Project **Agenda decisions**

Topic **IAS 36 *Impairment of Assets*—Calculation of value in use**

Introduction

1. In September 2010 the IFRS Interpretations Committee (Interpretations Committee) published a tentative agenda decision not to add an item to its agenda relating to IAS 36 *Impairment of Assets*.
2. The request received by the Interpretations Committee was to clarify whether estimated future cash flows expected to arise from dividends, calculated using dividend discount models (DDMs), are an appropriate cash flow projection when determining the calculation of value in use of a cash-generating unit (CGU) in accordance with IAS 36.33.
3. The Interpretations Committee tentatively decided not to add the issue to its agenda, because the current principles in IAS 36 relating to the calculation of value in use of a CGU are clear and that any guidance that the Interpretations Committee could provide would be in the nature of application guidance.
4. In addition, the Interpretations Committee noted that calculations using DDMs would rarely be appropriate when calculating value in use of a CGU in consolidated financial statements.

Comments received

5. The Interpretations Committee received five comment letters[1] on this issue.

6. All the comment letters agreed with the tentative agenda decision not to add this issue to its agenda made by the Interpretations Committee.

7. Nevertheless, four of the comment letters contained suggestions for amendments to the wording of the tentative agenda decision.

8. These suggestions, which related to the wording of the tentative agenda decision included the following:

    (a) The sentence ‘calculations using DDMs would ***rarely*** be appropriate’ should be removed and it should clearly be stated that DDMs can be used when it is consistent with the requirements of IAS 36 because:

        (i) the tentative agenda decision may give the impression that DDMs are substantially prohibited even in a situation when the method is consistent with requirement of IAS 36; and

        (ii) if the Interpretations Committee’s intention is to prohibit a specific method for calculating value in use, then this should be done either through an interpretation or through an amendment to IAS 36.

    (b) The agenda decision should acknowledge that IAS 36.79 allows, because of practical reasons, for liabilities to be included in the calculation of recoverable amount of a CGU in specific fact patterns.

    (c) The distinction between consolidated financial statements and separate financial statements in the tentative agenda decision adds unnecessary complexity.

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[1] Deloitte Touche Tohmatsu, Canadian Accounting Standards Board (AcSB), European Financial Reporting Advisory Group(EFRAG), Michael Straut and ORGANISMO ITALIANO DI CONTABILITA OIC.

(d) The tentative agenda decision is inconsistent with a previous decision made by the Interpretations Committee. In May 2009 the Interpretations Committee concluded that it is not clear whether an entity applies the guidance in IAS 36 or IAS 39 *Financial Instruments; Recognition and Measurement* when testing an investment in an associate for impairment for the purposes of separate financial statements. However, the tentative agenda decision seems to assume that impairment of an investment in separate financial statements should be determined in accordance with IAS 36, not IAS 39 (or IFRS 9 *Financial Instruments*).

Staff analysis

The wording 'calculation using DDMs would rarely be appropriate' should be removed

9. The tentative agenda decision stated that calculations using DDMs would rarely be appropriate when calculating value in use of a CGU in consolidated financial statements.

10. Two comment letters pointed out that this may have the unintended consequence of prohibiting the use of DDMs to determine value in use of a CGU in consolidated financial statements, even in circumstances when use of DDMs would be consistent with the requirements of IAS 36.

11. The staff note that IAS 36 does not provide specific guidance about which methods can and cannot be used to calculate value in use.

12. Consequently, the staff believe that IAS 36 requires an entity to follow the principles in IAS 36 but also to use judgement in determining the specific method used to calculate value in use of a CGU.

13. The staff also believe that the Interpretations Committee's intention is not to prohibit entities from using the DDM to calculate value in use when appropriate, but to prescribe that careful consideration should be given to determining whether DDMs can be applied to calculate value in use of a CGU in accordance with the principles of IAS 36.

14. The staff also acknowledge that the use of the word ‘rarely’ in the tentative agenda decision may create unintended consequences and therefore suggest eliminating this wording.

