

## I

(Acts whose publication is obligatory)

**COMMISSION REGULATION (EC) No 2236/2004**

**of 29 December 2004**

**amending Regulation (EC) No 1725/2003 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council as regards International Financial Reporting Standards (IFRSs) Nos 1, 3 to 5, International Accounting Standards (IASs) Nos 1, 10, 12, 14, 16 to 19, 22, 27, 28, 31 to 41 and the interpretations by the Standard Interpretation Committee (SIC) Nos 9, 22, 28 and 32**

(Text with EEA relevance)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

Having regard to Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards <sup>(1)</sup>, and in particular Article 3(1) thereof,

Whereas:

(1) By Commission Regulation (EC) No 1725/2003 <sup>(2)</sup>, certain international standards and interpretations that were extant at 1 September 2002 were adopted.

(2) On 31 March 2004, the International Accounting Standard Board (IASB) published among others three new standards, International Financial Reporting Standards (IFRSs) Nos 3 to 5, and two revised standards, IASs Nos 36 and 38, containing consequential changes. Those new standards further complete the 'stable platform', that is the set of standards which listed Community companies will have to apply in their consolidated accounts from 1 January 2005 onwards. The general objective is to improve the quality of International Accounting Standards (IASs) as well as to increase convergence of accounting standards around the world.

(3) The consultation with technical experts in the field confirms that the new IFRSs and the revised IASs meet the technical criteria for adoption set out in Article 3 of Regulation (EC) No 1606/2002, and in particular the requirement of being conducive to the European public good.

(4) The adoption of IAS 36 implies, by way of consequence, amendments to IAS 16, which was adopted by Regulation (EC) No 1725/2003, in order to ensure consistency between the accounting standards concerned.

(5) The adoption of IFRS 3, 4 and 5 implies, by way of consequence, amendments to other international accounting standards and interpretations in order to ensure consistency between international accounting standards. Those consequential amendments are affecting International Financial Reporting Standard (IFRS) No 1, International Accounting Standards (IASs) Nos 1, 10, 12, 14, 16 to 19, 27, 28, 31 to 34, 36 to 41 and interpretation issued by the Standard Interpretation Committee (SIC) No 32. In addition, the adoption of IFRS 3 makes redundant the International Accounting Standard (IAS) 22 and the interpretations issued by the Standard Interpretation Committee (SIC) Nos 9, 22 and 28; they should accordingly be replaced. Furthermore, adoption of IFRS 5 should lead to a replacement of IAS 35.

(6) Regulation (EC) No 1725/2003 should therefore be amended accordingly.

(7) The measures provided for in this Regulation are in accordance with the opinion of the Accounting Regulatory Committee,

HAS ADOPTED THIS REGULATION:

*Article 1*

The Annex to Regulation (EC) No 1725/2003 is amended as follows:

(1) The International Accounting Standard (IAS) 22 and the interpretations by the Standard Interpretation Committee (SIC) Nos 9, 22 and 28 are replaced by International Financial Reporting Standard (IFRS) 3 [*Business combinations*] as set out in the Annex to this Regulation;

<sup>(1)</sup> OJ L 243, 11.9.2002, p. 1.

<sup>(2)</sup> OJ L 261, 13.10.2003, p. 1. Regulation as last amended by Regulation (EC) No 2086/2004 (OJ L 363, 9.12.2004, p. 1).

- (2) The (IFRS) Nos 4 [*Insurance contracts*] is inserted as set out in the Annex to this Regulation;
- (3) IAS 35 is replaced by IFRS 5 [*Non-current assets held for sale and discontinued operations*] as set out in the Annex to this Regulation;
- (4) IASs Nos 36 and 38 are replaced by IASs Nos 36 and 38 as set out in the Annex to this Regulation;
- (5) The adoption of IFRS 3 implies, by way of consequence, amendments to IFRS 1, to IASs 12, 14, 16, 19, 27, 28, 31, 32, 33, 34, 37, 39 and to SIC 32 in order to ensure consistency between accounting standards;
- (6) The adoption of IFRS 4 implies, by way of consequence, amendments to IFRS 1 and to IASs 18, 19, 32, 37, 39, 40 in order to ensure consistency between international accounting standards;
- (7) The adoption of IFRS 5 implies, by way of consequence, amendments to IFRS 1, IFRS 3 and to IASs 1, 10, 16, 17, 27, 28, 31, 36, 37, 38, 40, 41 in order to ensure consistency between international accounting standards;

Article 2

This Regulation shall enter into force on the third day following that of its publication in the *Official Journal of the European Union*.

It shall apply from 1 January 2005 at the latest.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 29 December 2004.

For the Commission  
Charlie McCREEVY  
Member of the Commission

---

## ANNEX

## INTERNATIONAL FINANCIAL REPORTING STANDARDS

No	Title
IFRS 3	Business combinations
IFRS 4	Insurance contracts
IFRS 5	Non-current assets held for sale and discontinued operations
IAS 36	Impairment of assets
IAS 38	Intangible assets

**Business combinations**

## SUMMARY

	Paragraphs
Objective	1
Scope	2-13
Identifying a business combination	4-9
Business combinations involving entities under common control	10-13
Method of accounting	14-15
Application of the purchase method	16-65
Identifying the acquirer	17-23
Cost of a business combination	24-35
Adjustments to the cost of a business combination contingent on future events	32-35
Allocating the cost of a business combination to the assets acquired and liabilities and contingent liabilities assumed	36-60
Acquiree's identifiable assets and liabilities	41-44
Acquiree's intangible assets	45-46
Acquiree's contingent liabilities	47-50
Goodwill	51-55
Excess of acquirer's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over cost	56-57
Business combination achieved in stages	58-60
Initial accounting determined provisionally	61-65
Adjustments after the initial accounting is complete	63-64
Recognition of deferred tax assets after the initial accounting is complete	65
Disclosure	66-77
Transitional provisions and effective date	78-85
Previously recognised goodwill	79-80
Previously recognised negative goodwill	81
Previously recognised intangible assets	82
Equity accounted investments	83-84
Limited retrospective application	85
Withdrawal of other pronouncements	86-87

**OBJECTIVE**

1. The objective of this IFRS is to specify the financial reporting by an entity when it undertakes a *business combination*. In particular, it specifies that all business combinations should be accounted for by applying the purchase method. Therefore, the acquirer recognises the acquiree's identifiable assets, liabilities and *contingent liabilities* at their *fair values* at the *acquisition date*, and also recognises *goodwill*, which is subsequently tested for impairment rather than amortised.

**SCOPE**

2. Except as described in paragraph 3, entities shall apply this IFRS when accounting for business combinations.
3. This IFRS does not apply to:
  - (a) business combinations in which separate entities or *businesses* are brought together to form a *joint venture*.
  - (b) *business combinations involving entities or businesses under common control*.
  - (c) business combinations involving two or more *mutual entities*.
  - (d) business combinations in which separate entities or businesses are brought together to form a *reporting entity* by contract alone without the obtaining of an ownership interest (for example, combinations in which separate entities are brought together by contract alone to form a dual listed corporation).

*Identifying a business combination*

4. A business combination is the bringing together of separate entities or businesses into one reporting entity. The result of nearly all business combinations is that one entity, the acquirer, obtains *control* of one or more other businesses, the acquiree. If an entity obtains control of one or more other entities that are not businesses, the bringing together of those entities is not a business combination. When an entity acquires a group of assets or net assets that does not constitute a business, it shall allocate the cost of the group between the individual identifiable assets and liabilities in the group based on their relative fair values at the date of acquisition.
5. A business combination may be structured in a variety of ways for legal, taxation or other reasons. It may involve the purchase by an entity of the equity of another entity, the purchase of all the net assets of another entity, the assumption of the liabilities of another entity, or the purchase of some of the net assets of another entity that together form one or more businesses. It may be effected by the issue of equity instruments, the transfer of cash, cash equivalents or other assets, or a combination thereof. The transaction may be between the shareholders of the combining entities or between one entity and the shareholders of another entity. It may involve the establishment of a new entity to control the combining entities or net assets transferred, or the restructuring of one or more of the combining entities.
6. A business combination may result in a parent-subsidary relationship in which the acquirer is the *parent* and the acquiree a *subsidiary* of the acquirer. In such circumstances, the acquirer applies this IFRS in its consolidated financial statements. It includes its interest in the acquiree in any separate financial statements it issues as an investment in a subsidiary (see IAS 27 *Consolidated and Separate Financial Statements*).

