information available. In determining this amount, an ~~enterprise~~ entity considers the outcome of recent transactions for similar assets.

~~30~~ 35. Certain ~~enterprises~~ entities that are regularly involved in the purchase and sale of unique intangible assets have developed techniques for estimating their fair values indirectly. These techniques may be used for initial measurement of an intangible asset acquired in a business combination ~~that is an acquisition~~ if their objective is to estimate fair value as defined in this [draft] Standard and if they reflect current transactions and practices in the industry to which the asset belongs. These techniques include, where appropriate, applying multiples reflecting current market transactions to certain indicators driving the profitability of the asset (such as revenue, market shares, operating profit, etc.) or discounting estimated future net cash flows from the asset.

~~31. In accordance with this Standard and the requirements in IAS 22 (revised 1998) for the recognition of identifiable assets and liabilities:~~

~~(a) an acquirer recognises an intangible asset that meets the recognition criteria in paragraphs 19 and 20, even if that intangible asset had not been recognised in the financial statements of the acquiree; and~~

(b) if the cost (i.e. fair value) of an intangible asset acquired as part of a business combination that is an acquisition cannot be measured reliably, that asset is not recognised as a separate intangible asset but is included in goodwill (see paragraph 56).

32. Unless there is an active market for an intangible asset acquired in a business combination that is an acquisition, IAS 22 (revised 1998) limits the cost initially recognised for the intangible asset to an amount that does not create or increase any negative goodwill arising at the date of acquisition.

Acquisition by way of a Government Grant

33 36. In some cases, an intangible asset may be acquired free of charge, or for nominal consideration, by way of a government grant. This may occur when a government transfers or allocates to an enterprise entity intangible assets such as airport landing rights, licences to operate radio or television stations, import licences or quotas or rights to access other restricted resources. Under IAS 20, Accounting for Government Grants and Disclosure of Government Assistance, an enterprise entity may choose to recognise both the intangible asset and the grant at fair value initially. If an enterprise entity chooses not to recognise the asset initially at fair value, the enterprise entity recognises the asset initially at a nominal amount (under the other treatment permitted by IAS 20) plus any expenditure that is directly attributable to preparing the asset for its intended use.

Exchanges of Assets

34 37. An intangible asset may be acquired in exchange or part exchange for a dissimilar another intangible asset or another asset. Except when paragraph 39 applies, The the cost of such an item is measured at the fair value of the asset received, which is equivalent to the fair value of the asset given up, adjusted by the amount of any cash or cash equivalents transferred. The fair value of the asset received is used to measure its cost if it is more clearly evident than the fair value of the asset given up.

38. Paragraph 18(b) specifies that a condition for the recognition of an intangible asset is that the cost of the asset can be measured reliably. To determine whether the cost of an intangible asset acquired

with consideration other than cash or other monetary assets can be measured reliably, an entity considers the guidance in paragraphs 33-35. An entity will be unable to measure reliably the fair value of an intangible asset when comparable market transactions are infrequent and alternative estimates of fair value (for example, based on discounted cash flow projections) cannot be determined.

39. The cost of an intangible asset acquired in exchange for a similar asset is measured at the carrying amount of the asset given up when the fair value of neither of the assets exchanged can be determined reliably.

35. An intangible asset may be acquired in exchange for a similar asset that has a similar use in the same line of business and that has a similar fair value. An intangible asset may also be sold in exchange for an equity interest in a similar asset. In both cases, since the earnings process is incomplete, no gain or loss is recognised on the transaction. Instead, the cost of the new asset is the carrying amount of the asset given up. However, the fair value of the asset received may provide evidence of an impairment loss in the asset given up. Under these circumstances an impairment loss is recognised for the asset given up and the carrying amount after impairment is assigned to the new asset.

Internally Generated Goodwill

36 40. Internally generated goodwill should shall not be recognised as an asset.

37 41. In some cases, expenditure is incurred to generate future economic benefits, but it does not result in the creation of an intangible asset that meets the recognition criteria in this [draft] Standard. Such expenditure is often described as contributing to internally generated goodwill. Internally generated goodwill is not recognised as an asset because it is not an identifiable resource (that is, it is not separable nor does it arise from contractual or other legal rights) controlled by the enterprise entity that can be measured reliably at cost.

38 42. Differences between the market value of an enterprise entity and the carrying amount of its identifiable net assets at any point in time may capture a range of factors that affect the value of the enterprise entity. However, such differences cannot be considered to represent the cost of intangible assets controlled by the enterprise entity.

Internally Generated Intangible Assets

~~39~~ 43. It is sometimes difficult to assess whether an internally generated intangible asset qualifies for recognition. It is often difficult to:

(a) identify whether, and the point of time when, there is an identifiable asset that will generate probable future economic benefits; and

(b) determine the cost of the asset reliably. In some cases, the cost of generating an intangible asset internally cannot be distinguished from the cost of maintaining or enhancing the ~~enterprise~~ entity's internally generated goodwill or of running day-to-day operations.

Therefore, in addition to complying with the general requirements for the recognition and initial measurement of an intangible asset, an ~~enterprise~~ entity applies the requirements and guidance in paragraphs ~~40-55~~ 44-59 below to all internally generated intangible assets.

~~40~~ 44. To assess whether an internally generated intangible asset meets the criteria for recognition, an ~~enterprise~~ entity classifies the generation of the asset into:

(a) a research phase; and

(b) a development phase.

Although the terms 'research' and 'development' are defined, the terms 'research phase' and 'development phase' have a broader meaning for the purpose of this [draft] Standard.

~~41~~ 45. If an ~~enterprise~~ entity cannot distinguish the research phase from the development phase of an internal project to create an intangible asset, the ~~enterprise~~ entity treats the expenditure on that project as if it were incurred in the research phase only.

Research Phase

~~42~~ 46. No intangible asset arising from research (or from the research phase of an internal project) ~~should~~ shall be recognised. Expenditure on research (or on the research phase of an internal project) ~~should~~ shall be recognised as an expense when it is incurred.

~~43~~ 47. This [draft] Standard takes the view that, in the research phase of an internal project, an ~~enterprise~~ entity cannot demonstrate that an intangible asset exists that will generate probable future economic benefits. Therefore, this expenditure is always recognised as an expense ***when it is incurred.***

~~44~~ 48. Examples of research activities are:

(a) activities aimed at obtaining new knowledge;

(b) the search for, evaluation and final selection of, applications of research findings or other knowledge;

(c) the search for alternatives for materials, devices, products, processes, systems or services; and

(d) the formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes, systems or services.

Development Phase

~~45~~ 49. An intangible asset arising from development (or from the development phase of an internal project) ~~should~~ shall be recognised if, and only if, an ~~enterprise~~ entity can demonstrate all of the following:

(a) the technical feasibility of completing the intangible asset so that it will be available for use or sale;

(b) its intention to complete the intangible asset and use or sell it;

(c) its ability to use or sell the intangible asset;

(d) how the intangible asset will generate probable future economic benefits. Among other things, the ~~enterprise should~~ entity shall demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;

(e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and

(f) its ability to measure the expenditure attributable to the intangible asset during its development reliably.

~~46~~ 50. In the development phase of an internal project, an ~~enterprise~~ entity can, in some instances, identify an intangible asset and demonstrate that the asset will generate probable future economic benefits. This is because the development phase of a project is further advanced than the research phase.

~~47~~ 51. Examples of development activities are:

(a) the design, construction and testing of pre-production or pre-use prototypes and models;

(b) the design of tools, jigs, moulds and dies involving new technology;

(c) the design, construction and operation of a pilot plant that is not of a scale economically feasible for commercial production; and

(d) the design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services.

~~48~~ 52. To demonstrate how an intangible asset will generate probable future economic benefits, an ~~enterprise~~ entity assesses the future economic benefits to be received from the asset using the principles in [draft] IAS 36, Impairment of Assets. If the asset will generate economic benefits only in combination with other assets, the ~~enterprise~~ entity applies the concept of cash-generating units as set out in [draft] IAS 36.

~~49~~ 53. Availability of resources to complete, use and obtain the benefits from an intangible asset can be demonstrated by, for example, a business plan showing the technical, financial and other resources needed and the ~~enterprise~~ entity's ability to secure those resources. In certain cases, an ~~enterprise~~ entity demonstrates the availability of external finance by obtaining a lender's indication of its willingness to fund the plan.

~~50~~ 54. An ~~enterprise~~ entity's costing systems can often measure reliably the cost of generating an intangible asset internally, such as salary and other expenditure incurred in securing copyrights or licences or developing computer software.

~~51~~ 55. Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance ~~should~~ shall not be recognised as intangible assets.

~~52~~ 56. This [draft] Standard takes the view that expenditure on internally generated brands, mastheads, publishing titles, customer lists and items similar in substance cannot be distinguished from the cost of developing the business as a whole. Therefore, such items are not recognised as intangible assets.

Cost of an Internally Generated Intangible Asset

~~53~~ 57. The cost of an internally generated intangible asset for the purpose of paragraph ~~22~~ 21 is the sum of expenditure incurred from the date when the intangible asset first meets the recognition criteria in paragraphs ~~19-20~~ 18, 19 and ~~45~~ 49. Paragraph ~~59~~ 63 prohibits reinstatement of expenditure recognised as an expense in previous annual financial statements or interim financial reports.

~~54~~ 58. The cost of an internally generated intangible asset comprises all expenditure that can be directly attributed~~, or allocated on a reasonable and consistent basis,~~ and is necessary to creating, producing, and preparing the asset for ~~its intended use~~ it to be capable of operating in the manner intended by management. The cost includes, if applicable:

(a) expenditure on materials and services used or consumed in generating the intangible asset;

(b) the salaries, wages and other employment related costs of personnel directly engaged in generating the asset; and

(c) any expenditure that is directly attributable to generating the asset, such as fees to register a legal right and the amortisation of patents and licences that are used to generate the asset. ~~; and~~

~~(d) overheads that are necessary to generate the asset and that can be allocated on a reasonable and consistent basis to the asset (for example, an allocation of the depreciation of property, plant and equipment, insurance premiums and rent). Allocations of overheads are made on bases similar to those used in allocating overheads to inventories (see IAS 2, Inventories). IAS 23,~~

~~Borrowing Costs, establishes criteria for the recognition of interest as a component of the cost of an internally generated intangible asset.~~

~~55~~ 59. The following are not components of the cost of an internally generated intangible asset:

(a) selling, administrative and other general overhead expenditure unless this expenditure can be directly attributed to preparing the asset for use;

(b) clearly identified inefficiencies and initial operating losses incurred before an asset achieves planned performance; and

(c) expenditure on training staff to operate the asset.

Example Illustrating Paragraph ~~53~~ 57

An ~~enterprise~~ entity is developing a new production process. During 20X5, expenditure incurred was 1,000, of which 900 was incurred before 1 December 20X5 and 100 was incurred between 1 December 20X5 and 31 December 20X5. The ~~enterprise~~ entity is able to demonstrate that, at 1 December 20X5, the production process met the criteria for recognition as an intangible asset. The recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be 500.

At the end of 20X5, the production process is recognised as an intangible asset at a cost of 100 (expenditure incurred since the date when the recognition criteria were met, that is, 1 December 20X5). The 900 expenditure incurred before 1 December 20X5 is recognised as an expense because the recognition criteria were not met until 1 December 20X5. This expenditure will never form part of the cost of the production process recognised in the balance sheet.

During 20X6, expenditure incurred is 2,000. At the end of 20X6, the recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be 1,900.

At the end of 20X6, the cost of the production process is 2,100 (100 expenditure recognised at the end of 20X5 plus 2,000 expenditure recognised in 20X6). The ~~enterprise~~ entity recognises an impairment loss of 200 to adjust the carrying amount of the process before impairment loss (2,100) to its recoverable amount (1,900). This impairment loss will be reversed in a subsequent period if the requirements for the reversal of an impairment loss in [draft] IAS 36, Impairment of Assets, are met.

Recognition of an Expense

~~56~~ 60. Expenditure on an intangible item ~~should~~ shall be recognised as an expense when it is incurred unless:

(a) it forms part of the cost of an intangible asset that meets the recognition criteria (see paragraphs ~~18-55~~ 17-59); or

(b) the item is acquired in a business combination ~~that is an acquisition~~ and cannot be recognised as an intangible asset. If this is the case, this expenditure (included in the cost of ~~acquisition~~ the business combination) ~~should~~ shall form part of the amount attributed to goodwill ~~(negative goodwill)~~ at the acquisition date ~~of acquisition~~ (see ~~IAS 22 (revised 1998)~~ [draft] IFRS X, Business Combinations).

~~57~~ 61. In some cases, expenditure is incurred to provide future economic benefits to an ~~enterprise~~ entity, but no intangible asset or other asset is acquired or created that can be recognised. In these cases, the expenditure is recognised as an expense when it is incurred. For example, apart from when it forms part of the cost of a business combination, expenditure on research is always recognised as an expense when it is incurred (see paragraph ~~42~~ 46). Examples of other expenditure that is recognised as an expense when it is incurred include:

(a) expenditure on start-up activities (start-up costs), unless this expenditure is included in the cost of an item of property, plant and equipment under [draft] IAS 16, Property, Plant and Equipment. Start-up costs may consist of establishment costs such as legal and secretarial costs incurred in establishing a legal entity, expenditure to open a new facility or business (pre-opening costs) or expenditures for commencing new operations or launching new products or processes (pre-operating costs);

(b) expenditure on training activities;

(c) expenditure on advertising and promotional activities; and

(d) expenditure on relocating or re-organising part or all of an ~~enterprise~~ entity.

~~58~~ 62. Paragraph ~~56~~ 60 does not preclude recognising a prepayment as an asset when payment for the delivery of goods or services has been made in advance of the delivery of goods or the rendering of services.

Past Expenses not to be Recognised as an Asset

~~59~~ 63. Expenditure on an intangible item that was initially recognised as an expense by ~~a reporting enterprise~~ an entity in previous annual financial statements or interim financial reports ~~should~~ shall not be recognised as part of the cost of an intangible asset at a later date.

Subsequent Expenditure

~~60~~ 64. Except as described in paragraph 67, Ssubsequent expenditure on an intangible asset after its purchase or its completion ~~should~~ shall be recognised as an expense when it is incurred unless:

(a) it is probable that this expenditure will ~~enable the asset to generate~~ increase the future economic benefits embodied in the asset in excess of its ~~originally assessed~~ standard of performance assessed immediately before the expenditure was made; and

(b) this expenditure can be measured and attributed to the asset reliably.

If these conditions are met, the subsequent expenditure ~~should~~ shall be added to the cost of the intangible asset.~~[1]~~

~~61~~ 65. Subsequent expenditure on a recognised intangible asset is recognised as an expense if this expenditure is required to maintain the asset at its ~~originally assessed~~ standard of performance assessed immediately before the expenditure was made. The nature of intangible assets is such that, in many cases, it is not possible to determine whether subsequent expenditure is likely to enhance or maintain the future economic benefits ~~that will flow to the enterprise from~~ embodied in those assets. In addition, it is often difficult to attribute such expenditure directly to a particular intangible asset rather than the business as a whole. Therefore, only rarely will expenditure incurred after the initial recognition of a purchased intangible asset or after completion of an internally generated intangible asset result in additions to the cost of the intangible asset.

~~62~~ 66. Consistently with paragraph ~~51~~ 55, subsequent expenditure on brands, mastheads, publishing titles, customer lists and items similar in substance (whether externally purchased or internally generated) is always recognised as an expense to avoid the recognition of internally generated goodwill.

~~[1] See also SIC - 6, Costs of Modifying Existing Software.~~

67. Research or development expenditure that:

(a) relates to an in-process research or development project acquired separately or in a business combination and recognised as an intangible asset; and

(b) is incurred after the acquisition of that project

shall be accounted for in accordance with paragraphs 46-59.

68. The requirement in paragraph 67 means that subsequent expenditure on an in-process research or development project acquired separately or in a business combination and recognised as an intangible asset is:

(a) recognised as an expense when incurred if it is in the nature of research expenditure;

(b) recognised as an expense when incurred if it is in the nature of development expenditure that does not satisfy the criteria for recognition as an intangible asset in paragraph 49; and

(c) added to the carrying amount of the acquired in-process research or development project if it is in the nature of development expenditure that satisfies the recognition criteria in paragraph 49.

Measurement Subsequent to Initial Recognition

Benchmark Treatment

~~63~~ 69. After initial recognition, an intangible asset ~~should~~ shall be carried at its cost less any accumulated amortisation and any accumulated impairment losses.

Allowed Alternative Treatment

~~64~~ 70. After initial recognition, an intangible asset ~~should~~ shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated amortisation and any subsequent accumulated impairment losses. For the purpose of revaluations under this [draft] Standard, fair value ~~should~~ shall be determined by reference to an active market. Revaluations ~~should~~ shall 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.