15. Consequently, the staff suggest amending the tentative agenda decision wording as follows:

    (a) ‘calculations using DDMs would rarely be appropriate when calculating value in use of a CGU’ is deleted; and

    (b) the wording that an entity ‘should exercise<u> careful judgement to determine whether, in specific facts and circumstances, application of DDMs to calculate value in use of a CGU is consistent with the principles in IAS 36</u>’ is added.

IAS 36 allows a CGU to include liability

16. One comment letter noted that the tentative agenda decision does not reflect paragraph 79 of IAS 36, which allows a CGU to include liabilities in the calculation of value in use in specific circumstances for practical reasons.

17. Additionally, the comment letter also points out that the tentative agenda decision refers to paragraph 30-57 of IAS 36 as the guidance on the principles but that it does not also cite paragraphs 74-79.

18. The staff agree with these comments and suggest adding a mention of the guidance in paragraph 79 of IAS 36 and a reference to paragraphs 74–79.

The reference to separate financial statements is not necessary

19. One comment letter argues the reference to separate financial statements is not necessary because the distinction between consolidated financial statements and separate financial statements merely adds unnecessary complexity to the tentative agenda decision.

20. Additionally, the comment letter asserts that the Interpretations Committee should provide more explanation of the rationale for its tentative decision.

21. The staff agree that the reference to separate and consolidated financial statements may give rise to unnecessary complexity in the current wording of the tentative agenda decision.

22. Consequently, the staff suggest eliminating the reference to separate and consolidated financial statements and focusing on the contrast between calculating value in use of an investment and value in use of a CGU.

23. The staff also believe that the proposed wording for the final agenda decision explains the rationale of the Interpretation Committee's decision sufficiently.

Inconsistency with a previous decision by the Interpretations Committee

24. One comment letter points out that the tentative agenda decision is inconsistent with the previous decision made by the Interpretations Committee in May 2009 relating to whether, in its separate financial statements, the investor should determine impairment of an investment in an associate in accordance with IAS 36 or with IAS 39.

25. The staff propose that eliminating the reference to separate and consolidated financial statements in the amended agenda decision will address this concern.

Staff recommendation and question for the Interpretations Committee

26. The staff provide the proposed amended wording for the agenda decision in Appendix A.

27. The staff would like to put the following questions to the Interpretations Committee.

Questions for the Interpretations Committee
1. Does the Interpretations Committee agree with the staff's recommendation that the tentative agenda decision in September 2010 should be finalised, subject to some drafting changes? 2. Does the Interpretations Committee have any comments on the proposed wording for the final agenda decision in Appendix A?

Appendix A – Proposed wording for Agenda decision

A1. The staff proposes the following wording as published in *IFRIC Update* for the agenda decision (new text is underlined and deleted text is struck through):

IAS 36 *Impairment of Assets* – Calculation of value in use

The Committee received a request for clarification on whether estimated future cash flows expected to arise from dividends, that are calculated using dividend discount models (DDMs), are an appropriate cash flow projection when determining the calculation of value in use of a cash-generating unit (CGU) in accordance with paragraph 33 of IAS 36.

The Committee noted that paragraphs 30–57 <u>and paragraphs 74–79 of</u> ~~in~~ IAS 36 provide guidance on the principles to be applied in calculating value in use of a CGU. The Committee observed that calculations using DDMs may be appropriate when calculating value in use of a single asset, for example when determining whether an investment is impaired ~~in the separate financial statements of an entity~~. However, the Committee observed that ~~calculations using DDMs would rarely be appropriate when calculating value in use of a CGU in consolidated financial statements~~ <u>entities should exercise careful judgement to determine whether, in specific facts and circumstances, application of DDMs to calculate value in use of a CGU is consistent with the principles in IAS 36</u>. This is~~, the cash flows used to calculate value in use of a CGU in the consolidated financial statements may be different to the cash flows used to calculate value in use of an investment in the separate financial statements. For example, the cash flows associated with liabilities are usually excluded from the value in use of a CGU~~ <u>because DDMs typically include cash flows associated with liabilities that, in accordance with the principles of IAS 36, are usually excluded from the determination of value in use of a CGU unless paragraph 79 of IAS 36 applies</u>.