**IFRS 3**

7. A business combination may involve the purchase of the net assets, including any goodwill, of another entity rather than the purchase of the equity of the other entity. Such a combination does not result in a parentsubsidiary relationship.
8. Included within the definition of a business combination, and therefore the scope of this IFRS, are business combinations in which one entity obtains control of another entity but for which the date of obtaining control (ie the acquisition date) does not coincide with the date or dates of acquiring an ownership interest (ie the *date or dates of exchange*). This situation may arise, for example, when an investee enters into share buy-back arrangements with some of its investors and, as a result, control of the investee changes.
9. This IFRS does not specify the accounting by venturers for interests in joint ventures (see IAS 31 *Interests in Joint Ventures*).

*Business combinations involving entities under common control*

10. A business combination involving entities or businesses under common control is a business combination in which all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.
11. A group of individuals shall be regarded as controlling an entity when, as a result of contractual arrangements, they collectively have the power to govern its financial and operating policies so as to obtain benefits from its activities. Therefore, a business combination is outside the scope of this IFRS when the same group of individuals has, as a result of contractual arrangements, ultimate collective power to govern the financial and operating policies of each of the combining entities so as to obtain benefits from their activities, and that ultimate collective power is not transitory.
12. An entity can be controlled by an individual, or by a group of individuals acting together under a contractual arrangement, and that individual or group of individuals may not be subject to the financial reporting requirements of IFRSs. Therefore, it is not necessary for combining entities to be included as part of the same consolidated financial statements for a business combination to be regarded as one involving entities under common control.
13. The extent of *minority interests* in each of the combining entities before and after the business combination is not relevant to determining whether the combination involves entities under common control. Similarly, the fact that one of the combining entities is a subsidiary that has been excluded from the consolidated financial statements of the group in accordance with IAS 27 is not relevant to determining whether a combination involves entities under common control.

**METHOD OF ACCOUNTING**

14. **All business combinations shall be accounted for by applying the purchase method.**
15. The purchase method views a business combination from the perspective of the combining entity that is identified as the acquirer. The acquirer purchases net assets and recognises the assets acquired and liabilities and contingent liabilities assumed, including those not previously recognised by the acquiree. The measurement of the acquirer's assets and liabilities is not affected by the transaction, nor are any additional assets or liabilities of the acquirer recognised as a result of the transaction, because they are not the subjects of the transaction.

**APPLICATION OF THE PURCHASE METHOD**

16. Applying the purchase method involves the following steps:
  - (a) identifying an acquirer;

- (b) measuring the cost of the business combination;

and

- (c) allocating, at the acquisition date, the cost of the business combination to the assets acquired and liabilities and contingent liabilities assumed.

*Identifying the acquirer*

**17. An acquirer shall be identified for all business combinations. The acquirer is the combining entity that obtains control of the other combining entities or businesses.**

18. Because the purchase method views a business combination from the acquirer's perspective, it assumes that one of the parties to the transaction can be identified as the acquirer.

19. Control is the power to govern the financial and operating policies of an entity or business so as to obtain benefits from its activities. A combining entity shall be presumed to have obtained control of another combining entity when it acquires more than one-half of that other entity's voting rights, unless it can be demonstrated that such ownership does not constitute control. Even if one of the combining entities does not acquire more than one-half of the voting rights of another combining entity, it might have obtained control of that other entity if, as a result of the combination, it obtains:

- (a) power over more than one-half of the voting rights of the other entity by virtue of an agreement with other investors;

or

- (b) power to govern the financial and operating policies of the other entity under a statute or an agreement;

or

- (c) power to appoint or remove the majority of the members of the board of directors or equivalent governing body of the other entity;

or

- (d) power to cast the majority of votes at meetings of the board of directors or equivalent governing body of the other entity.

20. Although sometimes it may be difficult to identify an acquirer, there are usually indications that one exists. For example:

- (a) if the fair value of one of the combining entities is significantly greater than that of the other combining entity, the entity with the greater fair value is likely to be the acquirer;

- (b) if the business combination is effected through an exchange of voting ordinary equity instruments for cash or other assets, the entity giving up cash or other assets is likely to be the acquirer;

and

- (c) if the business combination results in the management of one of the combining entities being able to dominate the selection of the management team of the resulting combined entity, the entity whose management is able so to dominate is likely to be the acquirer.

**IFRS 3**

21. In a business combination effected through an exchange of equity interests, the entity that issues the equity interests is normally the acquirer. However, all pertinent facts and circumstances shall be considered to determine which of the combining entities has the power to govern the financial and operating policies of the other entity (or entities) so as to obtain benefits from its (or their) activities. In some business combinations, commonly referred to as reverse acquisitions, the acquirer is the entity whose equity interests have been acquired and the issuing entity is the acquiree. This might be the case when, for example, a private entity arranges to have itself 'acquired' by a smaller public entity as a means of obtaining a stock exchange listing. Although legally the issuing public entity is regarded as the parent and the private entity is regarded as the subsidiary, the legal subsidiary is the acquirer if it has the power to govern the financial and operating policies of the legal parent so as to obtain benefits from its activities. Commonly the acquirer is the larger entity; however, the facts and circumstances surrounding a combination sometimes indicate that a smaller entity acquires a larger entity. Guidance on the accounting for reverse acquisitions is provided in paragraphs B1-B15 of Appendix B.
22. When a new entity is formed to issue equity instruments to effect a business combination, one of the combining entities that existed before the combination shall be identified as the acquirer on the basis of the evidence available.
23. Similarly, when a business combination involves more than two combining entities, one of the combining entities that existed before the combination shall be identified as the acquirer on the basis of the evidence available. Determining the acquirer in such cases shall include a consideration of, amongst other things, which of the combining entities initiated the combination and whether the assets or revenues of one of the combining entities significantly exceed those of the others.

*Cost of a business combination*

24. **The acquirer shall measure the cost of a business combination as the aggregate of:**
  - (a) **the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the acquirer, in exchange for control of the acquiree;**  
  
**plus**
  - (b) **any costs directly attributable to the business combination.**
25. The acquisition date is the date on which the acquirer effectively obtains control of the acquiree. When this is achieved through a single exchange transaction, the date of exchange coincides with the acquisition date. However, a business combination may involve more than one exchange transaction, for example when it is achieved in stages by successive share purchases. When this occurs:
  - (a) the cost of the combination is the aggregate cost of the individual transactions;  
  
and
  - (b) the date of exchange is the date of each exchange transaction (ie the date that each individual investment is recognised in the financial statements of the acquirer), whereas the acquisition date is the date on which the acquirer obtains control of the acquiree.
26. Assets given and liabilities incurred or assumed by the acquirer in exchange for control of the acquiree are required by paragraph 24 to be measured at their fair values at the date of exchange. Therefore, when settlement of all or any part of the cost of a business combination is deferred, the fair value of that deferred component shall be determined by discounting the amounts payable to their present value at the date of exchange, taking into account any premium or discount likely to be incurred in settlement.