~~65~~ 71. The allowed alternative treatment does not allow:

(a) the revaluation of intangible assets that have not previously been recognised as assets; or

(b) the initial recognition of intangible assets at amounts other than their cost.

~~66~~ 72. The allowed alternative treatment is applied after an asset has been initially recognised at cost. However, if only part of the cost of an intangible asset is recognised as an asset because the asset did not meet the criteria for recognition until part of the way through the process (see paragraph ~~53~~ 57), the allowed alternative treatment may be applied to the whole of that asset. Also, the allowed alternative treatment may be applied to an intangible asset that was received by way of a government grant and recognised at a nominal amount (see paragraph ~~33~~ 36).

~~67~~ 73. It is uncommon for an active market with the characteristics described in paragraph 7 to exist for an intangible asset, although this may occur. For example, in certain jurisdictions, an active market may exist for freely-transferable taxi licences, fishing licences or production quotas. However, an active market cannot exist for brands, newspaper mastheads, music and film publishing rights, patents or trademarks, because each such asset is unique. Also, although intangible assets are bought and sold, contracts are negotiated between individual buyers and sellers, and transactions are relatively infrequent. For these reasons, the price paid for one asset may not provide sufficient evidence of the fair value of another. Finally, prices are often not available to the public.

~~68~~ 74. The frequency of revaluations depends on the volatility of the fair values of the intangible assets being revalued. If the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is necessary. Some intangible assets may experience significant and volatile movements in fair value thus necessitating annual revaluation. Such frequent revaluations are unnecessary for intangible assets with only insignificant movements in fair value.

~~69~~ 75. If an intangible asset is revalued, any accumulated amortisation 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; or

(b) eliminated against the gross carrying amount of the asset and the net amount restated to the revalued amount of the asset.

~~70~~ 76. If an intangible asset is revalued, all the other assets in its class ~~should~~ shall also be revalued, unless there is no active market for those assets.

~~71~~ 77. A class of intangible assets is a grouping of assets of a similar nature and use in an ~~enterprise~~ entity's operations. The items within a class of intangible assets are revalued simultaneously in order to avoid selective revaluation of assets and the reporting of amounts in the financial statements representing a mixture of costs and values as at different dates.

~~72~~ 78. If an intangible asset in a class of revalued intangible assets cannot be revalued because there is no active market for this asset, the asset ~~should~~ shall be carried at its cost less any accumulated amortisation and impairment losses.

~~73~~ 79. If the fair value of a revalued intangible asset can no longer be determined by reference to an active market, the carrying amount of the asset ~~should~~ shall be its revalued amount at the date of the last revaluation by reference to the active market less any subsequent accumulated amortisation and any subsequent accumulated impairment losses.

~~74~~ 80. The fact that an active market no longer exists for a revalued intangible asset may indicate that the asset may be impaired and that it needs to be tested under [draft] IAS 36, Impairment of Assets.

~~75~~ 81. If the fair value of the asset can be determined by reference to an active market at a subsequent measurement date, the allowed alternative treatment is applied from that date.

~~76~~ 82. If an intangible asset's carrying amount is increased as a result of a revaluation, the increase ~~should~~ shall be credited directly to equity under the heading of revaluation surplus. However, a revaluation increase ~~should~~ shall be recognised as income to the extent that it reverses a revaluation decrease of the same asset and that revaluation decrease was previously recognised as an expense.

~~77~~ 83. If an asset's carrying amount is decreased as a result of a revaluation, the decrease ~~should~~ shall be recognised as an expense. However, a revaluation decrease ~~should~~ shall 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.

~~78~~ 84. The cumulative 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~~ entity; in such a case, the amount of the surplus realised is the difference between amortisation based on the revalued carrying amount of the asset and amortisation that would have been

recognised based on the asset's historical cost. The transfer from revaluation surplus to retained earnings is not made through the income statement.

~~Amortisation~~ Useful Life

~~Amortisation Period~~

85. An entity shall assess whether the useful life of an intangible asset is finite or indefinite and, if finite, the length of, or number of production or similar units comprising, that useful life. An intangible asset shall be regarded by the entity as having an indefinite useful life when, based on an analysis of all of the relevant factors, there is no foreseeable limit on the period over which the asset is expected to generate net cash inflows for the entity.

~~79. The depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed twenty years from the date when the asset is available for use. Amortisation should commence when the asset is available for use.~~

86. The accounting for an intangible asset is based on its useful life. An intangible asset with a finite useful life is amortised (see paragraphs 93-102), and an intangible asset with an indefinite useful life is not (see paragraphs 103-106). Appendix A includes examples illustrating the determination of useful life for different intangible assets, and the subsequent accounting for those assets based on the useful life determinations.

~~80~~ 87. ~~As the future economic benefits embodied in an intangible asset are consumed over time, the carrying amount of the asset is reduced to reflect that consumption. This is achieved by systematic allocation of the cost or revalued amount of the asset, less any residual value, as an expense over the asset's useful life. Amortisation is recognised whether or not there has been an increase in, for example, the asset's fair value or recoverable amount.~~ Many factors ~~need to be~~ are considered in determining the useful life of an intangible asset, including:

(a) the expected usage of the asset by the ~~enterprise~~ entity and whether the asset could be managed efficiently ~~managed~~ by another management team;

(b) typical product life cycles for the asset and public information on estimates of useful lives of similar types of assets that are used in a similar way;

(c) technical, technological, commercial or other types of obsolescence;

(d) the stability of the industry in which the asset operates and changes in the market demand for the products or services output from the asset;

(e) expected actions by competitors or potential competitors;

(f) the level of maintenance expenditure required to obtain the expected future economic benefits from the asset and the ~~company~~ entity's ability and intent to reach such a level;

(g) the period of control over the asset and legal or similar limits on the use of the asset, such as the expiry dates of related leases; and

(h) whether the useful life of the asset is dependent on the useful life of other assets of the ~~enterprise~~ entity.

88. The term 'indefinite' does not mean 'infinite'. The useful life of an intangible asset reflects only that level of future maintenance expenditure required to maintain the asset at its standard of performance assessed at the time of estimating the asset's useful life, and the entity's ability and intent to reach such a level. A conclusion that the useful life of an intangible asset is indefinite should not depend on planned future expenditure in excess of that required to maintain the asset at that standard of performance.

~~81~~ 89. Given the history of rapid changes in technology, computer software and many other intangible assets are susceptible to technological obsolescence. Therefore, it is likely that their useful life will be short.

~~82. Estimates of the useful life of an intangible asset generally become less reliable as the length of the useful life increases. This Standard adopts a presumption that the useful life of intangible assets is unlikely to exceed twenty years.~~

83. In rare cases, there may be persuasive evidence that the useful life of an intangible asset will be a specific period longer than twenty years. In these cases, the presumption that the useful life generally does not exceed twenty years is rebutted and the enterprise:

(a) amortises the intangible asset over the best estimate of its useful life;

(b) estimates the recoverable amount of the intangible asset at least annually in order to identify any impairment loss (see paragraph 99); and

(c) discloses the reasons why the presumption is rebutted and the factor(s) that played a significant role in determining the useful life of the asset (see paragraph 111(a)).

Examples

A. An enterprise has purchased an exclusive right to generate hydro-electric power for sixty years. The costs of generating hydro-electric power are much lower than the costs of obtaining power from alternative sources. It is expected that the geographical area surrounding the power station will demand a significant amount of power from the power station for at least sixty years.

The enterprise amortises the right to generate power over sixty years, unless there is evidence that its useful life is shorter.

B. An enterprise has purchased an exclusive right to operate a toll motorway for thirty years. There is no plan to construct alternative routes in the area served by the motorway. It is expected that this motorway will be in use for at least thirty years.

The enterprise amortises the right to operate the motorway over thirty years, unless there is evidence that its useful life is shorter.

84 90. The useful life of an intangible asset may be very long but it is always or even finite indefinite. Uncertainty justifies estimating the useful life of an intangible asset on a prudent basis, but it does not justify choosing a life that is unrealistically short.

85. If control over the future economic benefits from an intangible asset is achieved through legal rights that have been granted for a finite period, the useful life of the intangible asset should not exceed the period of the legal rights unless:

(a) the legal rights are renewable; and

(b) renewal is virtually certain.

91. The useful life of an intangible asset that arises from contractual or other legal rights shall not exceed the period of the contractual or other legal rights, but may be shorter depending on the period over which the entity expects to use the asset. If the contractual or other legal rights are conveyed for a limited term that can be renewed, the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost.

86 92. There may be both economic and legal factors influencing the useful life of an intangible asset: economic factors determine the period over which future economic benefits will be received by the entity; legal factors may restrict the period over which the enterprise entity controls access to these benefits. The useful life is the shorter of the periods determined by these factors.

87. The following factors, among others, indicate that renewal of a legal right is virtually certain:

(a) the fair value of the intangible asset does not reduce as the initial expiry date approaches, or does not reduce by more than the cost of renewing the underlying right;

(b) there is evidence (possibly based on past experience) that the legal rights will be renewed; and

(c) there is evidence that the conditions necessary to obtain the renewal of the legal right (if any) will be satisfied.

Intangible Assets with Finite Useful Lives

Amortisation Period and Amortisation Method

~~88~~ 93. The depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life. Amortisation shall begin when the asset is available for use. The amortisation method used ~~should~~ shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the ~~enterprise~~ entity. If that pattern cannot be determined reliably, the straight-line method ~~should~~ shall be used. The amortisation charge for each period ~~should~~ shall be recognised as an expense unless another ~~International Accounting~~ Standard permits or requires it to be included in the carrying amount of another asset.

~~89~~ 94. A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the unit of production method. The method used for an asset is selected based on the expected pattern of consumption of future economic benefits embodied in the asset and is ~~consistently~~ applied consistently from period to period, unless there is a change in the expected pattern of consumption of those future economic benefits ~~to be derived from that asset~~. There will rarely, if ever, be persuasive evidence to support an amortisation method for intangible assets with finite useful lives that results in a lower amount of accumulated amortisation than under the straight-line method.

~~90~~ 95. Amortisation is usually recognised as an expense. However, sometimes, the future economic benefits embodied in an asset are absorbed by the ~~enterprise~~ entity in producing other assets rather than giving rise to an expense. In these cases, the amortisation charge forms part of the cost of the other asset and is included in its carrying amount. For example, the amortisation of intangible assets used in a production process is included in the carrying amount of inventories (see [draft] IAS 2, Inventories).

Residual Value

~~91~~ 96. The residual value of an intangible asset with a finite useful life ~~should~~ shall be assumed to be zero unless:

(a) there is a commitment by a third party to purchase the asset at the end of its useful life; or

(b) there is an active market for the asset and:

(i) residual value can be determined by reference to that market; and

(ii) it is probable that such a market will exist at the end of the asset's useful life.

~~92~~ 97. The depreciable amount of an asset with a finite useful life is determined after deducting its residual value. A residual value other than zero implies that an ~~enterprise~~ entity expects to dispose of the intangible asset before the end of its economic life.

~~93~~ 98. ~~If the benchmark treatment is adopted,~~ An estimate of an asset's ~~the~~ residual value is based on the amount recoverable from disposal ~~estimated~~ using prices prevailing at the date of ~~acquisition of the asset~~ the estimate, for the sale of a similar asset that has reached the end of its ~~estimated~~ useful life and that has operated under conditions similar to those in which the asset will be used. The residual value is ~~not subsequently increased for changes in prices or value. If the allowed alternative treatment is adopted, a new estimate of residual value is made at the date of each revaluation of the asset using prices prevailing at that date~~ reviewed as at each balance sheet date. A change in the asset's residual value, other than a change reflected in an impairment loss recognised under [draft] IAS 36, Impairment of Assets, is accounted for prospectively as an adjustment to future amortisation.

Review of Amortisation Period and Amortisation Method

~~94~~ 99. The amortisation period and the amortisation method for an intangible asset with a finite useful life ~~should~~ shall be reviewed at least at ~~each financial year end~~ the end of each annual reporting period. If the expected useful life of the asset is ~~significantly~~ different from previous estimates, the amortisation period ~~should~~ shall be

changed accordingly. If there has been a ~~significant~~ change in the expected pattern of consumption of the future economic benefits ~~from~~ embodied in the asset, the amortisation method ~~should~~ shall be changed to reflect the changed pattern. Such changes ~~should~~ shall be accounted for as changes in accounting estimates under [draft] IAS 8, ~~Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies~~ Accounting Policies, Changes in Accounting Estimates and Errors, by adjusting the amortisation charge for the current and future periods.

~~95~~ 100. During the life of an intangible asset, it may become apparent that the estimate of its useful life is inappropriate. For example, the useful life may be extended by subsequent expenditure that improves the condition of the asset ~~beyond its originally assessed standard of performance~~. Also, the recognition of an impairment loss may indicate that the amortisation period needs to be changed.

101. A change in the amortisation method is a change in the technique used to apply the entity's accounting policy to recognise amortisation as an asset's future economic benefits are consumed. Therefore, it is a change in accounting estimate.

~~96~~ 102. Over time, the pattern of future economic benefits expected to flow to an ~~enterprise~~ entity from an intangible asset may change. For example, it may become apparent that a diminishing balance method of amortisation is appropriate rather than a straight-line method. Another example is if use of the rights represented by a licence is deferred pending action on other components of the business plan. In this case, economic benefits that flow from the asset may not be received until later periods.

Intangible Assets with Indefinite Useful Lives

103. An intangible asset with an indefinite useful life shall not be amortised.

104. Under [draft] IAS 36, Impairment of Assets, an entity is required to test an intangible asset with an indefinite useful life for impairment by comparing its recoverable amount with its carrying amount:

(a) at the end of each annual reporting period; and

(b) whenever there is an indication that the intangible asset may be impaired.

Review of Useful Life Assessment

105. The useful life of an intangible asset that is not being amortised shall be reviewed each period to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. If they do not, the change in the useful life assessment from indefinite to finite shall be accounted for as a change in an accounting estimate under [draft] IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors, by amortising the intangible asset prospectively over its remaining useful life in accordance with paragraphs 93-102.

106. Under [draft] IAS 36, reassessing the useful life of an intangible asset as finite rather than indefinite is an indicator that the asset may be impaired. As a result, the entity tests the asset for impairment by comparing its recoverable amount, determined in accordance with [draft] IAS 36, with its carrying amount, and recognising any excess of the carrying amount over the recoverable amount as an impairment loss.

Recoverability of the Carrying Amount - Impairment Losses

97 107. To determine whether an intangible asset is impaired, an enterprise entity applies [draft] IAS 36, Impairment of Assets. That [draft] Standard explains when and how an enterprise entity 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.

98. Under IAS 22 (revised 1998), Business Combinations, if an impairment loss occurs before the end of the first annual accounting period commencing after acquisition for an intangible asset acquired in a business combination that was an acquisition, the impairment loss is recognised as an adjustment to both the amount assigned to the intangible asset and the goodwill (negative goodwill) recognised at the date of acquisition. However, if the impairment loss relates to specific events or changes in circumstances occurring after the date of acquisition, the impairment loss is recognised under IAS 36 and not as an adjustment to the amount assigned to the goodwill (negative goodwill) recognised at the date of acquisition.

99. In addition to following the requirements included in IAS 36, Impairment of Assets, an enterprise should estimate the recoverable amount of the following intangible assets at least at each financial year end, even if there is no indication that the asset is impaired:

(a) an intangible asset that is not yet available for use; and

(b) an intangible asset that is amortised over a period exceeding twenty years from the date when the asset is available for use.

The recoverable amount should be determined under IAS 36 and impairment losses recognised accordingly.

100. The ability of an intangible asset to generate sufficient future economic benefits to recover its cost is usually subject to great uncertainty until the asset is available for use. Therefore, this Standard requires an enterprise to test for impairment, at least annually, the carrying amount of an intangible asset that is not yet available for use.

101. It is sometimes difficult to identify whether an intangible asset may be impaired because, among other things, there is not necessarily any obvious evidence of obsolescence. This difficulty arises particularly if the asset has a long useful life. As a consequence, this Standard requires, as a minimum, an annual calculation of the recoverable amount of an intangible asset if its useful life exceeds twenty years from the date when it becomes available for use.

102. The requirement for an annual impairment test of an intangible asset applies whenever the current total estimated useful life of the asset exceeds twenty years from when it became available for use. Therefore, if the useful life of an intangible asset was estimated to be less than twenty years at initial recognition, but the useful life is extended by subsequent expenditure to exceed twenty years from when the asset became available for use, an enterprise performs the impairment test required under paragraph 99(b) and also makes the disclosure required under paragraph 111(a).

