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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting:	**December 2008, London**
Project:	**IFRS for Private Entities (formerly IFRS for SMEs)**
Subject:	**Redeliberation of Approach for Impairment of Non-financial Assets Draft of Section 26 – Impairment of Non-financial Assets (Attachment to Agenda Paper 5B)**

Section 26
Impairment of Non-financial Assets

26.1 This section shall be applied in accounting for the **impairment** of all assets, other than the following, for which other sections of this [draft] standard establish requirements for recognition of impairment:

(a) **deferred tax assets** (see Section 28 *Income Taxes*).

(b) assets arising from **employee benefits** (see Section 27 *Employee Benefits*).

(c) **financial assets** within the scope of Section 11 *Financial Assets and Financial Liabilities*.

(d) **investment property** measured at **fair value** (see Section 15 *Investment Property*).

(e) **biological assets** related to agricultural activity measured at fair value less estimated costs to sell (see Section 35 *Specialised Industries*).

Impairment of inventories

Selling price less costs to complete and sell

26.2 An entity shall assess at each **reporting date** whether any inventories are impaired. The entity shall make the assessment by comparing the **carrying amount** of each item of inventory (or group of similar items—see paragraph 26.3) with its selling price less costs to complete and sell. If an item of inventory (or group of similar items) is impaired, the entity shall reduce the carrying amount of the inventory (or the group) to its selling price less costs to complete and sell. That reduction is an **impairment loss** and it is recognised immediately in profit or loss.

26.3 If it is **impracticable** to determine the selling price less costs to complete and sell for inventories item by item, the entity may group items of inventory relating to the same product line that have similar purposes or end uses, are produced and marketed in the same geographical area for the purpose of assessing impairment.

Reversal of impairment

26.4 An entity shall make a new assessment of selling price less costs to complete and sell in each subsequent period. When the circumstances that previously caused inventories to be impaired no longer exist or when there is clear evidence of an increase in selling price less costs to complete and sell because of changed economic circumstances, the entity shall reverse the amount of the impairment (ie the reversal is limited to the amount of the original impairment loss) so that the new carrying amount is the lower of the cost and the revised selling price less costs to complete and sell.

Impairment of non-financial assets other than inventories

General principles

26.5 If, and only if, the **recoverable amount** of an asset is less than its carrying amount, the entity shall reduce the carrying amount of the asset to its recoverable amount. That reduction is an impairment loss.

26.6 An entity shall recognise an impairment loss immediately in profit or loss,

Indicators of impairment

26.7 An entity shall assess at each reporting date whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset. If there is no indication of impairment, it is not necessary to estimate the recoverable amount.

26.8 If it is not possible to estimate the recoverable amount of the individual asset, an entity shall determine the recoverable amount of the **cash-generating unit** to which the asset belongs (the asset's cash-generating unit). That is because measuring recoverable amount requires forecasting cash flows, and sometimes individual assets do not generate cash flows by themselves. An asset's cash generating unit is the smallest identifiable group of assets that includes the asset and generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

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

External sources of information

(a) during the period, an 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 entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which an asset is dedicated.

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

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

Internal sources of information

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

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

(g) evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected. In this context economic performance includes operating results and cash flows.

26.10 If there is an indication that an asset may be impaired, this may indicate that the entity should review the remaining useful life, the **depreciation (amortisation)** method or the **residual value** for the asset and adjust it in accordance with the section of this [draft] standard applicable to the asset (eg Section 16 *Property, Plant and Equipment* and Section 17 *Intangible Assets other than Goodwill*), even if no impairment loss is recognised for the asset.

Measuring recoverable amount

26.11 The recoverable amount of an asset or a cash-generating unit is the higher of its **fair value less costs to sell** [NEW GLOSSARY TERM] and its **value in use** [NEW GLOSSARY TERM]. If it is not possible to estimate the recoverable amount of the individual asset, references in paragraphs 26.12 to 26.20 to asset should be read as references also to asset's cash-generating unit.

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

26.13 If it is not possible to determine fair value less costs to sell for an asset because there is no basis for making a reliable estimate of that amount, the entity shall use the value in use of the asset as its recoverable amount.

Fair value less costs to sell

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

Value in use

26.15 Value in use is the present value of the future cash flows expected to be derived from an asset. This present value calculation involves the following steps:

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

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

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

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

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

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

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

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

26.17 In measuring value in use, estimates of future cash flows shall include:

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

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

(c) net cash flows, if any, expected to be received (or paid) for the disposal of the asset at the end of its useful life in an arm's length transaction between knowledgeable, willing parties.

The entity may wish to use any recent financial budgets/forecasts to estimate the cash flows if available. To estimate cash flow projections beyond the period covered by the most recent budgets/forecasts an entity may wish to extrapolate the projections based on the budgets/forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified.

26.18 Estimates of future cash flows shall not include:

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

(b) income tax receipts or payments.

