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International Accounting Standards Board



**INFORMATION FOR OBSERVERS**

**Board Meeting:** **15 May 2007, London**

**Project:** **Annual Improvements**

**Subject:** **Impairment of investment in associate (Agenda paper 5D)**

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1. The staff have identified that the following issue would be most appropriately resolved via the annual improvements process.

   *Issue:* Should IAS 28 be clarified to make clear the extent to which an impairment recognised against an investment in an associate shall be reversed?

## Staff recommendation

2. The staff recommends that the Board:

   - should add this issue to the annual improvements project; and
   - should amend IAS 28 as proposed in paragraph 12 of this paper.

## Background

3. The staff have been notified of unclear guidance in IAS 28 regarding the extent to which impairment reversals shall be recognised against an investment in an associate.

4. Impairment testing of an investment in an associate is performed by testing the entire carrying amount of the investment in the associate under IAS 36. Paragraph 33 of IAS 28 is clear that goodwill included in the carrying amount of an associate is not tested for impairment separately under IAS 36. The guidance in IAS 28 paragraph 33 is as follows:

> 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 IAS 36 *Impairment of Assets*. Instead, the entire carrying amount of the investment is tested under IAS 36 for impairment, by comparing its recoverable amount (higher of value in use and fair value less costs to sell) with its carrying amount, whenever application of the requirements in IAS 39 indicates that the investment may be impaired. 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 associate, including the cash flows from the operations of the 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.

5. The guidance in paragraph 33 of IAS 28 treats the investment in the associate as a single asset for impairment purposes. This suggests that the fact that goodwill is included in the carrying amount of an investment in an associate does not prevent the full reversal of impairment if the recoverable amount of the associate increases in a subsequent period.

**Summary of guidance on impairment reversals for cash generating units and for other investments**

6. Impairment losses recognised against non-financial assets within a cash generating unit are recognised first against goodwill and then against other non-financial assets pro rata to their carrying amount (IAS 36 paragraph 104). Reversals of impairment are recognised except reversals of impairment against goodwill (IAS 36 paragraphs 122-124).

7. The treatment of impairment losses and reversals thereof in IAS 39 varies according to the classification of the financial asset:
   (a) *Financial assets carried at amortised cost:* impairment losses are recognised in the income statement. Reversals are also recognised in the income statement (IAS 39 paragraph 65).
   (b) *Financial assets classified as available for sale:* impairment losses are recognised in the income statement. Reversals of impairment are recognised directly in equity as part of the ongoing re-measurement to fair value for AFS equity investments (IAS 39 paragraph 69). Impairment reversals of AFS debt investments are recognised in the income statement provided certain conditions are met (IAS 39 paragraph 70). The fair value increases recognised directly in equity are recycled to the income statement when the AFS investment is sold (IAS 39 paragraph 55(b)).
   (c) *Financial assets classified as at fair value through profit or loss:* No distinction is made between impairment losses and other reductions in fair value. All fair value increases and decreases are recognised in the income statement (IAS 39 paragraph 46).

**Proposed solution**

8. The constituent that drew our attention to this issue suggested treating the investment in the associate as a single asset and requiring reversal of impairment losses without the limits that are placed on the reversal of goodwill impairments when goodwill is recognised as a separate asset.

9. The staff agrees with this proposal and believes that it would not be appropriate to require allocation of the impairment against the goodwill balance embedded within the equity investment. Accordingly it is appropriate that impairment losses recognised against an investment in an associate are reversed if there is a subsequent recovery in the recoverable amount of the associate.

## Staff recommendation

10. IAS 28 should be amended as proposed in paragraph 12.

11. **Does the Board agree?**

## Drafting

12. The staff recommend that IAS 28 should be amended as follows:

## Impairment losses

…

33 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 IAS 36 *Impairment of Assets*. Instead, the entire carrying amount of the investment is tested under IAS 36 for impairment as a single asset, by comparing its recoverable amount (higher of value in use and fair value less costs to sell) with its carrying amount, whenever application of the requirements in IAS 39 indicates that the investment may be impaired. Impairment reversals are also accounted for under IAS 36. 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 associate, including the cash flows from the operations of the 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.

# Basis for Conclusions on
# Proposed Amendments to IAS 28 Investments in Associates

*This Basis for Conclusions accompanies, but is not part of, the draft amendments.*

## Impairment losses

BC1 The Board has identified unclear guidance in IAS 28 regarding the extent to which impairment reversals shall be recognised against an investment in an associate.

BC2 The Board has decided to address this ambiguity by clarifying that an investment in an associate is treated as a single asset for impairment testing and that reversals of impairment should be recognised against an investment in an associate in accordance with the guidance in IAS 36. It is not appropriate to allocate an impairment loss against an associate to the goodwill and other assets underlying the equity investment.