Retirements and Disposals

~~103~~ 108. An intangible asset ~~should~~ shall be derecognised (eliminated from the balance sheet) on:

(a) disposal; or

(b) when no future economic benefits are expected from its use ~~and subsequent~~ or disposal.

~~104~~ 109. Gains or losses arising from the retirement or disposal of an intangible asset ~~should~~ shall be determined as the difference between the net disposal proceeds and the carrying amount of the asset. ~~and~~ They ~~should~~ shall be recognised as income or expense in ~~the income statement~~ profit or loss in the period in which the retirement or disposal occurs (unless [draft] IAS 17, Leases, requires otherwise on a sale and leaseback).

110. The disposal of an intangible asset may occur by sale or by entering into a finance lease. In determining the date of disposal of such an item, an entity applies the criteria in IAS 18, Revenue, for recognising revenue from the sale of goods. [Draft] IAS 17 applies to disposal by a sale and leaseback.

111. The consideration receivable on disposal of an intangible asset is recognised initially at fair value. If payment for such an intangible asset is deferred, the consideration received is recognised initially at the cash price equivalent. The difference between the nominal amount of the consideration and the cash price equivalent is recognised as interest revenue under IAS 18 according to the effective yield on the receivable.

~~105. If an intangible asset is exchanged for a similar asset under the circumstances described in paragraph 35, the cost of the acquired asset is equal to the carrying amount of the asset disposed of and no gain or loss results.~~

~~106~~ 112. Amortisation of an ~~An~~ intangible asset ~~that~~ with a finite useful life does not cease when it becomes temporarily idle or 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~~, unless the asset's depreciable amount is fully allocated. At least at ~~each financial year end~~ the end of

each annual reporting period, an ~~enterprise~~ entity tests the asset for impairment under [draft] IAS 36, Impairment of Assets, and recognises any impairment loss accordingly.

Disclosure

General

~~107~~ 113. The financial statements ~~should~~ shall disclose the following for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets:

(a) whether the useful lives are indefinite or finite and, if finite, the useful lives or the amortisation rates used;

(b) the amortisation methods used for intangible assets with finite useful lives;

(c) the gross carrying amount and ~~the~~ any accumulated amortisation (aggregated with accumulated impairment losses) at the beginning and end of the period;

(d) the line item(s) of the income statement in which ~~the~~ any amortisation of intangible assets is included;

(e) a reconciliation of the carrying amount at the beginning and end of the period showing:

(i) additions, indicating separately those from internal development, those acquired separately, and those acquired through business combinations;

(ii) retirements and disposals;

(iii) increases or decreases during the period resulting from revaluations under paragraphs ~~64, 76 and 77~~ 70, 82 and 83 and from impairment losses recognised or reversed directly in equity under [draft] IAS 36, Impairment of Assets (if any);

(iv) impairment losses recognised in ~~the income statement~~ profit or loss during the period under [draft] IAS 36 (if any);

(v) impairment losses reversed in ~~the income statement~~ profit or loss during the period under [draft] IAS 36 (if any);

(vi) any amortisation recognised during the period;

(vii) net exchange differences arising on the translation of the financial statements into a different presentation currency,

and on the translation of a foreign ~~entity~~ operation into the presentation currency of the reporting entity; and

(viii) other changes in the carrying amount during the period.

~~Comparative information is not required.~~

~~108~~ 114. A class of intangible assets is a grouping of assets of a similar nature and use in an ~~enterprise~~ entity's operations. Examples of separate classes may include:

(a) brand names;

(b) mastheads and publishing titles;

(c) computer software;

(d) licences and franchises;

(e) copyrights, patents and other industrial property rights, service and operating rights;

(f) recipes, formulae, models, designs and prototypes; and

(g) intangible assets under development.

The classes mentioned above are disaggregated (aggregated) into smaller (larger) classes if this results in more relevant information for the users of the financial statements.

~~109~~ 115. An ~~enterprise~~ entity discloses information on impaired intangible assets under [draft] IAS 36 in addition to the information required by paragraph ~~107~~ 113(e)(iii) to (v).

~~110~~ 116. [Draft] IAS 8 requires ~~An enterprise~~ an entity to discloses the nature and effect of a change in an accounting estimate that has a material effect in the current period or that is expected to have a material effect in subsequent periods~~, under IAS 8, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policy~~. Such disclosure may arise from changes in:

(a) the ~~amortisation period~~ assessment of an intangible asset's useful life;

(b) the amortisation method; or

(c) residual values.

~~111~~ 117. The financial statements ~~should~~ shall also disclose:

(a) if an intangible asset is ~~amortised over more than twenty years, the reasons why the presumption that the useful life of an intangible asset will not exceed twenty years from the date when the asset is available for use is rebutted~~ assessed as having an indefinite useful life, the carrying amount of that asset and the reasons supporting the assessment of an indefinite useful life. In giving these reasons, the ~~enterprise should~~ entity shall describe the factor(s) that played a significant role in determining ~~the~~ that it has an indefinite useful life ~~of the asset~~;

(b) a description, the carrying amount and remaining amortisation period of any individual intangible asset that is material to the financial statements of the ~~enterprise~~ entity as a whole;

(c) for intangible assets acquired by way of a government grant and initially recognised at fair value (see paragraph ~~33~~ 36):

(i) the fair value initially recognised for these assets;

(ii) their carrying amount; and

(iii) whether they are carried under the benchmark or the allowed alternative treatment for subsequent measurement;

(d) the existence and carrying amounts of intangible assets whose title is restricted and the carrying amounts of intangible assets pledged as security for liabilities; and

(e) the amount of contractual commitments for the acquisition of intangible assets.

~~112~~ 118. When an ~~enterprise~~ entity describes the factor(s) that played a significant role in determining that the useful life of an intangible asset ~~that~~ is ~~amortised over more than twenty years~~ indefinite, the ~~enterprise~~ entity considers the list of factors in paragraph ~~80~~ 87.

Intangible Assets Carried Under the Allowed Alternative Treatment

~~113~~ 119. If intangible assets are carried at revalued amounts, the following ~~should~~ shall be disclosed:

(a) by class of intangible assets:

(i) the effective date of the revaluation;

(ii) the carrying amount of revalued intangible assets; and

(iii) the carrying amount that would have been ~~included~~ recognised in the financial statements had the revalued class of intangible assets been carried under the benchmark treatment in paragraph ~~63~~ 69; ~~and~~

(b) the amount of the revaluation surplus that relates to intangible assets at the beginning and end of the period, indicating the changes during the period and any restrictions on the distribution of the balance to shareholders; and

(c) the methods and significant assumptions applied in estimating the asset fair values.

~~114~~ 120. It may be necessary to aggregate the classes of revalued assets into larger classes for disclosure purposes. However, classes are not aggregated if this would result in the combination of a class of intangible assets that includes amounts measured under both benchmark and allowed alternative treatments for subsequent measurement.

Research and Development Expenditure

~~115~~ 121. The financial statements ~~should~~ shall disclose the aggregate amount of research and development expenditure recognised as an expense during the period.

~~116~~ 122. Research and development expenditure comprises all expenditure that is directly attributable to research or development activities ~~or that can be allocated on a reasonable and consistent basis to such activities~~ (see paragraphs ~~54-55~~ 58 and 59 for guidance on the type of expenditure to be included for the purpose of the disclosure requirement in paragraph ~~115~~ 121).

Other Information

~~117~~ 123. An ~~enterprise~~ entity is encouraged, but not required, to ~~give~~ disclose the following information:

(a) a description of any fully amortised intangible asset that is still in use; and

(b) a brief description of significant intangible assets controlled by the ~~enterprise~~ entity but not recognised as assets because they did not meet the recognition criteria in this [draft] Standard or because they were acquired or generated before ~~this Standard~~ the version of IAS 38, Intangible Assets, that was issued in 1998 was effective.

Transitional Provisions and Effective Date

~~*118. At the date when this Standard becomes effective (or at the date of adoption, if earlier), it should be applied as set out in the following tables. In all cases other than those detailed in these tables, this Standard should be applied retrospectively, unless it is impracticable to do so.*~~

~~119. The tables below require retrospective application whenever this is necessary to eliminate an item that no longer qualifies for recognition under this Standard or if the previous measurement of an intangible asset contradicted the principles set out in this Standard (for example, intangible assets that have never been amortised or that have been revalued but not by reference to an active market). In other cases, prospective application of the recognition and amortisation requirements is required or, in some cases, permitted.~~

~~*120 The effect of adopting this Standard on its effective date (or earlier) should be recognised under IAS 8, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies, that is, as an adjustment either to the opening balance of retained earnings of the earliest period presented (IAS 8 benchmark treatment) or to the net profit or loss for the current period (IAS 8 allowed alternative treatment).*~~

~~*121. In the first annual financial statements issued under this Standard, an enterprise should disclose the transitional provisions adopted where transitional provisions under this Standard permit a choice.*~~

124. This [draft] Standard shall apply:

(a) to the accounting for intangible assets acquired in business combinations for which the agreement date is after [date the revised Standard is issued]; and

(b) to the accounting for all other intangible assets prospectively from the beginning of the first annual reporting period beginning on or after [date the revised Standard is issued].

125. An entity shall, at the beginning of the first annual reporting period beginning on or after [date the revised Standard is issued], apply this

[draft] Standard to reassess the useful lives of intangible assets recognised at that date that were not acquired in business combinations for which the agreement date is after [date the revised Standard is issued]. If, as a result of that reassessment, the entity changes its assessment of the useful life of an asset, that change shall be accounted for as a change in an accounting estimate under [draft] IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors.

Intangible Assets Acquired in Exchange for Similar Assets

126. The requirement in paragraph 124(b) to apply this [draft] Standard prospectively means that if an exchange of assets was measured under paragraph 35 of the version of IAS 38 issued in 1998 on the basis of the carrying amount of the asset given up, the entity does not restate the carrying amount of the asset acquired to reflect the fair value of the consideration given.

Early Application

127. Entities are encouraged to apply the requirements of this [draft] Standard before the effective dates specified in paragraph 124. However, if an entity applies this [draft] Standard before those effective dates, it also shall apply [draft] IFRS X, Business Combinations, and [draft] IAS 36 (revised 200X), Impairment of Assets, at the same time.

~~Transitional Provisions - Recognition~~	
~~Circumstances~~	~~Requirements~~
~~*1. An intangible item was recognised as a separate asset – whether or not described as an intangible asset – and, at the effective date of this Standard (or at the date of adoption of this Standard, if earlier), the item does not meet the definition of, or recognition criteria for, an intangible asset.*~~	
~~*(a) The item was acquired in a business combination that was an acquisition.*~~	~~*(i) Re-allocate the item to the goodwill (negative goodwill) resulting from the same acquisition; and*~~ ~~*(ii) adjust the goodwill (negative goodwill) recognised at the date of acquisition retrospectively, as if the item had always been included in the goodwill (negative goodwill) recognised at the date of acquisition. For example, if the goodwill was recognised as an asset and amortised, estimate the accumulated amortisation that would have been recognised, had the item been included in the goodwill recognised at the date of acquisition, and adjust the carrying amount of the goodwill accordingly.*~~
~~*(b) The item was not acquired in a business combination that was an acquisition (for example, it was purchased separately or generated internally).*~~	~~*Derecognise the item (eliminate it from the balance sheet).*~~

~~Transitional Provisions - Recognition (continued)~~	
~~Circumstances~~	~~Requirements~~
~~*2. An intangible item was recognised as a separate asset – whether or not described as an intangible asset – and, at the effective date of this Standard (or at the date of adoption of this Standard, if earlier), the item meets the definition of, and recognition criteria for, an intangible asset.*~~	
~~*(a) The asset was recognised initially at cost.*~~	~~*Classify the asset as an intangible asset. The cost initially recognised for the asset is deemed to have been properly determined. See transitional provisions for subsequent measurement and amortisation under circumstances 4 and 5 below.*~~
~~*(b) The asset was recognised initially at an amount other than cost.*~~	~~*(i) Classify the asset as an intangible asset; and*~~ ~~*(ii) re-estimate the carrying amount of the asset at cost (or revalued amount, after initial recognition at cost) less accumulated amortisation, determined under this Standard.*~~ ~~*If the cost of the intangible asset cannot be determined, derecognise the asset (eliminate it from the balance sheet).*~~

~~Transitional Provisions - Recognition (continued)~~	
~~Circumstances~~	~~Requirements~~
~~*3. At the effective date of this Standard (or at the date of adoption of this Standard, if earlier), an item meets the definition of, and recognition criteria for, an intangible asset but it was not previously recognised as an asset.*~~	
~~*(a) The intangible asset was acquired in a business combination that was an acquisition and formed part of the goodwill recognised.*~~	~~*Recognition of the intangible asset is encouraged, but not required. If the intangible asset is recognised:*~~ ~~*(i) measure the carrying amount of the asset at cost (or revalued amount) less accumulated amortisation determined under this Standard; and*~~ ~~*(ii) adjust the goodwill recognised at the date of acquisition retrospectively, as if the intangible asset had never been included in the goodwill recognised at the date of acquisition. For example, if the goodwill was recognised as an asset and amortised, estimate the effect on the accumulated amortisation of the goodwill of distinguishing the intangible asset separately and adjust the carrying amount of the goodwill accordingly.*~~
~~*(b) The intangible asset was not acquired in a business combination that was an acquisition (for example, it was purchased separately or generated internally).*~~	~~*The intangible asset should not be recognised.*~~

Transitional Provisions - Amortisation of an Intangible Asset Carried Under the Benchmark Treatment	
Circumstances	**Requirements**
4. The asset was not previously amortised or the amortisation charge was deemed to be nil.	*Restate the carrying amount of the asset as if the accumulated amortisation had always been determined under this Standard.*
5. The asset was previously amortised. Accumulated amortisation determined under this Standard is different to that previously determined (because the amortisation period and/or the amortisation method is different).	*Do not restate the carrying amount of the intangible asset for any difference between the accumulated amortisation in prior years and that calculated under this Standard. Amortise any carrying amount of the asset over its remaining useful life determined under this Standard (i.e. any change is treated as a change in accounting estimate – see paragraph 94).*

Transitional Provisions - Revalued Intangible Assets	
Circumstances	**Requirements**
6. An intangible asset was carried at a revalued amount not determined by reference to an active market:	
(a) There is an active market for the asset.	*The asset should be revalued by reference to this active market at the effective date of this Standard (or at the date of adoption of this Standard, if earlier).*
(b) There is no active market for the asset.	*(i) Eliminate the effect of any revaluation; and* *(ii) measure the carrying amount of the asset at cost less accumulated amortisation, determined under this Standard.*

Effective Date

122. This International Accounting Standard becomes operative for annual financial statements covering periods beginning on or after 1 July 1999. Earlier application is encouraged. If an enterprise applies this Standard for annual financial statements covering periods beginning before 1 July 1999, the enterprise should:

(a) disclose that fact; and

(b) adopt IAS 22 (revised 1998), Business Combinations, and IAS 36, Impairment of Assets, at the same time.

123. This Standard supersedes:

(a) IAS 4, Depreciation Accounting, with respect to the amortisation (depreciation) of intangible assets; and

(b) IAS 9, Research and Development Costs.

Appendix A

Assessing the Useful Lives of Intangible Assets

This appendix is illustrative only and does not form part of the [draft] Standard. It provides guidance on determining the useful life of an intangible asset for the purpose of applying the [draft] Standard.

A1. Each of the following examples describes an acquired intangible asset, the facts and circumstances surrounding the determination of its useful life, and the subsequent accounting based on that determination.

Example 1—an acquired customer list

A2. A direct-mail marketing company acquires a customer list and expects that it will be able to derive benefit from the information on the list for at least one year, but no more than three years.

A3. The customer list would be amortised over management's best estimate of its useful life, say 18 months. Although the direct-mail marketing company may intend to add customer names and other information to the list in the future, the expected benefits of the acquired customer list relate only to the customers on that list at the date it was acquired. The customer list also would be reviewed for impairment under [draft] IAS 36 *Impairment of Assets* by assessing at each balance sheet date whether there is any indication that the customer list may be impaired.

Example 2—an acquired patent that expires in 15 years

A4. The product protected by the patented technology is expected to be a source of cash flows for at least 15 years. The entity has a commitment from a third party to purchase that patent in five years for 60 per cent of the fair value of the patent at the date it was acquired, and the entity intends to sell the patent in five years.

A5. The patent would be amortised over its five-year useful life to the entity, with a residual value equal to the present value of 60 per cent of the

patent's fair value at the date it was acquired. The patent also would be reviewed for impairment under [draft] IAS 36 by assessing at each balance sheet date whether there is any indication that it may be impaired.

Example 3—an acquired copyright that has a remaining legal life of 50 years

A6. An analysis of consumer habits and market trends provides evidence that the copyrighted material will generate cash flows only for approximately 30 more years.