27. The published price at the date of exchange of a quoted equity instrument provides the best evidence of the instrument's fair value and shall be used, except in rare circumstances. Other evidence and valuation methods shall be considered only in the rare circumstances when the acquirer can demonstrate that the published price at the date of exchange is an unreliable indicator of fair value, and that the other evidence and valuation methods provide a more reliable measure of the equity instrument's fair value. The published price at the date of exchange is an unreliable indicator only when it has been affected by the thinness of the market. If the published price at the date of exchange is an unreliable indicator or if a published price does not exist for equity instruments issued by the acquirer, the fair value of those instruments could, for example, be estimated by reference to their proportional interest in the fair value of the acquirer or by reference to the proportional interest in the fair value of the acquiree obtained, whichever is the more clearly evident. The fair value at the date of exchange of monetary assets given to equity holders of the acquiree as an alternative to equity instruments may also provide evidence of the total fair value given by the acquirer in exchange for control of the acquiree. In any event, all aspects of the combination, including significant factors influencing the negotiations, shall be considered. Further guidance on determining the fair value of equity instruments is set out in IAS 39 *Financial Instruments: Recognition and Measurement*.
28. The cost of a business combination includes liabilities incurred or assumed by the acquirer in exchange for control of the acquiree. Future losses or other costs expected to be incurred as a result of a combination are not liabilities incurred or assumed by the acquirer in exchange for control of the acquiree, and are not, therefore, included as part of the cost of the combination.
29. The cost of a business combination includes any costs directly attributable to the combination, such as professional fees paid to accountants, legal advisers, valuers and other consultants to effect the combination. General administrative costs, including the costs of maintaining an acquisitions department, and other costs that cannot be directly attributed to the particular combination being accounted for are not included in the cost of the combination: they are recognised as an expense when incurred.
30. The costs of arranging and issuing financial liabilities are an integral part of the liability issue transaction, even when the liabilities are issued to effect a business combination, rather than costs directly attributable to the combination. Therefore, entities shall not include such costs in the cost of a business combination. In accordance with IAS 39, such costs shall be included in the initial measurement of the liability.
31. Similarly, the costs of issuing equity instruments are an integral part of the equity issue transaction, even when the equity instruments are issued to effect a business combination, rather than costs directly attributable to the combination. Therefore, entities shall not include such costs in the cost of a business combination. In accordance with IAS 32 *Financial Instruments: Disclosure and Presentation*, such costs reduce the proceeds from the equity issue.

#### Adjustments to the cost of a business combination contingent on future events

32. **When a business combination agreement provides for an adjustment to the cost of the combination contingent on future events, the acquirer shall include the amount of that adjustment in the cost of the combination at the acquisition date if the adjustment is *probable* and can be measured reliably.**
33. A business combination agreement may allow for adjustments to the cost of the combination that are contingent on one or more future events. The adjustment might, for example, be contingent on a specified level of profit being maintained or achieved in future periods, or on the market price of the instruments issued being maintained. It is usually possible to estimate the amount of any such adjustment at the time of initially accounting for the combination without impairing the reliability of the information, even though some uncertainty exists. If the future events do not occur or the estimate needs to be revised, the cost of the business combination shall be adjusted accordingly.

## IFRS 3

34. However, when a business combination agreement provides for such an adjustment, that adjustment is not included in the cost of the combination at the time of initially accounting for the combination if it either is not probable or cannot be measured reliably. If that adjustment subsequently becomes probable and can be measured reliably, the additional consideration shall be treated as an adjustment to the cost of the combination.
35. In some circumstances, the acquirer may be required to make a subsequent payment to the seller as compensation for a reduction in the value of the assets given, equity instruments issued or liabilities incurred or assumed by the acquirer in exchange for control of the acquiree. This is the case, for example, when the acquirer guarantees the market price of equity or debt instruments issued as part of the cost of the business combination and is required to issue additional equity or debt instruments to restore the originally determined cost. In such cases, no increase in the cost of the business combination is recognised. In the case of equity instruments, the fair value of the additional payment is offset by an equal reduction in the value attributed to the instruments initially issued. In the case of debt instruments, the additional payment is regarded as a reduction in the premium or an increase in the discount on the initial issue.

*Allocating the cost of a business combination to the assets acquired and liabilities and contingent liabilities assumed*

36. **The acquirer shall, at the acquisition date, allocate the cost of a business combination by recognising the acquiree's identifiable assets, liabilities and contingent liabilities that satisfy the recognition criteria in paragraph 37 at their fair values at that date, except for noncurrent assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, which shall be recognised at fair value less costs to sell. Any difference between the cost of the business combination and the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities so recognised shall be accounted for in accordance with paragraphs 51-57.**
37. **The acquirer shall recognise separately the acquiree's identifiable assets, liabilities and contingent liabilities at the acquisition date only if they satisfy the following criteria at that date:**
- (a) **in the case of an asset other than an *intangible asset*, it is probable that any associated future economic benefits will flow to the acquirer, and its fair value can be measured reliably;**
  - (b) **in the case of a liability other than a contingent liability, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and its fair value can be measured reliably;**
  - (c) **in the case of an intangible asset or a contingent liability, its fair value can be measured reliably.**
38. The acquirer's income statement shall incorporate the acquiree's profits and losses after the acquisition date by including the acquiree's income and expenses based on the cost of the business combination to the acquirer. For example, depreciation expense included after the acquisition date in the acquirer's income statement that relates to the acquiree's depreciable assets shall be based on the fair values of those depreciable assets at the acquisition date, ie their cost to the acquirer.

39. Application of the purchase method starts from the acquisition date, which is the date on which the acquirer effectively obtains control of the acquiree. Because control is the power to govern the financial and operating policies of an entity or business so as to obtain benefits from its activities, it is not necessary for a transaction to be closed or finalised at law before the acquirer obtains control. All pertinent facts and circumstances surrounding a business combination shall be considered in assessing when the acquirer has obtained control.
40. Because the acquirer recognises the acquiree's identifiable assets, liabilities and contingent liabilities that satisfy the recognition criteria in paragraph 37 at their fair values at the acquisition date, any minority interest in the acquiree is stated at the minority's proportion of the net fair value of those items. Paragraphs B16 and B17 of Appendix B provide guidance on determining the fair values of the acquiree's identifiable assets, liabilities and contingent liabilities for the purpose of allocating the cost of a business combination.

#### Acquiree's identifiable assets and liabilities

41. In accordance with paragraph 36, the acquirer recognises separately as part of allocating the cost of the combination only the identifiable assets, liabilities and contingent liabilities of the acquiree that existed at the acquisition date and satisfy the recognition criteria in paragraph 37. Therefore:
- (a) the acquirer shall recognise liabilities for terminating or reducing the activities of the acquiree as part of allocating the cost of the combination only when the acquiree has, at the acquisition date, an existing liability for restructuring recognised in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*;
- and
- (b) the acquirer, when allocating the cost of the combination, shall not recognise liabilities for future losses or other costs expected to be incurred as a result of the business combination.
42. A payment that an entity is contractually required to make, for example, to its employees or suppliers in the event that it is acquired in a business combination is a present obligation of the entity that is regarded as a contingent liability until it becomes probable that a business combination will take place. The contractual obligation is recognised as a liability by that entity in accordance with IAS 37 when a business combination becomes probable and the liability can be measured reliably. Therefore, when the business combination is effected, that liability of the acquiree is recognised by the acquirer as part of allocating the cost of the combination.
43. However, an acquiree's restructuring plan whose execution is conditional upon its being acquired in a business combination is not, immediately before the business combination, a present obligation of the acquiree. Nor is it a contingent liability of the acquiree immediately before the combination because it is not a possible obligation arising from a past event whose existence will be confirmed only by the occurrence or nonoccurrence of one or more uncertain future events not wholly within the control of the acquiree. Therefore, an acquirer shall not recognise a liability for such restructuring plans as part of allocating the cost of the combination.
44. The identifiable assets and liabilities that are recognised in accordance with paragraph 36 include all of the acquiree's assets and liabilities that the acquirer purchases or assumes, including all of its financial assets and financial liabilities. They might also include assets and liabilities not previously recognised in the acquiree's financial statements, eg because they did not qualify for recognition before the acquisition. For example, a tax benefit arising from the acquiree's tax losses that was not recognised by the acquiree before the business combination qualifies for recognition as an identifiable asset in accordance with paragraph 36 if it is probable that the acquirer will have future taxable profits against which the unrecognised tax benefit can be applied.