The Committee noted that the current principles in IAS 36 relating to the calculation of value in use of a CGU are clear and that any guidance <u>that</u> it could provide would be in the nature of application guidance. Consequently, the Committee ~~[~~decided~~]~~ not to add the issue to its agenda.

Deloitte.

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Mr Robert Garnett
Chairman
IFRS Interpretations Committee
30 Cannon Street
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Email: ifric@iasb.org

10 October 2010

Dear Mr Garnett,

Tentative agenda decision: IAS 36 Impairment of Assets — Calculation of value in use

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee's publication in the September 2010 IFRIC Update of the tentative decision not to take onto the IFRS Interpretations Committee's agenda a request for a clarification of IAS *36 Impairment of Assets* with respect to whether estimated future cash flows expected to arise from dividends that are calculated using dividend discount models (DDMs) are an appropriate cash flow projection when determining the value in use of a cash-generating unit (CGU) in accordance with paragraph 33 of IAS 36.

We agree with the IFRS Interpretations Committee's decision not to add this item onto its agenda for the reasons set out in the tentative agenda decision.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0)20 7007 0884.

Yours sincerely,

Veronica Poole
Global IFRS Leader - Technical

Mr. Robert P Garnett
Chairman of the IFRS Interpretations Committee
30 Cannon Street
London
United Kingdom

9 October 2010

Dear Mr. Robert P Garnett,

Tentative Agenda Decision: IAS 36 Impairment of Assets - Calculation of value in use

I am pleased to respond to the above tentative agenda decision published in the IFRIC update of September 2010.

The IFRS Interpretation Committee (here in after called "the Committee") was asked for clarification on whether estimated future cash flows expected to arise from dividends that are calculated using dividend discount models (DDMs), are an appropriate cash flow projection when determining the calculation of value in use of a cash-generating unit (CGU) in accordance with IAS 36 "*Impairment of Assets*".

The Committee noted that the current principles in IAS 36 relating to the calculation of value in use of a CGU are clear and that any guidance it could provide would be in the nature of application guidance. Consequently, the Committee decline to add the issue to its agenda.

I agree with the Committee's decision not to add item to its agenda for the reason mentioned in tentative agenda decision. However, I would like to bring to the notice of the Committee member the inconsistency noted in its September's tentative agenda decision and the IFRIC agenda decision posted in May 2009 IFRIC update concerning IAS 28 Investments in Associates—Impairment of investments in associates. In the earlier decision the Committee (previously IFRIC) concluded that it is not clear whether in its separate financial statements the investor should determine impairment of Associates and Subsidiaries in accordance with IAS 36 or IAS 39 Financial Instruments: Recognition and Measurement and referred the matter to the IASB for clarification as a part of Annual Improvement project. The Committee in its current tentative agenda decision implied that for assessment of impairment of investment in separate financial statement an investor refer IAS 36 and calculate value in use. The paragraph that cause such inference is as follows:

The Committee observed that calculations using DDMs may be appropriate when calculating value in use of a single asset, for example when determining whether an investment is impaired in the separate financial statements of an entity.
… That is, the cash flows used to calculate value in use of a CGU in the consolidated financial statements may be different to the cash flows used to calculate value in use of an investment in the separate financial statements.

The reference to value in use indicate that IAS 36 should be followed in determination of impairment of investment in associates or subsidiaries in separate financial statement which is not the case, had the impairment assessed under IAS 39.

In this regard I would request that the Committee should revisit its current tentative agenda decision in the light of May 2009 decision to avoid any ambiguity that may arise.

If you have any questions concerning my comments, please don’t hesitate to contact me.