A7. The copyright would be amortised over its 30-year estimated useful life. The copyright also would be reviewed for impairment under [draft] IAS 36 by assessing at each balance sheet date whether there is any indication that it may be impaired.

Example 4—an acquired broadcast licence that expires in five years

A8. The broadcast licence is renewable every 10 years if the company provides at least an average level of service to its customers and complies with the relevant legislative requirements. The licence may be renewed indefinitely at little cost and has been renewed twice before the most recent acquisition. The acquiring entity intends to renew the licence indefinitely and evidence supports its ability to do so. Historically, there has been no compelling challenge to the licence renewal. The technology used in broadcasting is not expected to be replaced by another technology any time in the foreseeable future. Therefore, the licence is expected to contribute to the entity's cash flows indefinitely.

A9. The broadcast licence would be treated as having an indefinite useful life because it is expected to contribute to the entity's cash flows indefinitely. Therefore, the licence would not be amortised until its useful life is determined to be finite. The licence would be tested for impairment under [draft] IAS 36 at the end of each annual reporting period and whenever there is an indication that it may be impaired.

Example 5—the broadcast licence in Example 4

A10. The licensing authority subsequently decides that it will no longer renew broadcast licences, but rather will auction those licences. At the time the licensing authority's decision is made, the broadcast licence has three years until it expires. The entity expects that the licence will continue to contribute to cash flows until the licence expires.

A11. Because the broadcast licence can no longer be renewed, its useful life is no longer indefinite. Thus, the acquired licence would be amortised over its remaining three-year useful life and immediately tested for impairment under [draft] IAS 36.

Example 6—an acquired airline route authority between two European cities that expires in three years

A12. The route authority may be renewed every five years, and the acquiring entity intends to comply with the applicable rules and regulations surrounding renewal. Route authority renewals are routinely granted at a minimal cost and historically have been renewed when the airline has complied with the applicable rules and regulations. The acquiring entity expects to provide service indefinitely between the two cities from its hub airports and expects that the related supporting infrastructure (airport gates, slots, and terminal facility leases) will remain in place at those airports for as long as it has the route authority. An analysis of demand and cash flows supports those assumptions.

A13. Because the facts and circumstances support the acquiring entity's ability to continue providing air service indefinitely between the two cities, the intangible asset related to the route authority is treated as having an indefinite useful life. Therefore, the route authority would not be amortised until its useful life is determined to be definite. It would be tested for impairment under [draft] IAS 36 at the end of each annual reporting period and whenever there is an indication that it may be impaired.

Example 7—an acquired trademark used to identify and distinguish a leading consumer product that has been a market-share leader for the past eight years

A14. The trademark has a remaining legal life of five years but is renewable every 10 years at little cost. The acquiring entity intends to continuously renew the trademark and evidence supports its ability to do so. An analysis of (1) product life cycle studies, (2) market, competitive and environmental trends, and (3) brand extension opportunities provides evidence that the trademarked product will generate cash flows for the acquiring entity for an indefinite period of time.

A15. The trademark would be treated as having an indefinite useful life because it is expected to contribute to cash flows indefinitely. Therefore, the trademark would not be amortised until its useful life is determined to be definite. It would be tested for impairment under [draft] IAS 36 at the end of each annual reporting period and whenever there is an indication that it may be impaired.

Example 8—a trademark acquired 10 years ago that distinguishes a leading consumer product

A16. The trademark was considered to have an indefinite useful life when it was acquired because the trademarked product was expected to generate cash flows indefinitely. However, unexpected competition has recently entered the market and will reduce future sales of the product. Management estimates that cash flows generated by the product will be 20 per cent less for the foreseeable future. However, management expects that the product will continue to generate cash flows indefinitely at those reduced amounts.

A17. As a result of the projected decrease in future cash flows, the entity determines that the estimated recoverable amount of the trademark is less than its carrying amount, and an impairment loss is recognised. Because it is still regarded as having an indefinite useful life, the trademark would continue to not be amortised but would be tested for impairment under [draft] IAS 36 at the end of each annual reporting period and whenever there is an indication that it may be impaired.

Example 9—a trademark for a line of products that was acquired several years ago in a business combination

A18. At the time of the business combination the acquiree had been producing the line of products for 35 years with many new models developed under the trademark. At the acquisition date the acquirer expected to continue producing the line, and an analysis of various economic factors indicated there was no limit to the period of time the trademark would contribute to cash flows. Consequently, the trademark was not amortised by the acquirer. However, management has recently decided that production of the product line will be discontinued over the next four years.

A19. Because the useful life of the acquired trademark is no longer regarded as indefinite, the carrying amount of the trademark would be tested for impairment under [draft] IAS 36 and amortised over its remaining four-year useful life.

Appendix B

Basis for Conclusions

Contents

Basis for Conclusions

Introduction

B1. This Basis for Conclusions summarises the Board's considerations in reaching the conclusions in the Exposure Draft of proposed amendments to IAS 38 *Intangible Assets*. Individual Board members gave greater weight to some factors than to others.

B2. The Exposure Draft has been issued by the Board as part of its project on business combinations. That project has two phases. The first has resulted in the Board issuing simultaneously ED 3, which is an Exposure Draft of a proposed IFRS *Business Combinations*, and this Exposure Draft, which proposes related changes to IAS 38 *Intangible Assets* and IAS 36 *Impairment of Assets*. Therefore, the Board's intention in developing its proposals to amend IAS 38 as part of the first phase of the project was not to reconsider all of the requirements in IAS 38. The changes proposed to IAS 38 are primarily concerned with:

(a) the notion of 'identifiability' as it relates to intangible assets;

(b) the useful life and amortisation of intangible assets; and

(c) the accounting for in-process research and development projects acquired in business combinations.

B3. The amendments to IAS 38 proposed in the May 2002 Exposure Draft *Improvements to International Accounting Standards* and the November 2002 Exposure Draft 2 *Share-based Payment* are also presented in the Exposure Draft as marked-up text. This Basis for Conclusions does not outline the Board's deliberations on the changes to IAS 38 proposed in the May 2002 and November 2002 Exposure Drafts. A list of those proposed changes is provided in Appendix C.

Definition of an intangible asset (paragraph 7)

B4. An intangible asset is defined in IAS 38 as "an identifiable non-monetary asset without physical substance held for use in the production or supply of goods or services, for rental to others, or for administrative services". The Exposure Draft proposes amending this definition by removing from it the requirement for the asset to be held for use in the production or supply of goods or services, for rental to others, or for administrative services.

B5. The Board agreed that the essential characteristics of intangible assets are that they:

(a) are resources controlled by the entity from which future economic benefits are expected to flow to the entity;

(b) lack physical substance; and

(c) are identifiable.

The Board concluded that the purpose for which an entity holds an item with these characteristics is not relevant to its classification as an intangible asset, and that all such items should be within the scope of IAS 38.

Identifiability (paragraph 11)

B6. Under both IAS 38 and the proposals in the Exposure Draft, a non-monetary asset without physical substance must be identifiable to meet the definition of an intangible asset. IAS 38 does not define 'identifiability', but states that an intangible asset can be distinguished from goodwill if the asset is separable, but that separability is not a necessary condition for identifiability. The Exposure Draft proposes that an asset be treated as meeting the identifiability criterion in the definition of an intangible asset when it is separable, or when it arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

Background to the Board's deliberations

B7. The Board was prompted to consider the issue of 'identifiability' as part of the first phase of its Business Combinations project as a result of changes during 2001 to the requirements in Canadian and United States standards on the separate recognition of intangible assets acquired in business combinations. The Board observed that intangible assets make up an increasing proportion of the assets of many entities, and that intangible assets acquired in a business combination are often included in the amount recognised as goodwill, despite the requirements in IAS 22 *Business Combinations* and IAS 38 for them to be recognised separately from goodwill. The Board agreed with the conclusion reached by the Canadian and US standard-setters that the usefulness of financial statements would be enhanced if intangible assets acquired in a business combination were distinguished from goodwill. Therefore, the Board agreed that the IFRS arising from the first phase of the Business Combinations project should provide a more definitive basis for identifying and recognising intangible assets acquired in a business combination separately from goodwill.

B8. In developing this Exposure Draft and ED 3, the Board affirmed the view in IAS 38 that identifiability is the characteristic that conceptually distinguishes other intangible assets from goodwill. The Board agreed that to provide a more definitive basis for identifying and recognising intangible assets separately from goodwill, the concept of identifiability would need to be articulated more clearly.

Clarifying identifiability (paragraph 11)

B9. Consistently with the guidance in IAS 38, the Board agreed that an intangible asset can be distinguished from goodwill if it is separable, ie capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged. Therefore, in the context of intangible assets, separability signifies identifiability, and intangible assets with that characteristic that are acquired in a business combination should be recognised as assets separately from goodwill.

B10. However, again consistently with the guidance in IAS 38, the Board agreed that separability is not the only sign of identifiability. The Board observed that, in contrast to goodwill, the values of many intangible

assets arise from rights conveyed legally by contract or statute. In the case of acquired goodwill, its value arises from the collection of assembled assets that make up an acquired entity or the value created by assembling a collection of assets through a business combination, such as the synergies that are expected to result from combining entities or operations. The Board also observed that, although many intangible assets are both separable and arise from contractual-legal rights, some contractual-legal rights establish property interests that are not readily separable from the entity as a whole. For example, under the laws of some jurisdictions some licences granted to an entity are not transferable except by sale of the entity as a whole. The Board concluded that the fact that an intangible asset arises from contractual or other legal rights is a characteristic that distinguishes it from goodwill. Therefore, intangible assets with that characteristic that are acquired in a business combination should be recognised as assets separately from goodwill.

Criteria for initial recognition

B11. Under IAS 38 and the proposals in this Exposure Draft, an intangible asset must be recognised if, and only if:

(a) it is probable that the future economic benefits that are attributable to the asset will flow to the entity; and

(b) the cost of the asset can be measured reliably.

The Board considered the application of the above recognition criteria to intangible assets acquired in business combinations. The Board's deliberations on this issue are outlined in paragraphs B12-B15.

Acquisition as part of a business combination (paragraphs 29-32)

B12. Paragraphs 29-32 of [draft] IAS 38 have been included in the Exposure Draft to clarify that the above recognition criteria will, with one exception, always be satisfied for an intangible asset acquired in a business combination. Therefore, those criteria have not been included in ED 3, which proposes requiring an acquirer to separately recognise at the acquisition date all of the acquiree's intangible assets as defined in [draft] IAS 38, other than an assembled workforce.

B13. In developing the proposals in ED 3, the Board observed that the fair value of an intangible asset reflects market expectations about the probability that the future economic benefits associated with the intangible asset will flow to the acquirer. In other words, the effect of probability is reflected in the fair value measurement of an intangible asset. Therefore, the probability recognition criterion will always be satisfied for intangible assets acquired in business combinations. The Board agreed that this highlights a general inconsistency between the recognition criteria for assets and liabilities in the *Framework* (which states that an item meeting the definition of an element should be recognised only if it is probable that any future economic benefits associated with the item will flow to or from the entity, and it can be measured reliably) and the fair value measurements required in, for example, a business combination. However, the Board agreed that the role of probability in the *Framework* should be considered more generally as part of a later Concepts project.

B14. The Board also concluded that, except for an assembled workforce (see paragraph B15), sufficient information should exist to measure reliably the fair value of an asset that has an underlying contractual or legal basis or is capable of being separated from the entity. In other words, the 'reliability of measurement' recognition criterion is subsumed within the 'identifiability' criterion for classifying an asset as an intangible asset and recognising it separately from goodwill. The Board observed that an asset that has an underlying contractual or legal basis is often associated with specific cash flow streams. The Board also observed that one way of demonstrating that an intangible asset is separable is to show that others have transferred or rented similar items as discrete units. If so, that previous behaviour suggests the availability of a price and a means to estimate fair value. The Board acknowledged that the fair value estimates for some intangible assets that meet the identifiability criterion might lack the precision of the fair value measurements for other assets. However, the Board concluded that the financial information provided by recognising those intangible assets at their estimated fair values will be more useful than the information provided if those intangible assets are subsumed into goodwill on the basis of measurement difficulties.

B15. In the case of an assembled workforce, the Board concluded that techniques to measure with sufficient reliability the fair value of that workforce and the related intellectual capital are not currently available.

The Board observed that the technique often used to measure the fair value of an assembled workforce is replacement cost—the cost to hire and train a comparable assembled workforce. The Board believes that replacement cost is not a representationally faithful measure of the fair value of the intellectual capital acquired in a business combination. It therefore decided that even if there are circumstances in which an assembled workforce acquired in a business combination could be viewed as meeting the contractual-legal or separability criteria, such intangibles should not be permitted to be recognised separately from goodwill.

Separate acquisition (paragraphs 22 and 23)

B16. Having agreed to include paragraphs 29-32 of [draft] IAS 38 in the Exposure Draft, the Board decided that it also needed to consider the role of the probability and 'reliability of measurement' recognition criteria for separately acquired intangible assets.

B17. Consistently with its conclusion about the role of probability in the recognition of intangible assets acquired in business combinations, the Board concluded that the probability recognition criterion will always be satisfied for separately acquired intangible assets. This is because the price an entity pays to acquire separately an intangible asset will normally reflect expectations about the probability that the future economic benefits associated with the intangible asset will flow to the entity. In other words, the effect of probability is reflected in the cost of the intangible asset.

B18. The Board also concluded that when an intangible asset is separately acquired in exchange for cash or other monetary assets, sufficient information should exist to measure the cost of that asset reliably. However, this might not be the case when the purchase consideration comprises non-monetary assets. The Board therefore agreed:

(a) to carry forward from IAS 38 the guidance in paragraph 23 of [draft] IAS 38; and

(b) to carry forward from the May 2002 Exposure Draft *Improvements to International Accounting Standards* the guidance in paragraphs 37-39 of [draft] IAS 38 on the acquisition of an intangible asset in exchange or part exchange for another non-monetary asset.

Subsequent accounting for intangible assets

B19. The Board initially decided that the scope of the first phase of its Business Combinations project should include a consideration of the subsequent accounting for intangible assets acquired in business combinations. To that end, the Board initially focused its attention on the following three issues:

(a) whether an intangible asset with a finite useful life and acquired in a business combination should continue to be accounted for after initial recognition in accordance with IAS 38.

(b) whether, and under what circumstances, an intangible asset acquired in a business combination could be regarded as having an indefinite useful life.

(c) how an intangible asset with an indefinite useful life (assuming such an asset exists) acquired in a business combination should be accounted for after initial recognition.

B20. However, during its deliberations of the issues in (b) and (c) of paragraph B19, the Board agreed that any conclusions it reached on those issues would equally apply to recognised intangible assets obtained in some way other than a business combination. The Board agreed that amending the requirements in IAS 38 only for intangible assets acquired in business combinations would create inconsistencies in the accounting for intangible assets depending on how they are obtained. Thus, similar items would be accounted for in dissimilar ways. The Board concluded that creating such inconsistencies would impair the usefulness of the information provided to users about an entity's intangible assets, because both comparability and reliability (which rests on the notion of representational faithfulness, ie that similar transactions are accounted for in the same way) would be diminished. Therefore, the Board agreed that any amendments it proposes to the requirements in IAS 38 to address the issues in (b) and (c) of paragraph B19 should apply to all recognised intangible assets, whether generated internally or acquired separately or as part of a business combination.

B21. Before beginning its deliberations of the issues identified in paragraph B19, the Board noted the concern expressed by some that, because of

the subjectivity involved in distinguishing goodwill from other intangible assets as at the acquisition date, differences between the subsequent treatment of goodwill and other intangible assets increases the potential for intangible assets to be misclassified at the acquisition date. The Board concluded, however, that adopting the 'separability' and 'contractual or other legal rights' criteria provides a reasonably definitive basis for separately identifying and recognising intangible assets acquired in a business combination. Therefore, the Board agreed that its analysis of the accounting for intangible assets after initial recognition should have regard only to the nature of those assets and not to the subsequent treatment of goodwill.

Accounting for intangible assets with finite useful lives acquired in business combinations

B22. The Board observed that IAS 38 requires an intangible asset to be measured after initial recognition by carrying that asset:

(a) at cost less any accumulated amortisation and any accumulated impairment losses; or

(b) at a revalued amount, being the asset's fair value, determined by reference to an active market, at the date of revaluation less any subsequent accumulated amortisation and any subsequent accumulated impairment losses. Under this approach, revaluations must be made with such regularity that at the balance sheet date the carrying amount of the asset does not differ materially from its fair value.

Whichever of the above methods is used, IAS 38 requires the depreciable amount of the asset to be amortised on a systematic basis over the best estimate of its useful life.