## IFRS 3

## Acquiree's intangible assets

45. In accordance with paragraph 37, the acquirer recognises separately an intangible asset of the acquiree at the acquisition date only if it meets the definition of an intangible asset in IAS 38 *Intangible Assets* and its fair value can be measured reliably. This means that the acquirer recognises as an asset separately from goodwill an in-process research and development project of the acquiree if the project meets the definition of an intangible asset and its fair value can be measured reliably. IAS 38 provides guidance on determining whether the fair value of an intangible asset acquired in a business combination can be measured reliably.
46. A non-monetary asset without physical substance must be identifiable to meet the definition of an intangible asset. In accordance with IAS 38, an asset meets the identifiability criterion in the definition of an intangible asset only if it:
- (a) 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
- (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.

## Acquiree's contingent liabilities

47. Paragraph 37 specifies that the acquirer recognises separately a contingent liability of the acquiree as part of allocating the cost of a business combination only if its fair value can be measured reliably. If its fair value cannot be measured reliably:
- (a) there is a resulting effect on the amount recognised as goodwill or accounted for in accordance with paragraph 56;
- and
- (b) the acquirer shall disclose the information about that contingent liability required to be disclosed by IAS 37.

Paragraph B16(l) of Appendix B provides guidance on determining the fair value of a contingent liability.

48. **After their initial recognition, the acquirer shall measure contingent liabilities that are recognised separately in accordance with paragraph 36 at the higher of:**
- (a) **the amount that would be recognised in accordance with IAS 37,**
- and**
- (b) **the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with IAS 18 *Revenue*.**
49. The requirement in paragraph 48 does not apply to contracts accounted for in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*. However, loan commitments excluded from the scope of IAS 39 that are not commitments to provide loans at below-market interest rates are accounted for as contingent liabilities of the acquiree if, at the acquisition date, it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation or if the amount of the obligation cannot be measured with sufficient reliability. Such a loan commitment is, in accordance with paragraph 37, recognised separately as part of allocating the cost of a combination only if its fair value can be measured reliably.

50. Contingent liabilities recognised separately as part of allocating the cost of a business combination are excluded from the scope of IAS 37. However, the acquirer shall disclose for those contingent liabilities the information required to be disclosed by IAS 37 for each class of provision.

#### Goodwill

51. **The acquirer shall, at the acquisition date:**

(a) **recognise goodwill acquired in a business combination as an asset;**

**and**

(b) **initially measure that goodwill at its cost, being the excess of the cost of the business combination over the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised in accordance with paragraph 36.**

52. Goodwill acquired in a business combination 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.

53. To the extent that the acquiree's identifiable assets, liabilities or contingent liabilities do not satisfy the criteria in paragraph 37 for separate recognition at the acquisition date, there is a resulting effect on the amount recognised as goodwill (or accounted for in accordance with paragraph 56). This is because goodwill is measured as the residual cost of the business combination after recognising the acquiree's identifiable assets, liabilities and contingent liabilities.

54. **After initial recognition, the acquirer shall measure goodwill acquired in a business combination at cost less any accumulated impairment losses.**

55. Goodwill acquired in a business combination shall not be amortised. Instead, the acquirer shall test it for impairment annually, or more frequently if events or changes in circumstances indicate that it might be impaired, in accordance with IAS 36 *Impairment of Assets*.

#### Excess of acquirer's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over cost

56. **If the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised in accordance with paragraph 36 exceeds the cost of the business combination, the acquirer shall:**

(a) **reassess the identification and measurement of the acquiree's identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination;**

**and**

(b) **recognise immediately in profit or loss any excess remaining after that reassessment.**

**IFRS 3**

57. A gain recognised in accordance with paragraph 56 could comprise one or more of the following components:
- (a) errors in measuring the fair value of either the cost of the combination or the acquiree's identifiable assets, liabilities or contingent liabilities. Possible future costs arising in respect of the acquiree that have not been reflected correctly in the fair value of the acquiree's identifiable assets, liabilities or contingent liabilities are a potential cause of such errors.
  - (b) a requirement in an accounting standard to measure identifiable net assets acquired at an amount that is not fair value, but is treated as though it is fair value for the purpose of allocating the cost of the combination. For example, the guidance in Appendix B on determining the fair values of the acquiree's identifiable assets and liabilities requires the amount assigned to tax assets and liabilities to be undiscounted.
  - (c) a bargain purchase.

**Business combination achieved in stages**

58. A business combination may involve more than one exchange transaction, for example when it occurs in stages by successive share purchases. If so, each exchange transaction shall be treated separately by the acquirer, using the cost of the transaction and fair value information at the date of each exchange transaction, to determine the amount of any goodwill associated with that transaction. This results in a step-by-step comparison of the cost of the individual investments with the acquirer's interest in the fair values of the acquiree's identifiable assets, liabilities and contingent liabilities at each step.
59. When a business combination involves more than one exchange transaction, the fair values of the acquiree's identifiable assets, liabilities and contingent liabilities may be different at the date of each exchange transaction. Because:
- (a) the acquiree's identifiable assets, liabilities and contingent liabilities are notionally restated to their fair values at the date of each exchange transaction to determine the amount of any goodwill associated with each transaction;
- and
- (b) the acquiree's identifiable assets, liabilities and contingent liabilities must then be recognised by the acquirer at their fair values at the acquisition date,

any adjustment to those fair values relating to previously held interests of the acquirer is a revaluation and shall be accounted for as such. However, because this revaluation arises on the initial recognition by the acquirer of the acquiree's assets, liabilities and contingent liabilities, it does not signify that the acquirer has elected to apply an accounting policy of revaluing those items after initial recognition in accordance with, for example, IAS 16 *Property, Plant and Equipment*.

60. Before qualifying as a business combination, a transaction may qualify as an investment in an associate and be accounted for in accordance with IAS 28 *Investments in Associates* using the equity method. If so, the fair values of the investee's identifiable net assets at the date of each earlier exchange transaction will have been determined previously in applying the equity method to the investment.

**Initial accounting determined provisionally**

61. The initial accounting for a business combination involves identifying and determining the fair values to be assigned to the acquiree's identifiable assets, liabilities and contingent liabilities and the cost of the combination.

62. If the initial accounting for a business combination can be determined only provisionally by the end of the period in which the combination is effected because either the fair values to be assigned to the acquiree's identifiable assets, liabilities or contingent liabilities or the cost of the combination can be determined only provisionally, the acquirer shall account for the combination using those provisional values. The acquirer shall recognise any adjustments to those provisional values as a result of completing the initial accounting:
- (a) within twelve months of the acquisition date;
- and
- (b) from the acquisition date. Therefore:
    - (i) the carrying amount of an identifiable asset, liability or contingent liability that is recognised or adjusted as a result of completing the initial accounting shall be calculated as if its fair value at the acquisition date had been recognised from that date.
    - (ii) goodwill or any gain recognised in accordance with paragraph 56 shall be adjusted from the acquisition date by an amount equal to the adjustment to the fair value at the acquisition date of the identifiable asset, liability or contingent liability being recognised or adjusted.
    - (iii) comparative information presented for the periods before the initial accounting for the combination is complete shall be presented as if the initial accounting had been completed from the acquisition date. This includes any additional depreciation, amortisation or other profit or loss effect recognised as a result of completing the initial accounting.

#### Adjustments after the initial accounting is complete

63. Except as outlined in paragraphs 33, 34 and 65, adjustments to the initial accounting for a business combination after that initial accounting is complete shall be recognised only to correct an error in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Adjustments to the initial accounting for a business combination after that accounting is complete shall not be recognised for the effect of changes in estimates. In accordance with IAS 8, the effect of a change in estimates shall be recognised in the current and future periods.
64. IAS 8 requires an entity to account for an error correction retrospectively, and to present financial statements as if the error had never occurred by restating the comparative information for the prior period(s) in which the error occurred. Therefore, the carrying amount of an identifiable asset, liability or contingent liability of the acquiree that is recognised or adjusted as a result of an error correction shall be calculated as if its fair value or adjusted fair value at the acquisition date had been recognised from that date. Goodwill or any gain recognised in a prior period in accordance with paragraph 56 shall be adjusted retrospectively by an amount equal to the fair value at the acquisition date (or the adjustment to the fair value at the acquisition date) of the identifiable asset, liability or contingent liability being recognised (or adjusted).