Yours faithfully,

Michael Straut

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Mr Robert Garnett
Chairman
IFRS Interpretations Committee
30 Cannon Street
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14th October 2010

Re: IAS 36 *Impairment of Assets* – Calculation of value in use

Dear Sir,

We are pleased to provide our comments on the IFRS Interpretations Committee's (the IFRS IC) tentative decision not to proceed with the agenda item on our request for guidance to clarify whether an entity can use dividend discount models (DDMs) when performing an impairment test under IAS 36 *Impairment of Assets*.

The issue that we have submitted is to be considered in the context of the impairment test of goodwill in the consolidated financial statements of an entity operating in the financial services sector (i.e. a banks or insurance companies) with regard to the determination of the recoverable amount of a cash generating unit (CGU) or group of CGUs to which the goodwill is allocated.

We believe that the wording of the IFRS IC' tentative decision could have a significant and undesirable effect in practice because according to our analysis of the European practices, the use of DDMs in testing goodwill for impairment is rather common in the financial services sector. Some important banks and insurance companies state in their notes to the financial statements to apply DDMs in testing the goodwill for impairment purposes. For your convenience we attach a copy of our analysis (Appendix 1).
We understand that, on one hand the IFRS IC considers the IAS 36 clear (the IFRS IC' tentative decision states that: *The Committee noted that the current principles in IAS 36 relating to the calculation of value in use of a CGU are clear and that any guidance it could provide would be in the nature of application guidance),* but on the other hand the IFRS IC provides a sort of interpretation stating: *The Committee observed that calculations using DDMs may be appropriate when calculating value in use of a single asset, for example when determining whether an investment is impaired in the separate financial statements of an entity. However, the Committee observed that calculations using DDMs would rarely be*

appropriate when calculating value in use of a CGU in consolidated financial statements. In our opinion, the reference to rare circumstances in which the DDMs may be applied is akin to an interpretation because it introduces facts not addressed by the principle. Therefore if the intention of the IFRS IC was to make an interpretation the required due process should be followed. On the contrary, if the intention was not to make an interpretation, the IFRS IC should remove the statement above pointed out.

We note that if the IFRS IC's intention is to highlight that it is not always appropriate to apply the DDMs then it would be preferable a more general statement, for example saying that the DDMs could be an appropriate method of calculating value in use in accordance with IAS 36 in specific circumstances, as already mentioned in the staff paper.

Moreover the IFRS IC's rejection notice on "IAS 36 Impairment of Assets — Calculation of value in use" mentions paragraphs 30–57 of IAS 36, but it does not consider paragraphs 74–79 of IAS 36, that seem to justify the inclusion of liabilities in the recoverable amount of a CGU. In particular:

- IAS 36.75 states that: "*The carrying amount of a cash-generating unit shall be determined on a basis consistent with the way the recoverable amount of the cash-generating unit is determined*" and
- IAS 36. 79 states that: "*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 been recognised (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*."

Therefore, we recommend the IFRS IC to remove the reference to 'rarely be appropriate' from the wording for rejection. In addition, we suggest to the IFRS IC to amend the wording for rejection in order to clarify that DDMs can be applied provided these are consistent with the requirements of IAS 36.

Yours faithfully,
Angelo Casò
(Chairman)

APPENDIX 1
CONSOLIDATED FINANCIAL STATEMENTS ANALYSIS

Company	Disclosure
AXA	Value in use consists of the net assets and expected future earnings from existing and new business, taking into account the cash generating units' future cash flows. Value in use calculations are also based on valuation techniques For Life & Savings businesses, such valuation techniques include discounted cash flows taking into account: • the current shareholders' net asset value plus future profitability on business in force. Such techniques (embedded value types of methodologies) are industry specific valuation methods which are consistent with the principles of discounted earnings approaches as the value of business in force results from the projection of distributable earnings. The current shareholders' net asset value is adjusted to take into account any difference between the basis of cash flows projections used in the value of business in force calculations and IFRS.
Banco Sabadell	The valuation method used was to discount the future distributable net profits associated with the operations of Banco Urquijo
Deutsche Bank	The Group determines the recoverable amount of its primary cash-generating units on the basis of value in use and employs a valuation model based on discounted cash flows ("DCF"). The DCF model employed by the Group reflects the specifics of the banking business and its regulatory environment. The model calculates the present value of the estimated future earnings that are distributable to shareholders after fulfilling the respective regulatory capital requirements.
Generali	The fair value of the Cash Generating Unit is determined on the basis of current market quotation or valuation techinques usually adopted (mainly DDM or Enterprise value).