B23. The Board observed that underpinning the requirement for all intangible assets to be amortised is the notion that they all have determinable and finite useful lives. Setting aside the question of whether, and under what circumstances, an intangible asset could be regarded as having an indefinite useful life, an important issue for the Board to consider was whether a departure from the above requirements in IAS 38 is warranted

for intangible assets acquired in a business combination that have finite useful lives.

B24. The Board agreed that any departure from the above requirements in IAS 38 for intangible assets with finite lives acquired in business combinations would create inconsistencies between the accounting for recognised intangible assets based wholly on the means by which they are obtained. In other words, similar items would be accounted for in dissimilar ways. The Board concluded that creating such inconsistencies would impair the usefulness of the information provided to users about an entity's intangible assets, because both comparability and reliability would be diminished.

B25. Therefore, the Board agreed that intangible assets with finite useful lives acquired in business combinations should be accounted for in accordance with IAS 38 after their initial recognition.

Impairment testing intangible assets with finite useful lives (paragraph 107)

B26. IAS 38 currently requires the recoverable amount of an intangible asset with a finite useful life that is being amortised over a period of more than 20 years, whether or not acquired in a business combination, to be measured at least at each financial year-end.

B27. The Board observed that the recoverable amount of a long-lived tangible asset needs to be measured only when, in accordance with IAS 36 *Impairment of Assets*, there is an indication that the asset may be impaired. The Board could see no conceptual reason for requiring the recoverable amounts of some identifiable assets being amortised over very long periods to be determined more regularly than for other identifiable assets being amortised or depreciated over very long periods. Therefore, the Board concluded that the recoverable amount of an intangible asset with a finite useful life that is amortised over a period of more than 20 years should be determined only when, in accordance with IAS 36, there is an indication that the asset may be impaired. Consequently, the Board decided to remove the requirement in IAS 38 for the recoverable amount of such an intangible asset to be measured at least at each financial year-end.

B28. The Board also decided that all of the requirements relating to impairment testing intangible assets should be included in [draft] IAS 36 rather than in [draft] IAS 38. Therefore, the Board agreed to relocate to [draft] IAS 36 the requirement in IAS 38 that an entity should estimate at the end of each annual reporting period the recoverable amount of an intangible asset not yet available for use, irrespective of whether there is any indication that it may be impaired.

Useful lives of intangible assets (paragraphs 85-92)

B29. This Exposure Draft proposes that an intangible asset should be regarded by an entity as having an indefinite useful life when, based on an analysis of all of the relevant factors, there is no foreseeable limit on the period over which the asset is expected to generate net cash inflows for the entity.

B30. The Board observed that the useful life of an intangible asset is related to the expected cash inflows that are associated with that asset. The Board agreed that, to be representationally faithful, the amortisation period for an intangible asset generally should reflect that useful life and, by extension, the cash flow streams associated with the asset. The Board concluded that it is possible for management to have the intent and the ability to maintain an intangible asset in such a way that there is no foreseeable limit on the period over which that particular asset is expected to generate net cash inflows for the entity. In other words, it is conceivable that an analysis of all the relevant factors (legal, regulatory, contractual, competitive, economic and other) could lead to a conclusion that there is no foreseeable limit on the period over which a particular intangible asset is expected to generate net cash inflows for the entity.

B31. For example, the Board observed that some intangible assets are based on legal rights that are conveyed in perpetuity rather than for finite terms. As such, those assets may have cash flows associated with them that may be expected to continue for many years or even indefinitely. The Board agreed that if the cash flows are expected to continue for a finite period, then the useful life of the asset is limited to that finite period. However, if the cash flows are expected to continue indefinitely, the useful life is indefinite.

B32. The Board observed that IAS 38 prescribes a presumptive maximum useful life for intangible assets of 20 years. The Board concluded that

such a presumption is inconsistent with the view that the amortisation period for an intangible asset should, to be representationally faithful, reflect its useful life and, by extension, the cash flow streams associated with the asset. The Board therefore agreed that the Exposure Draft should not propose a presumptive maximum useful life for intangible assets, even if they have finite useful lives.

Useful life constrained by contractual or other legal rights (paragraphs 91 and 92)

B33. The Board noted that the useful life of an intangible asset that arises from contractual or other legal rights is constrained by the duration of those rights. Thus, the useful life of such an asset cannot extend beyond the duration of those rights, and may be shorter. Accordingly, the Board concluded that in determining the useful life of an intangible asset, consideration should be given to the period that the entity expects to use the intangible asset, which is subject to the expiration of the contractual or other legal rights.

B34. However, the Board also observed that such rights are often conveyed for limited terms that may be renewed, and therefore considered whether renewals should be assumed in determining the useful life of such an intangible asset. The Board noted that some types of licences are initially issued for finite periods but renewals are routinely granted at little cost, provided that licensees have complied with the applicable rules and regulations. Such licences trade at prices that reflect more than the remaining term, thereby indicating that renewal at minimal cost is the general expectation. However, renewals are not assured for other types of licences and, even if they are renewed, substantial costs may be incurred to secure their renewal.

B35. The Board concluded that because the useful lives of some intangible assets depend, in economic terms, on renewal and on the associated costs of renewal, the Exposure Draft should propose requiring the useful lives assigned to those assets to reflect renewal when there is evidence to support renewal without significant cost.

Accounting for intangible assets with indefinite useful lives (paragraphs 103-106)

B36. The Exposure Draft proposes to prohibit the amortisation of intangible assets with indefinite useful lives. Therefore, such assets will be recognised after initial recognition at:

(a) a revalued amount, being fair value determined by reference to an active market less any accumulated impairment losses; or

(b) cost less any accumulated impairment losses.

Non-amortisation

B37. The Board observed that many assets yield benefits to an entity over several periods. Amortisation is the systematic allocation of the cost (or revalued amount) of an asset, less any residual value, to reflect the consumption over time of the future economic benefits embodied in that asset. Thus, if there is no foreseeable limit on the period over which an entity expects to consume the future economic benefits embodied in an asset, amortisation of that asset over, for example, an arbitrarily determined maximum period would not be representationally faithful.

B38. Consequently, the Board agreed that intangible assets with indefinite useful lives should not be amortised, but should, as with all assets, be subject to regular impairment testing. The Board's deliberations on the form that the impairment test should take, including the frequency of impairment testing, are included in the Basis for Conclusions to [draft] IAS 36. The Board further agreed that regular re-examinations should be required of the useful life of an intangible asset that is not being amortised to determine whether circumstances continue to support the assessment that the useful life is indefinite.

Revaluations

B39. Having agreed that intangible assets with indefinite useful lives should not be amortised, the Board considered whether to propose permitting such assets to be carried at revalued amounts in accordance with IAS 38. The Board could see no conceptual justification for precluding some intangible assets from being carried at revalued amounts solely on the

basis that there is no foreseeable limit on the period over which an entity expects to consume the future economic benefits embodied in those assets.

B40. As a result, the Board agreed that intangible assets with indefinite useful lives should be permitted to be carried at revalued amounts in accordance with IAS 38.

Research and development projects acquired in business combinations

B41. The Board considered the following issues in relation to in-process research and development (IPR&D) projects acquired in a business combination:

(a) whether the proposed criteria for recognising intangible assets acquired in a business combination separately from goodwill also should be applied to IPR&D projects acquired in a business combination;

(b) the subsequent accounting for IPR&D projects acquired in a business combination and recognised as assets separately from goodwill; and

(c) the treatment of subsequent expenditure on IPR&D projects acquired in a business combination and recognised as assets separately from goodwill.

The Board's deliberations on issue (a), although included in the Basis for Conclusions to ED 3, are also, for the sake of completeness, outlined below.

B42. The Board did not reconsider as part of the first phase of its Business Combinations project the existing requirements in IAS 38 for internally generated intangibles and expenditure on the research or development phase of an internal project. The Board agreed that a reconsideration of those requirements is outside the scope of this project.

Initial recognition separately from goodwill

B43. The Board observed that the criteria in IAS 22 *Business Combinations* and IAS 38 for recognising an intangible asset acquired in a business combination separately from goodwill apply to all intangible assets, including IPR&D projects. Therefore, under existing international Standards, any intangible item acquired in a business combination is recognised as an asset separately from goodwill when it is identifiable and can be measured reliably, and it is probable that any associated future economic benefits will flow to the acquirer. If these criteria are not satisfied, the expenditure on the cost or value of that item, which is included in the cost of the combination, forms part of the amount attributed to goodwill.

B44. The Board could see no conceptual justification for changing the approach in IAS 22 and IAS 38 of using the same criteria for all intangible assets acquired in a business combination when assessing whether those assets should be recognised separately from goodwill. The Board concluded that adopting different criteria would impair the usefulness of the information provided to users about the assets acquired in a combination because both comparability and reliability would be diminished. Therefore, this Exposure Draft and ED 3 propose that an acquirer recognises as an asset separately from goodwill any of the acquiree's IPR&D projects that meet the definition of an intangible asset. This will be the case when the IPR&D project meets the definition of an asset and is identifiable, that is, separable or arises from contractual or other legal rights.

B45. The Board acknowledged that applying the same criteria to all intangible assets acquired in a business combination to assess whether they should be recognised separately from goodwill results in treating some IPR&D projects acquired in business combinations differently from similar projects started internally. However, the Board concluded that this does not provide a basis for subsuming those acquired intangible assets within goodwill. Rather, it highlights a need to reconsider the conclusion in IAS 38 that an intangible asset can never exist in respect of an in-process research project and can exist in respect of an in-process development project only once all of the criteria for deferral in IAS 38 have been satisfied. The Board agreed that such a reconsideration is outside the scope of its Business Combinations project.

Subsequent accounting for IPR&D projects acquired in a business combination and recognised as intangible assets

B46. The Board observed that IAS 38 requires all recognised intangible assets to be accounted for after initial recognition at:

(a) cost less any accumulated amortisation and any accumulated impairment losses; or

(b) revalued amount, being the asset's fair value, determined by reference to an active market, at the date of revaluation less any subsequent accumulated amortisation and any subsequent accumulated impairment losses.

This includes: IPR&D projects acquired in a business combination that satisfy the criteria for recognition separately from goodwill; separately acquired IPR&D projects that satisfy the criteria in IAS 38 for recognition as an intangible asset; and recognised internally developed intangible assets arising from development or the development phase of an internal project.

B47. The Board could see no conceptual justification for changing the approach in IAS 38 of applying the same requirements to the subsequent accounting for all recognised intangible assets. The Board therefore agreed that IPR&D projects acquired in a business combination that satisfy the criteria for recognition as an asset separately from goodwill should be accounted for after initial recognition in accordance with the requirements applying to the subsequent accounting for other recognised intangible assets.

Subsequent expenditure on IPR&D projects acquired in a business combination and recognised as intangible assets (paragraphs 67 and 68)

B48. The Exposure Draft proposes that subsequent expenditure on an IPR&D project acquired separately or in a business combination and recognised as an intangible asset shall be:

(a) recognised as an expense when incurred if it is in the nature of research expenditure;

(b) recognised as an expense when incurred if it is in the nature of development expenditure that does not satisfy the criteria for recognition as an intangible asset in paragraph 49 of [draft] IAS 38; and

(c) added to the carrying amount of the acquired in-process research or development project if it is in the nature of development expenditure that satisfies the recognition criteria in paragraph 49 of [draft] IAS 38.

B49. In developing this proposal the Board observed that the treatment under IAS 38 of subsequent expenditure on an IPR&D project acquired in a business combination and recognised as an asset separately from goodwill is arguable. Some suggest that the requirements in IAS 38 relating to expenditure on research, development, or the research or development phase of an internal project should be applied. However, others argue that those requirements are ostensibly concerned with the initial recognition and measurement of internally generated intangible assets. Instead, the requirements in IAS 38 dealing with subsequent expenditure should be applied. Under those requirements, subsequent expenditure on an intangible asset after its purchase or completion must be recognised as an expense when it is incurred unless:

(a) it is probable that this expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance; and

(b) the expenditure can be measured and attributed to the asset reliably.

When these conditions are satisfied, the subsequent expenditure must be added to the carrying amount of the intangible asset.[1]

[1] Proposals to amend these requirements were included in the May 2002 Exposure Draft *Improvements to International Accounting Standards*. Under those proposals, subsequent expenditure on an intangible asset after its purchase or completion will be recognised as an expense when it is incurred unless:

(a) it is probable that the expenditure will increase the future economic benefits embodied in the asset in excess of its standard of performance assessed immediately before the expenditure was made; and

(b) the expenditure can be measured and attributed to the asset reliably.

B50. The Board observed that this uncertainty also exists for separately acquired IPR&D projects that satisfy the criteria in IAS 38 for recognition as intangible assets.

B51. The Board noted that applying the requirements in IAS 38 for expenditure on research, development, or the research or development phase of an internal project to subsequent expenditure on IPR&D projects acquired in a business combination and recognised as assets separately from goodwill would result in such subsequent expenditure being treated inconsistently with subsequent expenditure on other recognised intangible assets. However, applying the subsequent expenditure requirements in IAS 38 to subsequent expenditure on IPR&D projects acquired in a business combination and recognised as assets separately from goodwill would result in research and development expenditure being accounted for differently depending on whether a project is acquired or started internally.

B52. The Board concluded that until it has had the opportunity to review the requirements in IAS 38 for expenditure on research, development, or the research or development phase of an internal project, more useful information will be provided to users of an entity's financial statements if all such expenditure is accounted for consistently. This includes subsequent expenditure on a separately acquired IPR&D project that satisfies the criteria in IAS 38 for recognition as an intangible asset.

Transitional provisions (paragraphs 124-127)

B53. The Exposure Draft proposes that the revised Standard should apply to the accounting for intangible assets acquired in business combinations for which the agreement date is after the date the revised Standard is issued, and to the accounting for all other intangible assets prospectively from the beginning of the first annual reporting period beginning on or after the date the revised Standard is issued. The Exposure Draft also proposes that on initial application an entity should apply the revised Standard to reassess the useful lives of those other intangible assets. If, as a result of that reassessment, the entity changes its useful life assessment for an asset, that change shall be accounted for as a change in an accounting estimate under [draft] IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors.*

B54. The Board's deliberations on the transitional issues relating to the initial recognition of intangible assets acquired in business combinations and the impairment testing of intangible assets are addressed in the Basis for Conclusions to ED 3 and the Basis for Conclusions to [draft] IAS 36, respectively.

B55. In developing the proposals outlined in paragraph B53, the Board considered the following three questions:

(a) should the useful lives of, and accounting for, intangible assets already recognised at the effective date of the revised Standard continue to be determined in accordance with the requirements in IAS 38 (by amortising over a presumptive maximum period of 20 years), or in accordance with the requirements in the revised Standard?

(b) if the revised Standard is applied to intangible assets already recognised at its effective date, should the effect of a reassessment of an intangible asset's useful life as a result of the initial application of the revised Standard be recognised retrospectively or prospectively?

(c) should entities be required to apply the requirements in the revised Standard for subsequent expenditure on an acquired IPR&D project recognised as an intangible asset retrospectively to expenditure incurred before the effective date of the revised Standard?

B56. In relation to the first question above, the Board noted its previous conclusion that the most representationally faithful method of accounting for intangible assets is to amortise those with finite useful lives over their useful lives with no limit on the amortisation period, and not amortise those with indefinite useful lives. Thus, the Board concluded that the reliability and comparability of financial statements would be diminished if the revised Standard was not applied to intangible assets recognised before its effective date. Accordingly, the Exposure Draft proposes that the revised Standard should apply prospectively to intangible assets already recognised at the effective date of the revised Standard.

B57. In relation to the second question, the Board observed that a reassessment of an asset's useful life is regarded throughout IFRSs as a change in an accounting estimate, rather than a change in an accounting policy. For example, under IAS 38, if a new estimate of the expected useful life of an intangible asset is significantly different from previous estimates, the change must be accounted for as a change in accounting estimate under [draft] IAS 8. Under [draft] IAS 8, a change in an accounting estimate must be accounted for prospectively by including the effect of the change in the determination of profit or loss in:

(a) the period of the change, if the change in estimate affects that period only; or

(b) the period of the change and future periods, if the change in estimate affects both.

B58. Similarly, under [draft] IAS 16 *Property, Plant and Equipment*, if a new estimate of the expected useful life of an item of property, plant and equipment is significantly different from previous estimates, the change must be accounted for prospectively by adjusting the depreciation expense for the current and future periods.

B59. Therefore, the Board agreed that a reassessment of useful life resulting from the initial application of the revised Standard, including a reassessment from a finite to an indefinite useful life, should be accounted for as a change in an accounting estimate. Consequently, the effect of such a change should be recognised prospectively.

