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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting:	**Wednesday 20 February 2008, London**
Project:	**ED Annual improvements process–Comment analysis**
Subject:	**Q23 – Impairment of investments in associates (Agenda paper 4J)**

Issue: *Some entities that recognise an impairment loss in relation to an investment in an associate are not sure if they need to establish whether some, or all, of the impairment relates to goodwill of the associate. If that is the requirement then any reversal of the impairment is, presumably, only recognised to the extent that it does not relate to goodwill.*

The Board proposed clarifying that an investment in an associate should be treated as a single asset for impairment testing. The consequence would be that the impairment is not allocated to any assets of the associate, including goodwill. Accordingly, reversals of this impairment loss should be recognised as an adjustment to the investment in the associate to the extent that the recoverable amount of the associate increases.

STAFF RECOMMENDATION

1. The staff recommends that the Board proceed with the amendment to IAS 28 *Investments in Associates* to clarify the extent to which an impairment loss can be reversed, with additional explanation of its reasons for the amendment in the Basis for Conclusions.

BACKGROUND

2. The guidance in IAS 28 is unclear regarding the extent to which impairment reversals should be recognised as an adjustment to the carrying amount of an investment in an associate.

3. The annual improvements ED resolves this ambiguity by clarifying that an investment in an associate is treated as a single asset for impairment testing. It also specifies that any impairment loss is not allocated against any goodwill or other assets included in the investment balance. Accordingly, reversals of this impairment loss should be recognised as an adjustment to the investment in the associate to the extent that the recoverable amount of the associate increases.

COMMENT LETTER ANALYSIS

An overview

4. Of 75 letters received relating to the annual improvements process, 39 respondents commented on this issue. The majority of respondents agreed with the proposal in the ED. One third of respondents disagreed with the proposal, mainly arguing that the proposal is inconsistent with the requirements in IAS 36 *Impairment of Assets*, IAS 39 *Financial Instruments: Recognition and Measurement* and IAS 27 *Consolidated and Separate Financial Statements*. Some respondents argued that the Board should not discuss this issue as part of the annual improvements project.

5. Appendix 1 to this paper contains a summary of other specific points raised by the respondents.

Inconsistency with IAS 27 and proportionate consolidation

6. Some respondents[1] disagreed with the proposal because an entity would treat goodwill in an associate differently from goodwill in a subsidiary and in a jointly controlled entity accounted for using proportionate consolidation. An entity cannot reverse an impairment loss relating to goodwill in a subsidiary and such a jointly controlled entity; whereas an entity would reverse an impairment loss relating to the goodwill in an associate.

7. In addition, a few respondents[2] argued that goodwill is separately identifiable and for presentation reasons only it is subsumed within the carrying amount of an associate in the financial statements.

8. The staff notes that the nature of an investment in an associate is different from a subsidiary. The only asset that an entity controls and recognises when it has an investment in an associate is that investment; whereas an entity recognises separately all assets and liabilities of a subsidiary, as well as goodwill relating to that subsidiary. In accordance with existing requirements in IAS 28, goodwill included in the carrying amount of an associate is not separately recognised and, therefore not tested for impairment separately.

9. The staff acknowledges that an impairment loss on an interest in a jointly controlled entity would be treated differently depending on whether the entity is accounted for using the equity method or proportionate consolidation. ED 9 *Joint Arrangements* published in September 2007 proposes elimination of proportionate consolidation. As a result, an entity would use the equity method to account for its interests in joint ventures, thus removing this inconsistency relating to reversals of an impairment loss.

Inconsistency with IAS 36

10. Many constituents[3] that disagreed with the proposal argued that the amendment is inconsistent with IAS 36 regarding impairment of goodwill and supported the alternative view. They noted that the proposal could effectively result in recognition of internally generated goodwill.

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[1] Eg CL 21, 52, 54 and 58.
[2] Eg CL 54 and 70.
[3] Eg CL 17, 21, 40, 58, 60, 64 and 70.

> ‘‘we agree that this is an area of IAS 28 that needs clarification … we agree with the dissenting view of an IASB member and believe that if an associate has applied IAS 36 properly to its own assets and liabilities, any further impairment loss recognised by an investor should, by definition, relate to the goodwill that arose on acquisition by an investor of the associate. Therefore, according to the principle in IAS 36.124, such impairment losses should not later be reversed.’’ [CL 64]

11. One respondent (CL 24) also commented that the proposal is not consistent with the concept of allocating goodwill to a cash generating unit in IAS 36.

12. Again, the staff supports the proposal in the ED because of the differing nature of an investment in an associate and an investment in a subsidiary as detailed in paragraph 8 of this paper.

Inconsistency with IAS 39

13. Some respondents[4] disagreed with the amendment, because it conflicts with IAS 39. They claimed that, if an investment in an associate is treated as a single asset for an impairment test, it would be classified as an available-for-sale financial asset. An impairment loss on such financial assets is not reversed through profit or loss in accordance with IAS 39.