MPS	The impairment test process of MPS Group goodwill as of 31 December 2008 was carried out identifying the recoverable value of each CGU in the use value. The recoverable value of the MPS Group and of the CGUs was also determined thanks to a leading advising company (Advisor). The recoverable value of the MPS Group and of the banking CGUs was estimated with the Dividend Discount Model (DDM) method in the Excess Capital version determining the value of a company on the basis of future dividend flows which may be distributed to the shareholders taking into account the development expectations and in compliance with the capital requirements provided for by the Supervisory Authority discounted at a rate expressing the specific capital risk.
Societe generale	The recoverable amount of a CGU is calculated using the most appropriate method, notably by discounting net cash flows expected from the whole CGU rather than from individual legal entities. Cash flow used in that calculation are income available for distribution generated by all entities included in the CGU...
UBS	The recoverable amount is determined using a proprietary model based on discounted cash flows, which has been adapted to give effect to the special features of the banking business and its regulatory environment. The recoverable amount is determined by estimating streams of earnings available to shareholders in the next five years, discounted to their present values

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October 6, 2010

(by e-mail to ifric@ifrs.org)

IFRS Interpretations Committee
30 Cannon Street,
London EC4M 6XH
United Kingdom

Dear Sirs,

Re: Tentative agenda decision on IAS 36 *Impairment of Assets* – Calculation of value in use

This letter is the response of the staff of the Canadian Accounting Standards Board to the IFRS Interpretation Committee's tentative agenda decision on whether dividend discount models are appropriate when calculating the value in use of a cash-generating unit under IAS 36 *Impairment of Assets*. This tentative agenda decision was published in the September 2010 IFRIC Update.

The views expressed in this letter take into account comments from individual members of the staff of the Canadian Accounting Standards Board. They do not necessarily represent the view of the Canadian Accounting Standards Board or a common view of its staff. Views of the Canadian Accounting Standards Board are developed only through due process.

We agree with the Committee's decision not to add this item to its agenda for the reasons provided in the tentative agenda decision. However, we think the tentative agenda decision needs to be modified to clarify the Committee's rationale. We think the second paragraph of the tentative agenda decision is unclear and recommend removing the references to separate financial statements.

The tentative agenda decision explains there may be differences between calculating value in use of an investment in separate financial statements and in calculating value in use of a cash generating unit in consolidated financial statements. However, the distinction between separate and consolidated financial statements adds unnecessary complexity to the tentative agenda decision. We recommend removing the references to separate financial statements in order to emphasize that the method used to calculate value in use may be different for a single asset than for a cash-generating unit.

We think it is important for the tentative agenda decision to focus on explaining why calculations using dividend discount models would rarely be appropriate when calculating value in use of a cash-generating unit.

The Appendix includes suggested amendments to the tentative agenda decision to reflect our comments.

However, if the Committee decides to retain the references to separate financial statements in the tentative agenda decision, we recommend expanding the description of the issue to include the context of the request (i.e. determining value in use of a cash-generating unit that coincides with a legal entity, for example, a subsidiary, in the consolidated financial statements of the parent company).

We would be pleased to provide more detail if you require. If so, please contact Kathryn Ingram, Principal, Accounting Standards at +1 416 204-3475 (e-mail kathryn.ingram@cica.ca).