B60. The Board considered the view that because IAS 38 requires intangible assets to be treated as having a finite useful life, a change to an assessment of indefinite useful life for an intangible asset under the revised Standard represents a change in an accounting policy, rather than a change in an accounting estimate. The Board agreed that, even if this were the case, the useful life reassessment should nonetheless be accounted for prospectively. This is because retrospective application would require an entity to determine whether, at the end of each reporting period before the effective date of the revised Standard, the useful life of an intangible asset was indefinite. Such an assessment requires an entity to make estimates that would have been made at a prior date, and therefore raises problems in relation to the role of hindsight, in particular, whether the benefit of hindsight should be

included or excluded from those estimates and, if excluded, how the effect of hindsight can be separated from the other factors existing at the date for which the estimates are required.

B61. In relation to the third question, and as noted in paragraph B49, it is not clear whether IAS 38 requires subsequent expenditure on acquired IPR&D projects recognised as intangible assets to be accounted for:

(a) in accordance with its requirements for expenditure on research, development, or the research or development phase of an internal project; or

(b) in accordance with its requirements for subsequent expenditure on an intangible asset after its purchase or completion.

The Board concluded that subsequent expenditure on an acquired IPR&D project that is capitalised under (b) above before the effective date of the revised Standard might not have been capitalised had the revised Standard applied when the subsequent expenditure was incurred. This is because, under the revised Standard, such expenditure will be capitalised as an intangible asset only when it is in the nature of development expenditure and all of the criteria for deferral in IAS 38 are satisfied. In the Board's view, those criteria represent a higher recognition threshold than (b) above.

B62. Thus, retrospective application of the revised Standard to subsequent expenditure on acquired IPR&D projects incurred before the effective date of the revised Standard could result in previously capitalised expenditure being reversed. Such reversal would be required if the expenditure was in the nature of research expenditure, or the expenditure was in the nature of development expenditure and one or more of the criteria for deferral in IAS 38 were not satisfied at the time the expenditure was incurred. The Board agreed that determining whether, at the time the subsequent expenditure was incurred, the criteria for deferral were satisfied raises the same hindsight issues discussed in paragraph B60: it would require assessments to be made as of a prior date, and therefore raises problems in relation to how the effect of hindsight can be separated from factors existing at the date of the assessment. In addition, such assessments could, in many cases, be impracticable: the information needed may not exist, or no longer be

obtainable, or be obtainable only if the entity bears undue cost and effort.

B63. Therefore, the Board decided that the requirements in the revised Standard for subsequent expenditure on acquired IPR&D projects recognised as intangible assets should not be applied retrospectively to expenditure incurred before the effective date of the revised Standard. The Board noted that any amounts previously included in the carrying amount of such an asset would, in any event, be subject to the requirements for impairment testing in [draft] IAS 36 *Impairment of Assets*.

Early application (paragraph 127)

B64. The Board noted that the issue of any revised Standard demonstrates its opinion that application of the revised Standard will result in more useful information being provided to users about an entity's financial position, performance or cash flows. On that basis, a case exists for permitting, and indeed encouraging, entities to apply the revised IAS 38 before its effective date. However, the Board also considered the assertion that permitting a revised Standard to be applied before its effective date potentially diminishes comparability between entities in the period(s) leading up to that effective date, and has the effect of providing entities with an option.

B65. The Board concluded that the benefit of providing users with more useful information about an entity's financial position and performance by permitting early application of the revised IAS 38 outweighs the disadvantages of potentially diminished comparability. Therefore, the draft Standard proposes to encourage entities to apply the requirements of the revised Standard before its effective date, provided they also apply [draft] IFRS X *Business Combinations* and [draft] IAS 36 *Impairment of Assets* at the same time.

Appendix C

Amendments to IAS 38 proposed in the May 2002 Exposure Draft *Improvements to International Accounting Standards* and the November 2002 Exposure Draft 2 *Share-based Payment*

C1. In May 2002 the IASB issued an Exposure Draft *Improvements to International Accounting Standards.* In November 2002 the IASB issued Exposure Draft 2 *Share-based Payment*. The changes proposed in those Exposure Drafts will, if made, lead to a number of significant consequential amendments to IAS 38 *Intangible Assets.*

C2. The consequential amendments to IAS 38 proposed in the May 2002 Exposure Draft are presented in this Exposure Draft as marked-up text as follows:

(a) a change to the definition of 'residual value' in paragraph 7 of [draft] IAS 38.

(b) amendments to paragraphs 24 and 25 of [draft] IAS 38, and the inclusion of new paragraphs 26 and 27. These changes relate to measuring the cost of an intangible asset that is acquired separately (that is, not as part of a business combination).

(c) amendments to paragraph 37 of [draft] IAS 38, the inclusion of new paragraphs 38 and 39, and the deletion of (former) paragraph 35. These changes relate to the acquisition of an intangible asset in exchange or part-exchange for another non-monetary asset.

(d) amendments to paragraph 58 of [draft] IAS 38, which relate to the expenditure included in the cost of an internally generated intangible asset.

(e) amendments to paragraphs 64(a) and 65 of [draft] IAS 38, which relate to subsequent expenditure that increases the future economic benefits embodied in an asset in excess of its standard of performance assessed immediately before the expenditure was made.

(f) amendments to paragraph 98 of [draft] IAS 38, which relate to estimating the residual value of an intangible asset.

(g) amendments to paragraph 99 of [draft] IAS 38 and the inclusion of new paragraph 101. Those changes relate to changes in the expected pattern of consumption of the future economic benefits embodied in an intangible asset.

(h) amendments to paragraphs 108 and 109 of [draft] IAS 38, the inclusion of new paragraphs 110 and 111, and the deletion of (former) paragraph 105. These changes relate to the accounting for retirements and disposals of intangible assets.

(i) amendments to the disclosure requirements in paragraphs 113(e)(vii) and 117(e) of [draft] IAS 38, the additional disclosure requirement in paragraph 119(c), and the removal from paragraph 113 of the exemption from disclosing comparative information.

(j) the transitional provision in paragraph 126 of [draft] IAS 38 for the changes proposed to IAS 38 in the May 2002 Exposure Draft.

C3. Two consequential amendments to IAS 38 were proposed in Exposure Draft 2:

(a) the deletion of (former) paragraph 26. That paragraph related to intangible assets acquired in exchange for the issue of equity instruments.

(b) an amendment to the definition of 'cost' in paragraph 7.

C4. In addition, while developing this Exposure Draft the Board became aware of two consequential amendments to IAS 38 that should have been proposed in the May 2002 Exposure Draft, but which were inadvertently omitted. Those amendments have been included in this Exposure Draft as marked-up text of proposed paragraphs 112 and 122.

Appendix D

Alternative views on ED 3 *Business Combinations* and associated proposed amendments to IAS 36 and IAS 38

D1. Two Board members voted against the publication of ED 3 *Business Combinations* and the Exposure Draft of Proposed Amendments to IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets*. Their alternative views are set out in the appendix to the Basis for Conclusions on ED 3.

CONSEQUENTIAL AMENDMENTS TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

The amendments proposed in ED 3 and this Exposure Draft will lead to the consequential amendments set out below. Those consequential amendments are presented on the basis that the Board will proceed with all of the amendments to IFRSs and SIC Interpretations proposed in Exposure Drafts preceding ED 3 and this Exposure Draft.

For the purpose of this Exposure Draft, the new text is underlined and the deleted text is struck through. Amendments proposed in Exposure Drafts preceding ED 3 and this Exposure Draft are presented as clean, rather than marked-up, text.

Consequential Amendments to International Financial Reporting Standards

The following amendments shall apply to the accounting for business combinations for which the agreement date is on or after [date IFRS X Business Combinations is issued] and to the accounting for any goodwill and intangible assets acquired in those business combinations. In all other respects, the following amendments shall apply from the beginning of the first annual reporting period beginning on or after [date IFRS X Business Combinations is issued]. However, if an entity elects to adopt [draft] IFRS X Business Combinations, [draft] IAS 36 Impairment of Assets, and [draft] IAS 38 Intangible Assets early, it shall also apply the following amendments at the same time.

Amendments to IAS 10 *Events After the Balance Sheet Date*

Paragraph 21(a) is amended as follows:

21. The following are examples of non-adjusting events after the balance sheet date that would generally result in disclosure:

    (a) a major business combination after the balance sheet date (~~IAS 22~~ [draft] IFRS X, Business Combinations, requires specific disclosures in such cases) or disposing a major subsidiary;

Amendments to IAS 12 *Income Taxes*

Paragraphs 1(c), 6 and 9 of the Introduction to IAS 12 are amended as follows:

1. …

(c) the cost of a business combination ~~that is an acquisition~~ is allocated to the identifiable assets acquired and liabilities ~~acquired,~~ assumed by reference to their fair values but no equivalent adjustment is made for tax purposes.

…

6. The original IAS 12 did not refer explicitly to fair value adjustments made on a business combination. Such adjustments give rise to temporary differences and IAS 12 (revised) requires an enterprise to recognise the resulting deferred tax liability or (subject to the probability criterion for recognition) deferred tax asset with a corresponding effect on the determination of the amount of goodwill or ~~negative goodwill~~ any excess over the cost of the combination of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities. However, IAS 12 (revised) prohibits the recognition of deferred tax liabilities arising from the initial recognition of goodwill ~~itself (if amortisation of the goodwill is not deductible for tax purposes) and of deferred tax assets arising from negative goodwill that is treated as deferred income~~.

9. The original IAS 12 did not state explicitly whether deferred tax assets and liabilities may be discounted. IAS 12 (revised) prohibits discounting of deferred tax assets and liabilities. ~~An amendment to p~~Paragraph ~~39(i)~~ B15(i) of ~~IAS 22~~ [draft] IFRS X, Business Combinations, prohibits discounting of deferred tax assets acquired and deferred tax liabilities ~~acquired~~ assumed in a business combination. ~~Previously, paragraph 39(i) of IAS 22 neither prohibited nor required discounting of deferred tax assets and liabilities resulting from a business combination.~~

The third paragraph of the 'Objective' section of IAS 12 is amended as follows:

This Standard requires an ~~enterprise~~ entity to account for the tax consequences of transactions and other events in the same way that it accounts for the transactions and other events themselves. Thus, for transactions and other events recognised in the income statement, any related tax effects are also recognised in the income statement. For transactions and other events recognised directly in equity, any related tax effects are also recognised

directly in equity. Similarly, the recognition of deferred tax assets and liabilities in a business combination affects the amount of goodwill ~~or negative goodwill~~ arising in that ~~business~~ combination or the amount of any excess over the cost of the combination of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities.

New paragraphs 21A-21B are added, and paragraphs 15, 18, 19, 21, 22(a), 24, 26(c), 32, 58(b), 66-68 and the example following paragraph 68 are amended as follows:

15. A deferred tax liability ~~should~~ shall be recognised for all taxable temporary differences, ~~unless~~ except to the extent that the deferred tax liability arises from:

(a) the initial recognition of goodwill ~~for which amortisation is not deductible for tax purposes~~; or

…

18. Temporary differences also arise when:

(a) the cost of a business combination ~~that is an acquisition~~ is allocated to the identifiable assets acquired and liabilities ~~acquired~~ assumed by reference to their fair values but no equivalent adjustment is made for tax purposes (see paragraph 19);

(b) assets are revalued and no equivalent adjustment is made for tax purposes (see paragraph 20);

(c) goodwill ~~or negative goodwill~~ arises ~~on consolidation~~ in a business combination (see paragraph~~s~~ 21 ~~and 32~~);

…

19. ~~In a business combination that is an acquisition, the~~ The cost of ~~the acquisition~~ a business combination is allocated to the identifiable assets acquired and liabilities ~~acquired~~ assumed by reference to their fair values at the acquisition date ~~of the exchange transaction~~. Temporary differences arise when the tax bases of the identifiable assets acquired and liabilities ~~acquired~~ assumed are not affected by the business

combination or are affected differently. For example, when the carrying amount of an asset is increased to fair value but the tax base of the asset remains at cost to the previous owner, a taxable temporary difference arises which results in a deferred tax liability. The resulting deferred tax liability affects goodwill (see paragraph 66).

21. Goodwill arising in a business combination is measured as the excess of the cost of ~~an acquisition~~ the combination over the acquirer's interest in the net fair value of the acquiree's identifiable assets~~, and~~ liabilities ~~acquired~~ and contingent liabilities. Many taxation authorities do not allow ~~the amortisation~~ reductions in the carrying amount of goodwill as a deductible expense in determining taxable profit. Moreover, in such jurisdictions, the cost of goodwill is often not deductible when a subsidiary disposes of its underlying business. In such jurisdictions, goodwill has a tax base of nil. Any difference between the carrying amount of goodwill and its tax base of nil is a taxable temporary difference. However, this Standard does not permit the recognition of the resulting deferred tax liability because goodwill is measured as a residual and the recognition of the deferred tax liability would increase the carrying amount of goodwill.

21A. Subsequent reductions in a deferred tax liability that is unrecognised because it arises from the initial recognition of goodwill are also regarded as arising from the initial recognition of goodwill and are therefore not recognised under paragraph 15(a). For example, if goodwill acquired in a business combination has a cost of 100 but a tax base of nil, paragraph 15(a) prohibits the entity from recognising the resulting deferred tax liability. If the entity subsequently recognises an impairment loss of 20 for that goodwill, the amount of the taxable temporary difference relating to the goodwill is reduced from 100 to 80, with a resulting decrease in the value of the unrecognised deferred tax liability. That decrease in the value of the unrecognised deferred tax liability is also regarded as relating to the initial recognition of the goodwill and is therefore prohibited from being recognised under paragraph 15(a).

21B. Deferred tax liabilities for taxable temporary differences relating to goodwill are, however, recognised to the extent they do not arise from the initial recognition of goodwill. For example, if goodwill acquired in a business combination has a cost of 100 that is deductible for tax purposes at a rate of 20 per cent per year starting in the year of

acquisition, the tax base of the goodwill is 100 on initial recognition and 80 at the end of the year of acquisition. If the carrying amount of goodwill at the end of the year of acquisition remains unchanged at 100, a taxable temporary difference of 20 arises at the end of the year of acquisition. Because that taxable temporary difference does not relate to the initial recognition of the goodwill, the resulting deferred tax liability is recognised.

22. …

(a) in a business combination, an ~~enterprise~~ entity recognises any deferred tax liability or asset and this affects the amount of goodwill or ~~negative goodwill~~ the amount of any excess over the cost of the combination of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities (see paragraph 19);

…

24. A deferred tax asset ~~should~~ shall be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that:

~~(a) negative goodwill which is treated as deferred income in accordance with IAS 22, Business Combinations; or~~

~~(b) the initial recognition of an asset or liability in a transaction which:~~

(~~i~~ a) is not a business combination; and

(~~ii~~ b) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

26. …

(c) ~~in a business combination that is an acquisition,~~ the cost of ~~the acquisition~~ a business combination is allocated to the identifiable assets acquired and liabilities ~~recognised,~~ assumed by reference to

their fair values at the acquisition date ~~of the exchange transaction~~. When a liability assumed is recognised ~~on~~ at the acquisition date but the related costs are not deducted in determining taxable profits until a later period, a deductible temporary difference arises which results in a deferred tax asset. A deferred tax asset also arises where the fair value of an identifiable asset acquired is less than its tax base. In both cases, the resulting deferred tax asset affects goodwill (see paragraph 66); and

…

32. [Deleted] ~~This Standard does not permit the recognition of a deferred tax asset arising from deductible temporary differences associated with negative goodwill which is treated as deferred income in accordance with IAS 22, Business Combinations, because negative goodwill is a residual and the recognition of the deferred tax asset would increase the carrying amount of negative goodwill.~~

58. …

(b) a business combination ~~that is an acquisition~~ (see paragraphs 66 to 68).

66. As explained in paragraphs 19 and 26(c), temporary differences may arise in a business combination ~~that is an acquisition~~. In accordance with ~~IAS 22~~ [draft] IFRS X, Business Combinations, an ~~enterprise~~ entity recognises any resulting deferred tax assets (to the extent that they meet the recognition criteria in paragraph 24) or deferred tax liabilities as identifiable assets and liabilities at the acquisition date ~~of the acquisition~~. Consequently, those deferred tax assets and liabilities affect goodwill or ~~negative goodwill~~ the amount of any excess over the cost of the combination of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities. However, in accordance with paragraph~~s~~ 15(a) ~~and 24(a)~~, an ~~enterprise~~ entity does not recognise deferred tax liabilities arising from the initial recognition of goodwill. ~~itself (if amortisation of the goodwill is not deductible for tax purposes) and deferred tax assets arising from non-taxable negative goodwill which is treated as deferred income.~~

67. As a result of a business combination, an acquirer may consider it probable that it will recover its own deferred tax asset that was not

recognised prior to the business combination. For example, the acquirer may be able to utilise the benefit of its unused tax losses against the future taxable profit of the acquiree. In such cases, the acquirer recognises a deferred tax asset and takes this into account in determining the goodwill or ~~negative goodwill~~ the amount of any excess over the cost of the combination of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities ~~arising on the acquisition~~.