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

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

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

26.20 The discount rate (rates) used in the present value calculation shall be a pre-tax rate (rates) that reflect(s) current market assessments of:

(a) the time value of money; and

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

The discount rate (rates) used to measure an asset's value in use shall not reflect risks for which the future cash flow estimates have been adjusted, to avoid double-counting.

Recognising and measuring an impairment loss for a cash-generating unit

26.21 An impairment loss shall be recognised for a cash-generating unit if, and only if, the recoverable amount of the unit is less than the carrying amount of the unit. The impairment loss shall be allocated to reduce the carrying amount of the assets of the unit (group of units) in the following order:

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

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

26.22 However, an entity shall not reduce the carrying amount of any asset in the cash-generating unit below the highest of:

(a) its fair value less costs to sell (if determinable);

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

(c) zero.

26.23 Any excess amount of the impairment loss that cannot be allocated to an asset due to the restriction in paragraph 26.22 shall be allocated pro rata to the other assets of the cash-generating unit.

Reversal of an impairment loss

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

26.25 For all non-financial assets other than goodwill, an entity shall assess at each reporting date whether there is any indication that an impairment loss recognised in prior periods may no longer exist or may have decreased. Indications that an impairment loss may have decreased or may no longer exist are generally the opposite of those set out in paragraph 26.9. If any such indication exists, the entity shall determine whether all or part of the prior impairment loss should be reversed. The procedure for making that determination will depend on whether the prior impairment loss on the asset was based on:

(a) the recoverable amount of that individual asset (see paragraphs 26.26); or

(b) the recoverable amount of the cash-generating unit to which the asset belongs (see paragraph 26.27).

Reversal where recoverable amount was estimated for an individual impaired asset

26.26 Where the prior impairment loss was based on the recoverable amount of the individual impaired asset:

(a) The entity shall estimate the recoverable amount of the asset at the current reporting date.

(b) If the estimated recoverable amount of the asset exceeds its carrying amount, the entity shall increase the carrying amount to recoverable amount, subject to the limitation described in subparagraph (c) below. That increase is a reversal of an impairment loss. The entity shall recognise the reversal immediately in profit or loss.

(c) The reversal of an impairment loss shall not increase the carrying amount of the asset 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.

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

Reversal where recoverable amount was estimated for a cash-generating unit

26.27 Where the original impairment loss was based on the recoverable amount of the cash-generating unit to which the asset belongs:

(a) The entity shall estimate the recoverable amount of that cash-generating unit at the current reporting date.

(b) If the estimated recoverable amount of the cash-generating unit exceeds its carrying amount, that excess is a reversal of an impairment loss. The entity shall allocate the amount of that reversal to the assets of the unit, except for goodwill, pro rata with the carrying amounts of those assets, subject to the limitation described in subparagraph (c) below. Those increases in carrying amounts shall be treated as reversals of impairment losses for individual assets and recognised immediately in profit or loss.

(c) In allocating a reversal of an impairment loss for a cash-generating unit, the reversal shall not increase the carrying amount of any asset above the lower of

  (i) its recoverable amount, and

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

(d) Any excess amount of the reversal of the impairment loss that cannot be allocated to an asset due to the restriction in subparagraph (c) above shall be allocated pro rata to the other assets of the cash-generating unit, except for goodwill.

(e) After a reversal of an impairment loss is recognised, if applicable, the depreciation (amortisation) charge for any assets in the cash-generating unit 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.

Additional requirements for impairment of goodwill

26.28 Goodwill, by itself, cannot be sold. Nor does it generate cash flows to an entity that are independent of the cash flows of other assets. As a consequence, the fair value of goodwill cannot be measured directly. Therefore, the fair value of goodwill must be derived from measurement of the fair value of the cash generating unit of which the goodwill is a part.

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

26.30 If goodwill cannot be allocated to individual or groups of cash-generating units on a non-arbitrary basis, then for the purposes of testing goodwill the entity shall test the impairment of goodwill by determining the recoverable amount of

(a) the acquired entity in its entirety if the goodwill relates to an acquired entity which has not been integrated. Integrated means the acquired business has been restructured or dissolved into the reporting entity or other subsidiaries

(b) the entire group of entities, excluding any entities that have not been integrated if the goodwill relates to an entity which has been integrated.

In applying this paragraph, an entity will need to separate goodwill into goodwill relating to entities that have been integrated and goodwill relating to entities that have not been integrated. Also the entity should follow the requirements for cash-generating units in this section when calculating the recoverable amount of, and allocating impairment losses and reversals to assets belonging to, the acquired entity or the entire group of entities.

Disclosure

26.31 An entity shall disclose the following for each **category of assets** indicated in paragraph 26.32:

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

26.32 An entity shall disclose the information required by paragraph 26.31 for each of the following categories of asset:

(a) inventories

(b) property, plant and equipment (including investment property accounted for by the cost method)

(c) goodwill

(d) intangible assets other than goodwill

(e) investments in associates

(f) investments in joint ventures