Yours truly,

Peter Martin

Peter Martin, CA
Director,
Accounting Standards

Appendix

We suggest clarifying the tentative agenda decision as follows:

IAS 36 Impairment of Assets - Calculation of value in use

The Committee received a request for clarification on whether estimated future cash flows expected to arise from dividends, that are calculated using dividend discount models (DDMs), are an appropriate cash flow projection when determining the calculation of value in use of a cash-generating unit (CGU) in accordance with paragraph 33 of IAS 36.

The Committee noted that paragraphs 30–57 in IAS 36 provide guidance on the principles to be applied in calculating value in use of a CGU. The Committee observed that calculations using DDMs may be appropriate when calculating value in use of a single asset, for example when determining whether an investment is impaired~~ in the separate financial statements of an entity~~. However, the Committee observed that calculations using DDMs would rarely be appropriate when calculating value in use of a CGU <u>primarily because DDMs include </u>~~in consolidated financial statements. That is, the cash flows used to calculate value in use of a CGU in the consolidated financial statements may be different to the cash flows used to calculate value in use of an investment in the separate financial statements. For example, the ~~cash flows associated with liabilities, such as <u>those from financing activities and income taxes. In contrast, under IAS 36, the calculation of value in use does not include cash flows from these liabilities.</u>~~are usually excluded from the value in use of a CGU.~~

The Committee noted that the current principles in IAS 36 relating to the calculation of value in use of a CGU are clear and that any guidance it could provide would be in the nature of application guidance. Consequently, the Committee [decided] not to add the issue to its agenda.

DRAFT COMMENT LETTER
Comments should be submitted by 27 October 2010 to
Commentletters@efrag.org

XX October 2010

Robert Garnett, Chairman
IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Mr. Garnett,

Re: IAS 36 *Impairment of Assets* – Calculation of value in use

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the IFRS Interpretations Committee's ('the Interpretations Committee') tentative decision not to proceed with the agenda item on a request for guidance to clarify whether an entity can use a dividend discount model (DDM) when calculating value in use (VIU) for the purpose of performing an impairment test under IAS 36 *Impairment of Assets* in the consolidated financial statements of a parent entity. The issue relates to a situation when a subsidiary of the parent entity operates in the financial sector and is considered to be a separate cash-generating unit (CGU).

This letter is submitted in EFRAG's capacity of contributing to the Interpretations Committee's due process. EFRAG addresses wordings for rejection published by the Interpretations Committee by exception, i.e. when European constituents express concern that they are expected to have a significant and undesirable effect in practice and EFRAG would share that concern after proper assessment of the wording for rejection. Such circumstances have just arisen with the Interpretations Committee issuing its tentative wording for rejection on the application of dividend discount models.

The rejection notice in respect to the issue specifies that '…calculations using DDMs would rarely be appropriate when calculating value in use of a CGU in consolidated financial statements.' The Interpretations Committee supported its tentative conclusion by explaining that it believes that the cash flows used to calculate value in use of a CGU in the consolidated financial statements may be different to the cash flows used to calculate value in use of an investment in the separate financial statements. It added that for example, the cash flows associated with liabilities are usually excluded from the value in use of a CGU. It concluded that the current principles in IAS 36 relating to the calculation of the VIU of CGU are clear.

In EFRAG's view, it is inappropriate for the Interpretations Committee to create, what appears to be, a rebuttable presumption in the wording for rejection by stating that 'using DDMs would rarely be appropriate'. In our view, the wording for rejection risks prohibiting in practice the use of a particular approach in IAS 36, even in those cases when the approach could be applied in a manner that is consistent with the principles in paragraphs 30 to 57 of IAS 36 for the calculation of VIU.

Therefore, we recommend the Interpretations Committee to remove the reference to 'rarely be appropriate' from the wording for rejection. In addition, we recommend that the Interpretations Committee amend the wording for rejection to clarify that a DDM can be used provided this is consistent with the requirements under IAS 36.

If you would like to discuss our comments further, please do not hesitate to contact Isabel Batista, Alessandro Turris or me.

Yours sincerely

Françoise Flores

EFRAG, Chairman