68. When an acquirer did not recognise a deferred tax asset of the acquiree as an identifiable asset at the acquisition date ~~of a business combination~~ and that deferred tax asset is subsequently recognised in the acquirer's consolidated financial statements, the resulting deferred tax income is recognised in the income statement. In addition, the acquirer:

    (a) ~~adjusts~~ reduces the ~~gross~~ carrying amount of ~~the~~ goodwill ~~and the related accumulated amortisation~~ to the amount~~s~~ that would have been recorded if the deferred tax asset had been recognised as an identifiable asset ~~at~~ from the acquisition date ~~of the business combination~~; and

    (b) recognises the reduction in the ~~net~~ carrying amount of the goodwill as an expense.

    However, ~~the acquirer does not recognise negative goodwill,~~ this procedure cannot result in the creation of an excess over the cost of the combination of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities, nor ~~does~~ can it increase the ~~carrying~~ amount ~~of negative goodwill~~ previously recognised for any such excess.

Example

An ~~enterprise~~ entity acquired a subsidiary which had deductible temporary differences of 300. The tax rate at the time of the acquisition was 30%. The resulting deferred tax asset of 90 was not recognised as an identifiable asset in determining the goodwill of 500 resulting from the ~~acquisition~~ business combination. ~~The goodwill is amortised over 20 years. 2~~ Two years after the ~~acquisition~~ business combination, the ~~enterprise~~ entity assessed that future taxable profit would probably be sufficient for the ~~enterprise~~ entity to recover the benefit of all the deductible temporary differences.

The ~~enterprise~~ entity recognises a deferred tax asset of 90 (300 at 30%) and, in the income statement, deferred tax income of 90. It also reduces the ~~cost~~ carrying amount of the goodwill by 90 and recognises ~~the accumulated amortisation by 9 (representing 2 years' amortisation). The balance of 81 is recognised as~~ an expense for this amount in the income statement. Consequently, the cost of the goodwill~~, and the related accumulated amortisation, are~~ is reduced to the amount~~s~~ (410 ~~and 41~~) that would have been recorded if a deferred tax asset of 90 had been recognised as an identifiable asset at the acquisition date ~~of the business combination~~.

If the tax rate has increased to 40%, the ~~enterprise~~ entity recognises a deferred tax asset of 120 (300 at 40%) and, in the income statement, deferred tax income of 120. If the tax rate has decreased to 20%, the ~~enterprise~~ entity recognises a deferred tax asset of 60 (300 at 20%) and deferred tax income of 60. In both cases, the ~~enterprise~~ entity also reduces the ~~cost~~ carrying amount of the goodwill by 90 ~~and the accumulated amortisation by 9~~ and recognises ~~the balance of 81 as~~ an expense for that amount in the income statement.

Paragraphs 12 and 13 in Section A of Appendix A to IAS 12 are amended as follows:

12. The carrying amount of an asset is increased to fair value in a business combination ~~that is an acquisition~~ and no equivalent adjustment is made for tax purposes. (*note: on initial recognition, the resulting deferred tax liability increases goodwill or decreases ~~negative goodwill~~ the amount of any excess over the cost of the combination of the acquirer's interest*

in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities, see paragraph 66 of the Standard).

13. ~~Amortisation~~ Reductions in the carrying amount of goodwill ~~is~~ are not deductible in determining taxable profit and the cost of the goodwill would not be deductible on disposal of the business (*note: paragraph 15(a) of the Standard prohibits recognition of the resulting deferred tax liability*).

Paragraphs 9 and 10 in Section B of Appendix A to IAS 12 are amended as follows:

9. A liability is recognised at its fair value in a business combination ~~that is an acquisition~~, but none of the related expense is deducted in determining taxable profit until a later period. (*note: the resulting deferred tax asset decreases goodwill or increases ~~negative goodwill~~ the amount of any excess over the cost of the combination of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities, see paragraph 66 of the Standard).*

10. [Deleted] ~~Negative goodwill is included in the balance sheet as deferred income and the income will not be included in the determination of taxable profit. (*note: paragraph 24 of the Standard prohibits recognition of the resulting deferred tax asset*).~~

Example 3 in Appendix B of IAS 12 is amended as follows:

On 1 January X5 ~~enterprise~~ entity A acquired 100% of the shares of ~~enterprise~~ entity B at a cost of 600. ~~A amortises goodwill over 5 years. Goodwill amortisation is not deductible for tax purposes.~~ At the acquisition date, the tax base in A's tax jurisdiction of A's investment in B is 600. Reductions in the carrying amount of goodwill are not deductible for tax purposes. In addition, the cost of the goodwill would not be deductible if B were to dispose of its underlying business. The tax rate in A's tax jurisdiction is 30% and the tax rate in B's tax jurisdiction is 40%.

The fair value of the identifiable assets acquired and liabilities (excluding deferred tax assets and liabilities) ~~acquired~~ assumed by A is set out in the following table, together with their tax base in B's tax jurisdiction and the resulting temporary differences.

	Cost of Acquisition	*Tax Base*	*Temporary Differences*
Property, plant and equipment	270	155	115
Accounts receivable	210	210	-
Inventory	174	124	50
Retirement benefit obligations	(30)	-	(30)
Accounts payable	(120)	(120)	-
Fair value of the identifiable assets acquired and liabilities ~~acquired~~ assumed, excluding deferred tax	504	369	135

The deferred tax asset arising from the retirement benefit obligations is offset against the deferred tax liabilities arising from the property, plant and equipment and inventory (see paragraph 74 of the Standard).

No deduction is available in B's tax jurisdiction for the cost of the goodwill. Therefore, the tax base of the goodwill (in B's jurisdiction) is nil. However, in accordance with paragraph 15(a) of the Standard, A recognises no deferred tax liability for the taxable temporary difference associated, in B's tax jurisdiction, with the goodwill.

The carrying amount, in A's consolidated financial statements, of its investment in B is made up as follows:

Fair value of identifiable assets acquired and liabilities ~~acquired~~ assumed, excluding deferred tax	504
Deferred tax liability (135 at 40%)	(54)
Fair value of identifiable assets acquired and liabilities ~~acquired~~ assumed	450
Goodwill ~~(net of amortisation of nil)~~	150
Carrying amount	600

~~At~~ Because at the acquisition date ~~of acquisition,~~ the tax base, in A's tax jurisdiction, of A's investment in B is 600~~. Therefore~~, no temporary difference is associated, in A's jurisdiction, with the investment.

During X5, B's equity (incorporating the fair value adjustments made ~~on acquisition~~ as a result of the business combination) changed as follows:

At 1 January X5	450
Retained profit for X5 (net profit of 150, less dividend payable of 80)	70
At 31 December X5	520

A recognises a liability for any withholding tax or other taxes that it will suffer on the accrued dividend receivable of 80.

At 31 December X5, the carrying amount of A's underlying investment in B, excluding the accrued dividend receivable, is as follows:

Net assets of B	520
Goodwill ~~(net of amortisation of 30)~~	~~120~~ 150
Carrying amount	~~640~~ 670

The temporary difference associated with A's underlying investment is ~~40~~ 70 ~~as follows:~~. This amount is equal to the cumulative retained profit since the acquisition date.

~~Cumulative retained profit since acquisition~~	~~70~~
~~Cumulative amortisation of goodwill~~	~~(30)~~
	~~40~~

If A has determined that it will not sell the investment in the foreseeable future and that B will not distribute its retained profits in the foreseeable future, no deferred tax liability is recognised in relation to A's investment in B (see paragraphs 39 and 40 of the Standard). Note that this exception would apply for an investment in an associate only if there is an agreement requiring that the profits of the associate will not be distributed in the foreseeable future (see paragraph 42 of the Standard). A discloses the amount (~~40~~ 70) of the temporary difference for which no deferred tax is recognised (see paragraph 81(f) of the Standard).

…

Amendments to IAS 14 *Segment Reporting*

The second paragraph following the title of IAS 14 is amended as follows:

Paragraphs ~~116~~ 128 and ~~117~~ 129 of [draft] IAS 36, Impairment of Assets, set out ~~certain~~ disclosure requirements for reporting impairment losses by segment. In addition, paragraph 134 of [draft] IAS 36 sets out disclosure requirements for segments to which goodwill and identifiable intangible assets with indefinite useful lives have been allocated for the purpose of impairment testing.

Paragraphs 19 and 21 are amended as follows:

19. Examples of segment assets include current assets that are used in the operating activities of the segment, property, plant, and equipment, assets that are the subject of finance leases (IAS 17, Leases), and intangible assets. If a particular item of depreciation or amortisation is included in segment expense, the related asset is also included in segment assets. Segment assets do not include assets used for general ~~enterprise~~ entity or head-office purposes. Segment assets include operating assets shared by two or more segments if a reasonable basis for allocation exists. Segment assets include goodwill that is directly attributable to a segment or that can be allocated to a segment on a reasonable basis, and segment expense includes ~~related amortisation of~~ any impairment losses recognised for goodwill.

21. Measurements of segment assets and liabilities include adjustments to the prior carrying amounts of the identifiable segment assets and segment liabilities of a company acquired in a business combination ~~accounted for as a purchase~~, even if those adjustments are made only for the purpose of preparing consolidated financial statements and are not recorded in either the parent's or the subsidiary's separate financial statements. …

Amendments to IAS 16 *Property, Plant and Equipment*

Paragraph 54 is deleted.

54. [Deleted] ~~IAS 22, Business Combinations, explains how to deal with an impairment loss recognised before the end of the first annual accounting period commencing after a business combination that is an acquisition.~~

Amendments to IAS 19 *Employee Benefits*

Paragraph 108 is amended as follows:

108. In a business combination ~~that is an acquisition~~, an ~~enterprise~~ entity recognises assets and liabilities arising from post-employment benefits at the present value of the obligation less the fair value of any plan assets (see ~~IAS 22~~ [draft] IFRS X, Business Combinations). The present value of the obligation includes all of the following, even if the acquiree had not yet recognised them at the acquisition date ~~of the acquisition~~:

    (a) actuarial gains and losses that arose before the acquisition date ~~of the acquisition~~ (whether or not they fell inside the 10% 'corridor');

    (b) past service cost that arose from benefit changes, or the introduction of a plan, before the acquisition date ~~of the acquisition~~; and

    …

Paragraphs 19(c) and 70 of Appendix C to IAS 19 are amended as follows:

19. … The Board concluded that projected benefit methods are not appropriate, and should be eliminated, because such methods:

    …

    (c) do not attempt to measure fair value and cannot, therefore, be used in a business combination, as required by ~~IAS 22~~ [draft] IFRS X, Business Combinations. If an ~~enterprise~~ entity uses an accrued benefit method in a business combination, it would not be feasible for the ~~enterprise~~ entity to use a projected benefit method to account for the same obligation in subsequent periods.

70. Some commentators on E54 felt that the proposal to measure plan assets at market value would not be consistent with IAS 22, Business Combinations (subsequently replaced with [draft] IFRS X, Business Combinations), and with the measurement of financial assets as proposed in the discussion paper, Accounting for Financial Assets and Financial Liabilities, published by IASC's Financial Instruments Steering Committee in March 1997. Therefore, the Board decided that plan assets should be measured at fair value.

Amendments to IAS 27 *Consolidated and Separate Financial Statements*

Paragraphs 2, 15(a), 15(c)(i) and 23 are amended as follows:

2. This Standard does not deal with methods of accounting for business combinations and their effects on consolidation, including goodwill arising on a business combination (see ~~IAS 22 (revised 1998)~~ [draft] IFRS X, Business Combinations).

15. …

    (a) the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary are eliminated (see ~~IAS 22 (revised 1998)~~ [draft] IFRS X, Business Combinations, which describes the treatment of any resultant goodwill);

    …

    (c) …

        (i) the amount at the date of the original combination calculated in accordance with ~~IAS 22 (revised 1998)~~ [draft] IFRS X, Business Combinations; and

…

23. The income and expenses of a subsidiary are included in the consolidated financial statements from the acquisition date ~~of acquisition~~ as defined in ~~IAS 22 (revised 1998)~~ [draft] IFRS X, Business Combinations. …

Amendments to IAS 28 *Accounting for Investments in Associates*

The definition of 'joint control' in paragraph 3 is amended as follows:

> ***Joint control*** ***~~is the contractually agreed sharing of control~~*** ***over an economic activity exists only when the financial and operating decisions relating to the activity require the unanimous consent among the parties sharing control (the venturers).***

Paragraphs 17 and 23 are amended as follows:

17. An investment in an associate is accounted for under the equity method from the date on which it becomes an associate. On acquisition of the investment any difference ~~(whether positive or negative)~~ between the cost of the investment and the investor's share of the net fair value~~s~~ of the associate's ~~net~~ identifiable assets, liabilities and contingent liabilities ~~of the associate is treated as goodwill and~~ is accounted for in accordance with ~~IAS 22 (revised 1998)~~ [draft] IFRS X, Business Combinations. Therefore:

    (a) ~~Goodwill~~ goodwill relating to an associate is included in the carrying amount of the investment. However, amortisation of that goodwill is not permitted and is therefore not included in the determination of the investor's share of the associate's profits or losses;

    (b) any excess of the investor's share of the net fair value of the associate's identifiable assets, liabilities and contingent liabilities over the cost of the investment is excluded from the carrying amount of the investment and is instead included as income in the determination of the investor's share of the associate's profit or loss in the period in which the investment is acquired.

Appropriate adjustments to the investor's share of the associate's profits or losses after acquisition are also made to account for~~:~~

~~(a)~~ depreciation of the depreciable assets, based on their fair values at the acquisition date~~, of acquisition; and~~

~~(b) amortisation of the goodwill.~~

23. Because goodwill included in the carrying amount of an investment in an associate is not separately recognised, it is not tested for impairment separately by applying the requirements for impairment testing goodwill in [draft] IAS 36, Impairment of Assets. Instead, the entire carrying amount of the investment is tested under [draft] IAS 36 for impairment by comparing its recoverable amount (higher of value in use and net selling price) to its carrying amount whenever there is an indication that the investment may be impaired. ~~If there is an indication that an investment in an associate may be impaired, an entity applies IAS 36, Impairment of Assets.~~ In determining the value in use of the investment, an entity estimates:

    (a) its share of the present value of the estimated future cash flows expected to be generated by the ~~investee~~ associate as a whole, including the cash flows from the operations of the ~~investee~~ associate and the proceeds on the ultimate disposal of the investment; or

    (b) the present value of the estimated future cash flows expected to arise from dividends to be received from the investment and from its ultimate disposal.

Under appropriate assumptions, both methods give the same result. ~~Any resulting impairment loss for the investment is allocated in accordance with IAS 36. Therefore, it is allocated first to any remaining goodwill (see paragraph 17).~~

Amendments to IAS 31 *Financial Reporting of Interests in Joint Ventures*

The definition of 'joint control' in paragraph 2 is amended as follows:

> ***Joint control*** ~~***is the contractually agreed sharing of control***~~ ***over an economic activity*** ***exists only when the financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the venturers).***

Paragraph 6 is amended as follows:

6. The contractual arrangement establishes joint control over the joint venture. Such a requirement ensures that no single venturer is in a position to control unilaterally the activity. ~~The arrangement identifies those decisions in areas essential to the goals of the joint venture which require the consent of all the venturers and those decisions which may require the consent of a specified majority of the venturers.~~

Amendments to IAS 32 *Financial Instruments: Presentation and Disclosure*

Paragraph 1(d) is amended as follows:

1. This Standard shall be applied by all entities to all types of financial instruments except:

> ***…***
>
> ***(d) contracts for contingent consideration in a business combination (see*** ~~***paragraphs 65-67 of IAS 22***~~ ***[draft] IFRS X, Business Combinations).***
>
> ***…***

Amendments to IAS 34 *Interim Financial Reporting*

Paragraphs 16(i) and 18 are amended as follows:

16. An ~~***enterprise should***~~ ***entity shall include the following information, as a minimum, in the notes to its interim financial statements, if material and if not disclosed elsewhere in the interim financial report. The information*** ~~***should***~~ ***shall normally be reported on a financial year-to-date basis. However, the*** ~~***enterprise should***~~ ***entity shall also disclose any events or transactions that are material to an understanding of the current interim period:***

> ***…***
>
> ***(i) the effect of changes in the composition of the*** ~~***enterprise***~~ ***entity during the interim period, including business combinations, acquisition or disposal of subsidiaries and long-term investments, restructurings, and discontinuing operations. In the case of business combinations, the entity shall disclose the information required to be disclosed under paragraphs 65-72 of [draft] IFRS X, Business Combinations; and***
>
> ***…***

18. Other ~~International Accounting~~ Standards specify disclosures that should be made in financial statements. In that context, financial statements means complete sets of financial statements of the type normally included in an annual financial report and sometimes included in other reports. Except as required under paragraph 16(i), ~~The~~ the disclosures required by those other ~~International Accounting~~ Standards are not required if an ~~enterprise~~ entity's interim financial report includes only condensed financial statements and selected explanatory notes rather than a complete set of financial statements.