#### Recognition of deferred tax assets after the initial accounting is complete

65. If the potential benefit of the acquiree's income tax loss carry-forwards or other deferred tax assets did not satisfy the criteria in paragraph 37 for separate recognition when a business combination is initially accounted for but is subsequently realised, the acquirer shall recognise that benefit as income in accordance with IAS 12 *Income Taxes*. In addition, the acquirer shall:
- (a) reduce the carrying amount of goodwill to the amount that would have been recognised if the deferred tax asset had been recognised as an identifiable asset from the acquisition date;
- and
- (b) recognise the reduction in the carrying amount of the goodwill as an expense.

**IFRS 3**

However, this procedure shall not result in the creation of an excess as described in paragraph 56, nor shall it increase the amount of any gain previously recognised in accordance with paragraph 56.

**DISCLOSURE**

66. **An acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of business combinations that were effected:**
- (a) **during the period.**
  - (b) **after the balance sheet date but before the financial statements are authorised for issue.**
67. To give effect to the principle in paragraph 66(a), the acquirer shall disclose the following information for each business combination that was effected during the period:
- (a) the names and descriptions of the combining entities or businesses.
  - (b) the acquisition date.
  - (c) the percentage of voting equity instruments acquired.
  - (d) the cost of the combination and a description of the components of that cost, including any costs directly attributable to the combination. When equity instruments are issued or issuable as part of the cost, the following shall also be disclosed:
    - (i) the number of equity instruments issued or issuable;
    - and
    - (ii) the fair value of those instruments and the basis for determining that fair value. If a published price does not exist for the instruments at the date of exchange, the significant assumptions used to determine fair value shall be disclosed. If a published price exists at the date of exchange but was not used as the basis for determining the cost of the combination, that fact shall be disclosed together with: the reasons the published price was not used; the method and significant assumptions used to attribute a value to the equity instruments; and the aggregate amount of the difference between the value attributed to, and the published price of, the equity instruments.
  - (e) details of any operations the entity has decided to dispose of as a result of the combination.
  - (f) the amounts recognised at the acquisition date for each class of the acquiree's assets, liabilities and contingent liabilities, and, unless disclosure would be impracticable, the carrying amounts of each of those classes, determined in accordance with IFRSs, immediately before the combination. If such disclosure would be impracticable, that fact shall be disclosed, together with an explanation of why this is the case.
  - (g) the amount of any excess recognised in profit or loss in accordance with paragraph 56, and the line item in the income statement in which the excess is recognised.
  - (h) a description of the factors that contributed to a cost that results in the recognition of goodwill — a description of each intangible asset that was not recognised separately from goodwill and an explanation of why the intangible asset's fair value could not be measured reliably — or a description of the nature of any excess recognised in profit or loss in accordance with paragraph 56.
  - (i) the amount of the acquiree's profit or loss since the acquisition date included in the acquirer's profit or loss for the period, unless disclosure would be impracticable. If such disclosure would be impracticable, that fact shall be disclosed, together with an explanation of why this is the case.

68. The information required to be disclosed by paragraph 67 shall be disclosed in aggregate for business combinations effected during the reporting period that are individually immaterial.
69. If the initial accounting for a business combination that was effected during the period was determined only provisionally as described in paragraph 62, that fact shall also be disclosed together with an explanation of why this is the case.
70. To give effect to the principle in paragraph 66(a), the acquirer shall disclose the following information, unless such disclosure would be impracticable:
- (a) the revenue of the combined entity for the period as though the acquisition date for all business combinations effected during the period had been the beginning of that period.
  - (b) the profit or loss of the combined entity for the period as though the acquisition date for all business combinations effected during the period had been the beginning of the period.

If disclosure of this information would be impracticable, that fact shall be disclosed, together with an explanation of why this is the case.

71. To give effect to the principle in paragraph 66(b), the acquirer shall disclose the information required by paragraph 67 for each business combination effected after the balance sheet date but before the financial statements are authorised for issue, unless such disclosure would be impracticable. If disclosure of any of that information would be impracticable, that fact shall be disclosed, together with an explanation of why this is the case.

72. **An acquirer shall disclose information that enables users of its financial statements to evaluate the financial effects of gains, losses, error corrections and other adjustments recognised in the current period that relate to business combinations that were effected in the current or in previous periods.**

73. To give effect to the principle in paragraph 72, the acquirer shall disclose the following information:

- (a) the amount and an explanation of any gain or loss recognised in the current period that:
    - (i) relates to the identifiable assets acquired or liabilities or contingent liabilities assumed in a business combination that was effected in the current or a previous period;
- and
- (ii) is of such size, nature or incidence that disclosure is relevant to an understanding of the combined entity's financial performance.

- (b) if the initial accounting for a business combination that was effected in the immediately preceding period was determined only provisionally at the end of that period, the amounts and explanations of the adjustments to the provisional values recognised during the current period.

- (c) the information about error corrections required to be disclosed by IAS 8 for any of the acquiree's identifiable assets, liabilities or contingent liabilities, or changes in the values assigned to those items, that the acquirer recognises during the current period in accordance with paragraphs 63 and 64.

74. **An entity shall disclose information that enables users of its financial statements to evaluate changes in the carrying amount of goodwill during the period.**

75. To give effect to the principle in paragraph 74, the entity shall disclose a reconciliation of the carrying amount of goodwill at the beginning and end of the period, showing separately:

- (a) the gross amount and accumulated impairment losses at the beginning of the period;

**IFRS 3**

- (b) additional goodwill recognised during the period except goodwill included in a disposal group that, on acquisition, meets the criteria to be classified as held for sale in accordance with IFRS 5;
  - (c) adjustments resulting from the subsequent recognition of deferred tax assets during the period in accordance with paragraph 65;
  - (d) goodwill included in a disposal group classified as held for sale in accordance with IFRS 5 and goodwill derecognised during the period without having previously been included in a disposal group classified as held for sale;
  - (e) impairment losses recognised during the period in accordance with IAS 36;
  - (f) net exchange differences arising during the period in accordance with IAS 21 *The Effects of Changes in Foreign Exchange Rates*;
  - (g) any other changes in the carrying amount during the period;
- and
- (h) the gross amount and accumulated impairment losses at the end of the period.

76. The entity discloses information about the recoverable amount and impairment of goodwill in accordance with IAS 36 in addition to the information required to be disclosed by paragraph 75(e).
77. If in any situation the information required to be disclosed by this IFRS does not satisfy the objectives set out in paragraphs 66, 72 and 74, the entity shall disclose such additional information as is necessary to meet those objectives.

**TRANSITIONAL PROVISIONS AND EFFECTIVE DATE**

78. Except as provided in paragraph 85, this IFRS shall apply to the accounting for business combinations for which the *agreement date* is on or after 31 March 2004. This IFRS shall also apply to the accounting for:
- (a) goodwill arising from a business combination for which the agreement date is on or after 31 March 2004;
- or
- (b) any excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of a business combination for which the agreement date is on or after 31 March 2004.

*Previously recognised goodwill*

79. An entity shall apply this IFRS prospectively, from the beginning of the first annual period beginning on or after 31 March 2004, to goodwill acquired in a business combination for which the agreement date was before 31 March 2004, and to goodwill arising from an interest in a jointly controlled entity obtained before 31 March 2004 and accounted for by applying proportionate consolidation. Therefore, an entity shall:
- (a) from the beginning of the first annual period beginning on or after 31 March 2004, discontinue amortising such goodwill;

- (b) at the beginning of the first annual period beginning on or after 31 March 2004, eliminate the carrying amount of the related accumulated amortisation with a corresponding decrease in goodwill;

and

- (c) from the beginning of the first annual period beginning on or after 31 March 2004, test the goodwill for impairment in accordance with IAS 36 (as revised in 2004).

80. If an entity previously recognised goodwill as a deduction from equity, it shall not recognise that goodwill in profit or loss when it disposes of all or part of the business to which that goodwill relates or when a cashgenerating unit to which the goodwill relates becomes impaired.