14. The staff notes that an entity applies the impairment indicators in IAS 39 when determining whether the investment is impaired. However, it tests the investment for impairment in accordance with IAS 36, rather than IAS 39. In deliberating the issue, the Board discussed whether an entity should apply IAS 36 or IAS 39 when testing an investment in an associate for impairment. While some expressed concern regarding the IAS 36 impairment test, the Board decided that it was beyond the scope of the annual improvements process to change the current requirement in IAS 28 to test an investment in an associate for impairment in accordance with IAS 36.

15. Accordingly, the staff does not consider it appropriate at this time to align the requirements of IAS 28 with those of IAS 39 regarding the reversal of an impairment loss, because IAS 39 is not applied when recognising that impairment loss.

[4] Eg CL 21, 60 and 62.

Clarification regarding reversals of an impairment loss

16. Some respondents[5] proposed further clarification regarding reversals of an impairment loss, questioning whether paragraphs 109-123 of IAS 36 should be applied.

17. The wording in the ED stated 'any reversals of those impairment losses are recognised to the extent that the recoverable amount of the investment subsequently increases'. The ED did not mention IAS 36 with respect to reversals of an impairment loss. The staff, however, is of the opinion that any reversal of an impairment loss would be recognised in accordance with IAS 36, consistent with the investment being tested for impairment in accordance with IAS 36. Therefore, the staff proposes that the words 'in accordance with IAS 36' are included in the amendment to paragraph 33 of IAS 28.

Scope of annual improvements project

18. Some respondents[6] claimed that the allocation of impairment loss in an associate is a difficult and important issue that should not be discussed in an annual improvement project. The respondents were of the opinion that it should be addressed in a longer-term project, particularly given the dissenting opinion.

19. The staff believes that the amendment should be made as part of the annual improvement process. The proposal does not introduce new requirements, but provides clarity to an ambiguous requirement. The staff also notes that the respondents that agreed with the proposal expressed the need for clarity.

Board's rationale

20. Some respondents[7] commented that the Board's rationale for the allocation and reversal of an impairment loss on an investment in an associate is not explained sufficiently.

21. The staff agrees with those respondents and recommends that the Basis for Conclusions explain the reasons for the Board's decisions.

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[5] EG CL 17, 51 and 40.
[6] Eg 64 and 69.
[7] Eg CL 50, 60 and 69

RECOMMENDATION AND QUESTION TO THE BOARD

22. The staff recommends that the Board proceed with the amendment to IAS 28 to clarify the extent to which an impairment loss can be reversed, with additional explanation of its reasons for the amendment in the Basis for Conclusions.

    Does the Board agree?

APPENDIX 1: OTHER COMMENTS NOT CONSIDERED IN DETAIL IN THE AGENDA PAPER

23. In addition to the comments discussed in the agenda paper, some respondents raised other points. The staff does not intend to discuss each of these in detail but instead has set out below a summary of the points raised with a staff response.

Allocation of an impairment loss to goodwill and other assets

24. Some respondents[8] noted that for the purpose of calculating adjustments to the investor's share of an associate's profits or losses, an entity would have to allocate the impairment loss to goodwill and other assets of the associate. .

> ''...According to paragraph 23 [of IAS 28] adjustment to the investor's share of the associate's profits or losses should reflect … the depreciation of the fair value of depreciable assets at the acquisition date. To the extent that the impairment loss represents an adjustment to those fair values net of depreciation, it will have an impact on the depreciation amounts of subsequent periods. For depreciation purposes, it is necessary to do the allocation of the impairment loss that you suggest to remove by the new phrases in paragraph 33.'' [CL 20]

25. The staff notes that an allocation of an impairment loss to goodwill and other assets would conflict with the existing requirements in IAS 28 regarding impairment testing. An entity should test its investment in an associate for impairment as a single asset.

Clarification of wording in paragraphs 23 and 33 of IAS 28

26. One respondent asked for clarity regarding impairment of goodwill discussed in paragraph 23 of IAS 28 and that discussed in paragraph 33 (the paragraph being amended).

27. The staff thinks clarification is unnecessary. Paragraph 23 clearly discusses impairment of goodwill that is recognised by the associate, whereas paragraph 33 discusses impairment of goodwill recognised by the investor.

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[8] Eg CL 10, 15 and 20.

Accounting difference that is not an economic difference

28. One respondent noted:

> ‘‘One of the effects of the proposal would be to create a significant inconsistency in accounting treatments dependent on the amount of goodwill recorded on the associate’s or joint venture’s own balance sheet, arising from an accounting or structuring difference rather than an economic difference. For example, the proposal would result in an impairment in the carrying value of an associate or joint venture interest in an ‘acquisition vehicle’ formed to acquire a business (where goodwill would be recorded in the books of the associate or joint venture and so any impairment would not be reversible) being treated completely differently from an impairment of an associate or joint venture interest made directly into the same business (where goodwill would exist within equity accounting and impairments would be reversible under this proposal).’’ [CL 52]

29. If structured differently in this way, the investor’s interest in the business is different from a legal perspective, and as a consequence, may be different in terms of voting rights, significant influence or for tax or other reasons. The staff is of the view that accounting for reversals of an impairment loss cannot take into account all differences in structure that may not equate to a similar difference from an economic perspective.

APPENDIX 2: PROPOSAL OF THE REDRAFTED AMENDMENT TO IAS 28

30. [Paragraph omitted from the observer note]