Amendments to IAS 35 *Discontinuing Operations*

Paragraph 26 is amended and new paragraph 26A is added as follows:

26. Goodwill is directly attributable to a component of an entity only if it can be allocated to that component on a reasonable and consistent basis. ~~The~~ Therefore, the carrying amount (recoverable amount) of a discontinuing operation includes the carrying amount (recoverable amount) of any goodwill that can be allocated on a reasonable and consistent basis to that discontinuing operation.

26A. Under [draft] IAS 36, each cash-generating unit to which a portion of the carrying amount of goodwill is allocated for impairment testing purposes represents the smallest cash-generating unit to which a portion of that carrying amount can be allocated on a reasonable and consistent basis. Therefore, goodwill cannot be identified or associated with an asset group at a level lower than that cash-generating unit, other than in an arbitrary manner. Consequently, if:

(a) goodwill is an operating asset of a component that the entity disposes of; but

(b) that component is at a lower level than a cash-generating unit to which goodwill has been allocated for impairment testing purposes,

that component cannot meet the definition of a discontinuing operation. This is because the component would not be one to which the goodwill can be allocated on a 'reasonable and consistent basis'. Therefore, to meet the definition of a discontinuing operation, a component that the entity disposes of that has goodwill as one of its operating assets must be either at the same level as a cash-generating unit to which goodwill has been allocated for impairment testing purposes or at some more aggregated level.

Amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

Paragraph 5 is amended as follows:

5. Where another ~~International Accounting~~ Standard deals with a specific type of provision, contingent liability or contingent asset, an ~~enterprise~~ entity applies that Standard instead of this Standard. For example, [draft] IFRS X, Business Combinations, addresses the treatment by an acquirer of contingent liabilities assumed in a business combination. Similarly, certain types of provisions are also addressed in Standards on:

(a) construction contracts (see IAS 11, Construction Contracts);

(b) income taxes (see IAS 12, Income Taxes);

(c) leases (see IAS 17, Leases). However, as IAS 17 contains no specific requirements to deal with operating leases that have become onerous, this Standard applies to such cases; and

(d) employee benefits (see IAS 19, Employee Benefits).

Amendments to IAS 39 *Financial Instruments: Recognition and Measurement*

Paragraph 1(g) is amended as follows:

1. This Standard shall be applied by all entities to all types of financial instruments except:

…

(g) contracts for contingent consideration in a business combination (see ~~paragraphs 65-67 of IAS 22~~ [draft] IFRS X, Business Combinations).

…

19. … A loan acquired by an entity in a business combination is regarded as originated by the acquiring entity provided that it was similarly classified by the acquired entity. The loan is measured at the acquisition date under ~~IAS 22~~ [draft] IFRS X, Business Combinations. …

Amendments to SIC-32 *Intangible Assets – Web Site Costs*

Paragraphs 8-18 are amended as follows:

8. A web site arising from development ~~should~~ shall be recognised as an intangible asset if, and only if, in addition to complying with the general requirements described in [draft] IAS ~~38.19~~ 38.18 for recognition and initial measurement, an ~~enterprise~~ entity can satisfy the requirements in [draft] IAS ~~38.45~~ 38.49. In particular, an ~~enterprise~~ entity may be able to satisfy the requirement to demonstrate how its web site will generate probable future economic benefits under [draft] IAS ~~38.45(d)~~ 38.49(d) when, for example, the web site is capable of generating revenues, including direct revenues from enabling orders to be placed. An ~~enterprise~~ entity is not able to demonstrate how a web site developed solely or primarily for promoting and advertising its own products and services will generate probable future economic benefits, and consequently all expenditure on developing such a web site ~~should~~ shall be recognised as an expense when incurred.

9. Any internal expenditure on the development and operation of an ~~enterprise~~ entity's own web site ~~should~~ shall be accounted for in accordance with [draft] IAS 38. The nature of each activity for which expenditure is incurred (eg training employees and maintaining the web site) and the web site's stage of development or post-development ~~should~~ shall be evaluated to determine the appropriate accounting treatment (additional guidance is provided in the Appendix to this Interpretation). For example:

   (a) the Planning stage is similar in nature to the research phase in [draft] IAS ~~38.42-44~~ 38.46-.48. Expenditure incurred in this stage ~~should~~ shall be recognised as an expense when it is incurred.

   (b) the Application and Infrastructure Development stage, the Graphical Design stage and the Content Development stage, to the extent that content is developed for purposes other than to advertise and promote an ~~enterprise~~ entity's own products and services, are similar in nature to the development phase in [draft] IAS ~~38.45-.52~~ 38.49-.56. Expenditure incurred in these stages ~~should~~ shall be included in the cost of a web site recognised as an intangible asset in accordance with paragraph 8 of this Interpretation when the expenditure can be directly attributed, or allocated on a reasonable and consistent basis, to preparing the web site for its intended use. For example, expenditure on purchasing or creating content (other than content that advertises and promotes an ~~enterprise~~ entity's own products and services) specifically for a web site, or expenditure to enable use of the content (eg a fee for acquiring a licence to reproduce) on the web site, ~~should~~ shall be included in the cost of development when this condition is met. However, in accordance with [draft] IAS ~~38.59~~ 38.63, expenditure on an intangible item that was initially recognised as an expense in previous financial statements ~~should~~ shall not be recognised as part of the cost of an intangible asset at a later date (eg ~~when~~ if the costs of a copyright have been fully amortised, and the content is subsequently provided on a web site).

   (c) expenditure incurred in the Content Development stage, to the extent that content is developed to advertise and promote an ~~enterprise~~ entity's own products and services (eg digital photographs of products), ~~should~~ shall be recognised as an expense when incurred in accordance with [draft] IAS ~~38.57(c)~~ 38.61(c). For example, when accounting for expenditure on professional services for taking digital photographs of an ~~enterprise~~ entity's own products and for enhancing their display, expenditure ~~should~~ shall be recognised as an expense as the professional services are received during the process, not when the digital photographs are displayed on the web site.

   (d) the Operating stage begins once development of a web site is complete. Expenditure incurred in this stage ~~should~~ shall be recognised as an expense when it is incurred unless it meets the criteria in [draft] IAS ~~38.60~~ 38.64.

10. A web site that is recognised as an intangible asset under paragraph 8 of this Interpretation ~~should~~ shall be measured after initial recognition by applying the requirements of [draft] IAS ~~38.63 -.78~~ 38.69-.84. The best estimate of a web site's useful life ~~should~~ shall be short.

11. An intangible asset is defined in [draft] IAS 38.7 as an identifiable non-monetary asset without physical substance ~~held for use in the production or supply of goods or services, for rental to others, or for administrative purposes~~. [Draft] IAS 38.8 provides computer software as a common example of an intangible asset. By analogy, a web site is another example of an intangible asset.

12. [Draft] IAS ~~38.56~~ 38.60 requires expenditure on an intangible item to be recognised as an expense when incurred unless it forms part of the cost of an intangible asset that meets the recognition criteria in [draft] IAS ~~38.18-.55~~ 38.17-.59. [Draft] IAS ~~38.57~~ 38.61 requires expenditure on start-up activities to be recognised as an expense when incurred. An ~~enterprise~~ entity developing its own web site for internal or external access is not undertaking a start-up activity to the extent that an internally generated intangible asset is created. The requirements and guidance in [draft] IAS ~~38.40 -.55~~ 38.44-.59, in addition to the general requirements described in [draft] IAS ~~38.19~~ 38.18 for recognition and initial measurement of an intangible asset, apply to expenditure incurred on the development of an ~~enterprise~~ entity's own web site. As described in [draft] IAS ~~38.53 -.55~~ 38.57-.59, the cost of a web site recognised as an internally generated intangible asset comprises all expenditure that can be directly attributed~~, or allocated on a reasonable and consistent basis,~~ and is necessary to creating, producing, and preparing the asset for ~~its intended use~~ it to be capable of operating in the manner intended by management.

13. [Draft] IAS ~~38.42~~ 38.46 requires expenditure on research (or on the research phase of an internal project) to be recognised as an expense when incurred. The examples provided in [draft] IAS ~~38.44~~ 38.48 are similar to the activities undertaken in the Planning stage of a web site's development. Consequently, expenditure incurred in the Planning stage of a web site's development is recognised as an expense when incurred.

14. [Draft] IAS ~~38.45~~ 38.49 requires an intangible asset arising from the development phase of an internal project to be recognised only if an ~~enterprise~~ entity can demonstrate fulfilment of the six criteria specified.

One of the criteria is to demonstrate how a web site will generate probable future economic benefits ([draft] IAS ~~38.45(d)~~ 38.49(d)). [Draft] IAS ~~38.48~~ 38.52 indicates that this criterion is met by assessing the economic benefits to be received from the web site and using the principles in [draft] IAS 36, Impairment of Assets, which considers the present value of estimated future cash flows from continuing use of the web site. Future economic benefits flowing from an intangible asset, as stated in [draft] IAS ~~38.17~~ 38.16, may include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the ~~enterprise~~ entity. Therefore, future economic benefits from a web site may be assessed when the web site is capable of generating revenues. A web site developed solely or primarily for advertising and promoting an ~~enterprise~~ entity's own products and services is not recognised as an intangible asset, because the ~~enterprise~~ entity cannot demonstrate the future economic benefits that will flow. Consequently, all expenditure on developing a web site solely or primarily for promoting and advertising an ~~enterprise~~ entity's own products and services is recognised as an expense when incurred.

15. Under [draft] IAS ~~38.19~~ 38.18, an intangible asset is recognised if, and only if, it meets specified criteria. [Draft] IAS ~~38.53~~ 38.57 indicates that the cost of an internally generated intangible asset is the sum of expenditure incurred from the date when the intangible asset first meets the specified recognition criteria. When an ~~enterprise~~ entity acquires or creates content for purposes other than to advertise and promote an ~~enterprise~~ entity's own products and services, it may be possible to identify an intangible asset (eg a licence or a copyright) separate from a web site. However, a separate asset is not recognised when expenditure is directly attributed~~, or allocated on a reasonable and consistent basis,~~ to creating, producing, and preparing the web site for ~~its intended use~~ it to be capable of operating in the manner intended by management – the expenditure is included in the cost of developing the web site.

16. [Draft] IAS ~~38.57(c)~~ 38.61(c) requires expenditure on advertising and promotional activities to be recognised as an expense when incurred. Expenditure incurred on developing content that advertises and promotes an ~~enterprise~~ entity's own products and services (eg digital photographs of products) is an advertising and promotional activity, and consequently recognised as an expense when incurred ~~in accordance with IAS 38.57(c)~~.

17. Once development of a web site is complete, an ~~enterprise~~ entity begins the activities described in the Operating stage. Subsequent expenditure to enhance or maintain an ~~enterprise~~ entity's own web site is recognised as an expense when incurred unless it meets the recognition criteria in [draft] IAS ~~38.60~~ 38.64. [Draft] IAS ~~38.61~~ 38.65 explains that if the expenditure is required to maintain the asset at its ~~originally assessed~~ standard of performance assessed immediately before the expenditure was made, then the expenditure is recognised as an expense when incurred.

18. An intangible asset is measured after initial recognition by applying the requirements of [draft] IAS ~~38.63-.78~~ 38.69-.84. The Allowed Alternative Treatment in [draft] IAS ~~38.64~~ 38.70 is applied only when the fair value of an intangible asset can be determined by reference to an active market. However, as an active market is unlikely to exist for web sites, the Benchmark Treatment applies. Additionally, ~~since IAS 38.84 states that an intangible asset always has a finite useful life, a web site that is recognised as an asset is amortised over the best estimate of its useful life under IAS 38.79. As~~ as indicated in [draft] IAS ~~38.81~~ 38.89, many intangible assets are susceptible to technological obsolescence, and given the history of rapid changes in technology, the useful life of web sites will be short.

The Effective Date paragraph is amended as follows:

Effective Date: This Interpretation becomes effective on 25 March 2002. The effects of adopting this Interpretation ~~should~~ shall be accounted for using the transitional requirements ~~of IAS 38.118-.121~~ in the version of IAS 38 that was issued in 1998. Therefore, when a web site does not meet the criteria for recognition as an intangible asset, but was previously recognised as an asset, the item ~~should~~ shall be derecognised at the date when this Interpretation becomes effective. When a web site exists and the expenditure to develop it meets the criteria for recognition as an intangible asset, but was not previously recognised as an asset, the intangible asset ~~should~~ shall not be recognised at the date when this Interpretation becomes effective. When a web site exists and the expenditure to develop it meets the criteria for recognition as an intangible asset, was previously recognised as an asset and initially measured at cost, the amount initially recognised is deemed to have been properly determined.

The Example in the Appendix to SIC-32 is amended as follows:

Stage / Nature of Expenditure	Accounting treatment
Planning • undertaking feasibility studies • defining hardware and software specifications • evaluating alternative products and suppliers • selecting preferences	Expense when incurred under [draft] IAS ~~38.42~~ 38.46
Application and Infrastructure Development • purchasing or developing hardware	Apply the requirements of IAS 16
• obtaining a domain name • developing operating software (eg operating system and server software) • developing code for the application • installing developed applications on the web server • stress testing	Expense when incurred, unless the expenditure ~~is~~ can be directly attributed~~, or allocated on a reasonable and consistent basis,~~ to preparing the web site ~~for its intended use,~~ to operate in the manner intended by management, and the web site meets the recognition criteria under [draft] IAS ~~38.19~~ 38.18 and [draft] IAS ~~38.45~~ 38.49*
Graphical Design Development • designing the appearance (eg layout and colour) of web pages	Expense when incurred, unless the expenditure ~~is~~ can be directly attributed~~, or allocated on a reasonable and consistent basis,~~ to preparing the web site ~~for its intended use,~~ to operate in the manner intended by management, and the web site meets the recognition criteria under [draft] IAS ~~38.19~~ 38.18 and [draft] IAS ~~38.45~~ 38.49*

Content Development • creating, purchasing, preparing (eg creating links and identifying tags), and uploading information, either textual or graphical in nature, on the web site before the completion of the web site's development. Examples of content include information about an ~~enterprise~~ entity, products or services offered for sale, and topics that subscribers access.	Expense when incurred under [draft] IAS ~~38.57(c)~~ 38.61(c) to the extent that content is developed to advertise and promote an ~~enterprise~~ entity's own products and services (eg digital photographs of products). Otherwise, expense when incurred, unless the expenditure ~~is~~ can be directly attributed~~, or allocated on a reasonable and consistent basis,~~ to preparing the web site ~~for its intended use~~ to operate in the manner intended by management, and the web site meets the recognition criteria under [draft] IAS ~~38.19~~ 38.18 and [draft] IAS ~~38.45~~ 38.49*
Operating • updating graphics and revising content • adding new functions, features and content • registering the web site with search engines • backing up data • reviewing security access • analysing usage of the web site	Expense when incurred, unless in rare circumstances it meets the criteria in [draft] IAS ~~38.60~~ 38.64, in which case the expenditure is included in the cost of the web site

Other • selling, administrative and other general overhead expenditure unless it can be directly attributed to preparing the web site ~~for use~~ to operate in the manner intended by management • clearly identified inefficiencies and initial operating losses incurred before the web site achieves planned performance [eg false start testing] • training employees to operate the web site	Expense when incurred under [draft] IAS ~~38.53 .58~~ 38.57-.62

* All expenditure on developing a web site solely or primarily for promoting and advertising an ~~enterprise~~ entity's own products and services is recognised as an expense when incurred under [draft] IAS ~~38.56~~ 38.60.

Withdrawal of International Financial Reporting Standards and SIC Interpretations

IAS 22 *Business Combinations* is withdrawn because the issues addressed in that Standard are now dealt with in [draft] IFRS X *Business Combinations*. However, IAS 22 shall continue to apply to the accounting for the following business combinations until guidance on the application of the purchase method to those transactions has been issued by the International Accounting Standards Board:

(a) combinations involving two or more mutual entities; and

(b) combinations in which separate entities or operations of entities are brought together to form a reporting entity by contract only without the obtaining of an ownership interest (for example, combinations in which separate entities are brought together by contract only to form a dual listed corporation).

The following SIC Interpretations are withdrawn because the issues addressed in them are now dealt with in [draft] IFRS X *Business Combinations*:

- SIC-22 *Business Combinations – Subsequent Adjustment of Fair Values and Goodwill Initially Reported*

- SIC-28 *Business Combinations – "Date of Exchange" and Fair Value of Equity Instruments*.