*Previously recognised negative goodwill*

81. The carrying amount of negative goodwill at the beginning of the first annual period beginning on or after 31 March 2004 that arose from either

- (a) a business combination for which the agreement date was before 31 March 2004

or

- (b) an interest in a jointly controlled entity obtained before 31 March 2004 and accounted for by applying proportionate consolidation

shall be derecognised at the beginning of that period, with a corresponding adjustment to the opening balance of retained earnings.

*Previously recognised intangible assets*

82. The carrying amount of an item classified as an intangible asset that either

- (a) was acquired in a business combination for which the agreement date was before 31 March 2004

or

- (b) arises from an interest in a jointly controlled entity obtained before 31 March 2004 and accounted for by applying proportionate consolidation

shall be reclassified as goodwill at the beginning of the first annual period beginning on or after 31 March 2004, if that intangible asset does not at that date meet the identifiability criterion in IAS 38 (as revised in 2004).

*Equity accounted investments*

83. For investments accounted for by applying the equity method and acquired on or after 31 March 2004, an entity shall apply this IFRS in the accounting for:

- (a) any acquired goodwill included in the carrying amount of that investment. Therefore, amortisation of that notional goodwill shall not be included in the determination of the entity's share of the investee's profits or losses.

- (b) any excess included in the carrying amount of the investment of the entity's interest in the net fair value of the investee's identifiable assets, liabilities and contingent liabilities over the cost of the investment. Therefore, an entity shall include that excess as income in the determination of the entity's share of the investee's profits or losses in the period in which the investment is acquired.

**IFRS 3**

84. For investments accounted for by applying the equity method and acquired before 31 March 2004:
- (a) an entity shall apply this IFRS on a prospective basis, from the beginning of the first annual period beginning on or after 31 March 2004, to any acquired goodwill included in the carrying amount of that investment. Therefore, an entity shall, from that date, discontinue including the amortisation of that goodwill in the determination of the entity's share of the investee's profits or losses.
  - (b) an entity shall derecognise any negative goodwill included in the carrying amount of that investment at the beginning of the first annual period beginning on or after 31 March 2004, with a corresponding adjustment to the opening balance of retained earnings.

*Limited retrospective application*

85. An entity is permitted to apply the requirements of this IFRS to goodwill existing at or acquired after, and to business combinations occurring from, any date before the effective dates outlined in paragraphs 78-84, provided:
- (a) the valuations and other information needed to apply the IFRS to past business combinations were obtained at the time those combinations were initially accounted for;
- and
- (b) the entity also applies IAS 36 (as revised in 2004) and IAS 38 (as revised in 2004) prospectively from that same date, and the valuations and other information needed to apply those Standards from that date were previously obtained by the entity so that there is no need to determine estimates that would need to have been made at a prior date.

**WITHDRAWAL OF OTHER PRONOUNCEMENTS**

86. This IFRS supersedes IAS 22 *Business Combinations* (as issued in 1998).
87. This IFRS supersedes the following Interpretations:
- (a) SIC-9 *Business Combinations — Classification either as Acquisitions or Unitings of Interests*;
  - (b) SIC-22 *Business Combinations — Subsequent Adjustment of Fair Values and Goodwill Initially Reported*;
- and
- (c) SIC-28 *Business Combinations — 'Date of Exchange' and Fair Value of Equity Instruments*.
-

## APPENDIX A

## IFRS 3

**Defined terms**

*This appendix is an integral part of the IFRS.*

<b>acquisition date</b>	The date on which the acquirer effectively obtains <b>control</b> of the acquiree.
<b>agreement date</b>	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.
<b>business</b>	<p>An integrated set of activities and assets conducted and managed for the purpose of providing:</p> <ul style="list-style-type: none"><li>(a) a return to investors;</li></ul> <p style="text-align: center;">or</p> <ul style="list-style-type: none"><li>(b) lower costs or other economic benefits directly and proportionately to policyholders or participants.</li></ul> <p>A business generally consists of inputs, processes applied to those inputs, and resulting outputs that are, or will be, used to generate revenues. If <b>goodwill</b> is present in a transferred set of activities and assets, the transferred set shall be presumed to be a business.</p>
<b>business combination</b>	The bringing together of separate entities or <b>businesses</b> into one <b>reporting entity</b> .
<b>business combination involving entities or businesses under common control</b>	A <b>business combination</b> in which all of the combining entities or <b>businesses</b> ultimately are <b>controlled</b> by the same party or parties both before and after the combination, and that <b>control</b> is not transitory.
<b>contingent liability</b>	<p>Contingent liability has the meaning given to it in IAS 37 <i>Provisions, Contingent Liabilities and Contingent Assets</i>, ie:</p> <ul style="list-style-type: none"><li>(a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity;</li></ul> <p style="text-align: center;">or</p> <ul style="list-style-type: none"><li>(b) a present obligation that arises from past events but is not recognised because:<ul style="list-style-type: none"><li>(i) it is not <b>probable</b> that an outflow of resources embodying economic benefits will be required to settle the obligation;</li></ul></li></ul> <p style="text-align: center;">or</p> <ul style="list-style-type: none"><li>(ii) the amount of the obligation cannot be measured with sufficient reliability.</li></ul>
<b>control</b>	The power to govern the financial and operating policies of an entity or <b>business</b> so as to obtain benefits from its activities.

## IFRS 3

<b>date of exchange</b>	When a <b>business combination</b> is achieved in a single exchange transaction, the date of exchange is the <b>acquisition date</b> . When a <b>business combination</b> involves more than one exchange transaction, for example when it is achieved in stages by successive share purchases, the date of exchange is the date that each individual investment is recognised in the financial statements of the acquirer.
<b>fair value</b>	The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
<b>goodwill</b>	Future economic benefits arising from assets that are not capable of being individually identified and separately recognised.
<b>intangible asset</b>	Intangible asset has the meaning given to it in IAS 38 <i>Intangible Assets</i> , ie an identifiable nonmonetary asset without physical substance.
<b>joint venture</b>	Joint venture has the meaning given to it in IAS 31 <i>Interests in Joint Ventures</i> , ie a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control.
<b>minority interest</b>	That portion of the profit or loss and net assets of a <b>subsidiary</b> attributable to equity interests that are not owned, directly or indirectly through <b>subsidiaries</b> , by the parent.
<b>mutual entity</b>	An entity other than an investor-owned entity, such as a mutual insurance company or a mutual cooperative entity, that provides lower costs or other economic benefits directly and proportionately to its policyholders or participants.
<b>parent</b>	An entity that has one or more <b>subsidiaries</b> .
<b>probable</b>	More likely than not.
<b>reporting entity</b>	An entity for which there are users who rely on the entity's general purpose financial statements for information that will be useful to them for making decisions about the allocation of resources. A reporting entity can be a single entity or a group comprising a <b>parent</b> and all of its <b>subsidiaries</b> .
<b>subsidiary</b>	An entity, including an unincorporated entity such as a partnership, that is <b>controlled</b> by another entity (known as the <b>parent</b> ).

---

## APPENDIX B

## IFRS 3

**Application supplement**

*This appendix is an integral part of the IFRS.*

**Reverse acquisitions**

- B1 As noted in paragraph 21, in some business combinations, commonly referred to as reverse acquisitions, the acquirer is the entity whose equity interests have been acquired and the issuing entity is the acquiree. This might be the case when, for example, a private entity arranges to have itself 'acquired' by a smaller public entity as a means of obtaining a stock exchange listing. Although legally the issuing public entity is regarded as the parent and the private entity is regarded as the subsidiary, the legal subsidiary is the acquirer if it has the power to govern the financial and operating policies of the legal parent so as to obtain benefits from its activities.
- B2 An entity shall apply the guidance in paragraphs B3-B15 when accounting for a reverse acquisition.
- B3 Reverse acquisition accounting determines the allocation of the cost of the business combination as at the acquisition date and does not apply to transactions after the combination.

*Cost of the business combination*

- B4 When equity instruments are issued as part of the cost of the business combination, paragraph 24 requires the cost of the combination to include the fair value of those equity instruments at the date of exchange. Paragraph 27 notes that, in the absence of a reliable published price, the fair value of the equity instruments can be estimated by reference to the fair value of the acquirer or the fair value of the acquiree, whichever is more clearly evident.
- B5 In a reverse acquisition, the cost of the business combination is deemed to have been incurred by the legal subsidiary (ie the acquirer for accounting purposes) in the form of equity instruments issued to the owners of the legal parent (ie the acquiree for accounting purposes). If the published price of the equity instruments of the legal subsidiary is used to determine the cost of the combination, a calculation shall be made to determine the number of equity instruments the legal subsidiary would have had to issue to provide the same percentage ownership interest of the combined entity to the owners of the legal parent as they have in the combined entity as a result of the reverse acquisition. The fair value of the number of equity instruments so calculated shall be used as the cost of the combination.
- B6 If the fair value of the equity instruments of the legal subsidiary is not otherwise clearly evident, the total fair value of all the issued equity instruments of the legal parent before the business combination shall be used as the basis for determining the cost of the combination.

*Preparation and presentation of consolidated financial statements*

- B7 Consolidated financial statements prepared following a reverse acquisition shall be issued under the name of the legal parent, but described in the notes as a continuation of the financial statements of the legal subsidiary (ie the acquirer for accounting purposes). Because such consolidated financial statements represent a continuation of the financial statements of the legal subsidiary:
- (a) the assets and liabilities of the legal subsidiary shall be recognised and measured in those consolidated financial statements at their pre-combination carrying amounts.

**IFRS 3**

- (b) the retained earnings and other equity balances recognised in those consolidated financial statements shall be the retained earnings and other equity balances of the legal subsidiary immediately before the business combination.
  
- (c) the amount recognised as issued equity instruments in those consolidated financial statements shall be determined by adding to the issued equity of the legal subsidiary immediately before the business combination the cost of the combination determined as described in paragraphs B4-B6. However, the equity structure appearing in those consolidated financial statements (ie the number and type of equity instruments issued) shall reflect the equity structure of the legal parent, including the equity instruments issued by the legal parent to effect the combination.
  
- (d) comparative information presented in those consolidated financial statements shall be that of the legal subsidiary.

B8 Reverse acquisition accounting applies only in the consolidated financial statements. Therefore, in the legal parent's separate financial statements, if any, the investment in the legal subsidiary is accounted for in accordance with the requirements in IAS 27 *Consolidated and Separate Financial Statements* on accounting for investments in an investor's separate financial statements.

B9 Consolidated financial statements prepared following a reverse acquisition shall reflect the fair values of the assets, liabilities and contingent liabilities of the legal parent (ie the acquiree for accounting purposes). Therefore, the cost of the business combination shall be allocated by measuring the identifiable assets, liabilities and contingent liabilities of the legal parent that satisfy the recognition criteria in paragraph 37 at their fair values at the acquisition date. Any excess of the cost of the combination over the acquirer's interest in the net fair value of those items shall be accounted for in accordance with paragraphs 51-55. Any excess of the acquirer's interest in the net fair value of those items over the cost of the combination shall be accounted for in accordance with paragraph 56.

*Minority interest*

B10 In some reverse acquisitions, some of the owners of the legal subsidiary do not exchange their equity instruments for equity instruments of the legal parent. Although the entity in which those owners hold equity instruments (the legal subsidiary) acquired another entity (the legal parent), those owners shall be treated as a minority interest in the consolidated financial statements prepared after the reverse acquisition. This is because the owners of the legal subsidiary that do not exchange their equity instruments for equity instruments of the legal parent have an interest only in the results and net assets of the legal subsidiary, and not in the results and net assets of the combined entity. Conversely, all of the owners of the legal parent, notwithstanding that the legal parent is regarded as the acquiree, have an interest in the results and net assets of the combined entity.

B11 Because the assets and liabilities of the legal subsidiary are recognised and measured in the consolidated financial statements at their pre-combination carrying amounts, the minority interest shall reflect the minority shareholders' proportionate interest in the pre-combination carrying amounts of the legal subsidiary's net assets.

*Earnings per share*

B12 As noted in paragraph B7(c), the equity structure appearing in the consolidated financial statements prepared following a reverse acquisition reflects the equity structure of the legal parent, including the equity instruments issued by the legal parent to effect the business combination.

- B13 For the purpose of calculating the weighted average number of ordinary shares outstanding (the denominator) during the period in which the reverse acquisition occurs:
- (a) the number of ordinary shares outstanding from the beginning of that period to the acquisition date shall be deemed to be the number of ordinary shares issued by the legal parent to the owners of the legal subsidiary;
- and
- (b) the number of ordinary shares outstanding from the acquisition date to the end of that period shall be the actual number of ordinary shares of the legal parent outstanding during that period.
- B14 The basic earnings per share disclosed for each comparative period before the acquisition date that is presented in the consolidated financial statements following a reverse acquisition shall be calculated by dividing the profit or loss of the legal subsidiary attributable to ordinary shareholders in each of those periods by the number of ordinary shares issued by the legal parent to the owners of the legal subsidiary in the reverse acquisition.
- B15 The calculations outlined in paragraphs B13 and B14 assume that there were no changes in the number of the legal subsidiary's issued ordinary shares during the comparative periods and during the period from the beginning of the period in which the reverse acquisition occurred to the acquisition date. The calculation of earnings per share shall be appropriately adjusted to take into account the effect of a change in the number of the legal subsidiary's issued ordinary shares during those periods.

#### **Allocating the cost of a business combination**

- B16 This IFRS requires an acquirer to recognise the acquiree's identifiable assets, liabilities and contingent liabilities that satisfy the relevant recognition criteria at their fair values at the acquisition date. For the purpose of allocating the cost of a business combination, the acquirer shall treat the following measures as fair values:
- (a) for financial instruments traded in an active market the acquirer shall use current market values.
  - (b) for financial instruments not traded in an active market the acquirer shall use estimated values that take into consideration features such as price-earnings ratios, dividend yields and expected growth rates of comparable instruments of entities with similar characteristics.
  - (c) for receivables, beneficial contracts and other identifiable assets the acquirer shall use the present values of the amounts to be received, determined at appropriate current interest rates, less allowances for uncollectibility and collection costs, if necessary. However, discounting is not required for short-term receivables, beneficial contracts and other identifiable assets when the difference between the nominal and discounted amounts is not material.
  - (d) for inventories of:
    - (i) finished goods and merchandise the acquirer shall use selling prices less the sum of (1) the costs of disposal and (2) a reasonable profit allowance for the selling effort of the acquirer based on profit for similar finished goods and merchandise;
    - (ii) work in progress the acquirer shall use selling prices of finished goods less the sum of (1) costs to complete, (2) costs of disposal and (3) a reasonable profit allowance for the completing and selling effort based on profit for similar finished goods;and
    - (iii) raw materials the acquirer shall use current replacement costs.

**IFRS 3**

- (e) for land and buildings the acquirer shall use market values.
- (f) for plant and equipment the acquirer shall use market values, normally determined by appraisal. If there is no market-based evidence of fair value because of the specialised nature of the item of plant and equipment and the item is rarely sold, except as part of a continuing business, an acquirer may need to estimate fair value using an income or a depreciated replacement cost approach.
- (g) for intangible assets the acquirer shall determine fair value:
  - (i) by reference to an active market as defined in IAS 38 *Intangible Assets*;
  - or
  - (ii) if no active market exists, on a basis that reflects the amounts the acquirer would have paid for the assets in arm's length transactions between knowledgeable willing parties, based on the best information available (see IAS 38 for further guidance on determining the fair values of intangible assets acquired in business combinations).
- (h) for net employee benefit assets or liabilities for defined benefit plans the acquirer shall use the present value of the defined benefit obligation less the fair value of any plan assets. However, an asset is recognised only to the extent that it is probable it will be available to the acquirer in the form of refunds from the plan or a reduction in future contributions.
- (i) for tax assets and liabilities the acquirer shall use the amount of the tax benefit arising from tax losses or the taxes payable in respect of profit or loss in accordance with IAS 12 *Income Taxes*, assessed from the perspective of the combined entity. The tax asset or liability is determined after allowing for the tax effect of restating identifiable assets, liabilities and contingent liabilities to their fair values and is not discounted.
- (j) for accounts and notes payable, long-term debt, liabilities, accruals and other claims payable the acquirer shall use the present values of amounts to be disbursed in settling the liabilities determined at appropriate current interest rates. However, discounting is not required for short-term liabilities when the difference between the nominal and discounted amounts is not material.
- (k) for onerous contracts and other identifiable liabilities of the acquiree the acquirer shall use the present values of amounts to be disbursed in settling the obligations determined at appropriate current interest rates.
- (l) for contingent liabilities of the acquiree the acquirer shall use the amounts that a third party would charge to assume those contingent liabilities. Such an amount shall reflect all expectations about possible cash flows and not the single most likely or the expected maximum or minimum cash flow.

B17 Some of the above guidance requires fair values to be estimated using present value techniques. If the guidance for a particular item does not refer to the use of present value techniques, such techniques may be used in estimating the fair value of that item.

---

## APPENDIX C

## IFRS 3

**Amendments to other IFRSs**

The amendments in this appendix shall be applied to the accounting for business combinations for which the agreement date is on or after 31 March 2004, and to the accounting for any goodwill and intangible assets acquired in those business combinations. In all other respects, these amendments shall be applied for annual periods beginning on or after 31 March 2004.

However, if an entity elects in accordance with paragraph 85 to apply IFRS 3 from any date before the effective dates outlined in paragraphs 78-84, it shall also apply these amendments prospectively from that same date.

- C1 In International Financial Reporting Standards, including International Accounting Standards and Interpretations, applicable at 31 March 2004, references to the current version of IAS 22 *Business Combinations* are amended to IFRS 3 *Business Combinations*.
- C2 In IFRS 1 *First-time Adoption of International Financial Reporting Standards*, paragraph B1 is amended to read as follows.
- B1 A first-time adopter may elect not to apply IFRS 3 *Business Combinations* retrospectively to past business combinations (business combinations that occurred before the date of transition to IFRSs). However, if a first-time adopter restates any business combination to comply with IFRS 3, it shall restate all later business combinations and shall also apply IAS 36 *Impairment of Assets* (as revised in 2004) and IAS 38 *Intangible Assets* (as revised in 2004) from that same date. For example, if a first-time adopter elects to restate a business combination that occurred on 30 June 2002, it shall restate all business combinations that occurred between 30 June 2002 and the date of transition to IFRSs, and it shall also apply IAS 36 (as revised in 2004) and IAS 38 (as revised in 2004) from 30 June 2002.
- C3 [Amendment not applicable to bare Standards]
- C4 IAS 12 *Income Taxes* is amended as described below.

**Introduction**

In paragraph 1, the first subparagraph (c) is amended to read as follows:

- (c) the cost of a business combination is allocated to the identifiable assets acquired and liabilities assumed by reference to their fair values, but no equivalent adjustment is made for tax purposes.

Paragraphs 6 and 9 are amended to read as follows:

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 entity 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 any excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of the combination. However, IAS 12 (revised) prohibits the recognition of deferred tax liabilities arising from the initial recognition of goodwill.

**IFRS 3**

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. Paragraph B16(i) of IFRS 3 *Business Combinations* prohibits discounting of deferred tax assets acquired and deferred tax liabilities assumed in a business combination.

**Standard**

In the Objective, the third paragraph is amended to read as follows:

This Standard requires an 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 profit or loss, any related tax effects are also recognised in profit or loss. 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 arising in that business combination or the amount of any excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of the combination.

Paragraphs 15, 18, 19 and 21 are amended to read as follows:

15. ***A deferred tax liability shall be recognised for all taxable temporary differences, except to the extent that the deferred tax liability arises from:***

***(a) the initial recognition of goodwill;***

***or***

***...***

18. Temporary differences also arise when:

(a) the cost of a business combination is allocated by recognising the identifiable assets acquired and liabilities assumed at 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 arises in a business combination (see paragraphs 21 and 32);

***...***

19. The cost of a business combination is allocated by recognising the identifiable assets acquired and liabilities assumed at their fair values at the acquisition date. Temporary differences arise when the tax bases of the identifiable assets acquired and liabilities 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 the combination over the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities. Many taxation authorities do not allow 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.

Paragraphs 21A and 21B are added:

- 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 that year. Because that taxable temporary difference does not relate to the initial recognition of the goodwill, the resulting deferred tax liability is recognised.

Paragraphs 22(a), 24 and 26(c) are amended to read as follows:

22. ...

- (a) in a business combination, an entity recognises any deferred tax liability or asset and this affects the amount of goodwill 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 (see paragraph 19);

...

24. ***A deferred tax asset 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) is not a business combination;***

***and***

- (b) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).***

...

## IFRS 3

26. ...

- (c) the cost of a business combination is allocated by recognising the identifiable assets acquired and liabilities assumed at their fair values at the acquisition date. When a liability assumed is recognised 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 when 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

...

Paragraph 32 and the preceding heading are deleted.

Paragraphs 58(b) and 66-68 and the example following paragraph 68 are amended to read as follows and paragraph 68C is added:

58. ...

**(b) a business combination (see paragraphs 66 to 68).**

66. As explained in paragraphs 19 and 26(c), temporary differences may arise in a business combination. In accordance with IFRS 3 *Business Combinations*, an 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. Consequently, those deferred tax assets and liabilities affect goodwill or the amount of any excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of the combination. However, in accordance with paragraph 15(a), an entity does not recognise deferred tax liabilities arising from the initial recognition of goodwill.
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 before 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, but does not include it as part of the accounting for the business combination, and therefore does not take it into account in determining the goodwill or the amount of any excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of the combination.
68. If the potential benefit of the acquiree's income tax loss carryforwards or other deferred tax assets did not satisfy the criteria in IFRS 3 for separate recognition when a business combination is initially accounted for but is subsequently realised, the acquirer shall recognise the resulting deferred tax income in profit or loss. In addition, the acquirer shall:
- (a) reduce the carrying amount of goodwill to the amount that would have been recognised if the deferred tax asset had been recognised as an identifiable asset from the acquisition date;
- and
- (b) recognise the reduction in the carrying amount of goodwill as an expense.

However, this procedure shall not result in the creation of an excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of the combination, nor shall it increase the amount previously recognised for any such excess.

**Example**

An entity acquired a subsidiary that had deductible temporary differences of 300. The tax rate at the time of the acquisition was 30 per cent. The resulting deferred tax asset of 90 was not recognised as an identifiable asset in determining the goodwill of 500 that resulted from the business combination. Two years after the combination, the entity assessed that future taxable profit should be sufficient to recover the benefit of all the deductible temporary differences.

*The entity recognises a deferred tax asset of 90 and, in profit or loss, deferred tax income of 90. The entity also reduces the carrying amount of goodwill by 90 and recognises an expense for this amount in profit or loss. Consequently, the cost of the goodwill is reduced to 410, being the amount that would have been recognised had the deferred tax asset of 90 been recognised as an identifiable asset at the acquisition date.*

*If the tax rate had increased to 40 per cent, the entity would have recognised a deferred tax asset of 120 (300 at 40 per cent) and, in profit or loss, deferred tax income of 120. If the tax rate had decreased to 20 per cent, the entity would have recognised a deferred tax asset of 60 (300 at 20 per cent) and deferred tax income of 60. In both cases, the entity would also reduce the carrying amount of goodwill by 90 and recognise an expense for that amount in profit or loss.*

68C. As noted in paragraph 68A, the amount of the tax deduction (or estimated future tax deduction, measured in accordance with paragraph 68B) may differ from the related cumulative remuneration expense. Paragraph 58 of the Standard requires that current and deferred tax should be recognised as income or an expense and included in profit or loss for the period, except to the extent that the tax arises from (a) a transaction or event which is recognised, in the same or a different period, directly in equity, or (b) a business combination. If the amount of the tax deduction (or estimated future tax deduction) exceeds the amount of the related cumulative remuneration expense, this indicates that the tax deduction relates not only to remuneration expense but also to an equity item. In this situation, the excess of the associated current or deferred tax should be recognised directly in equity.

C5 IAS 14 *Segment Reporting* is amended as described below.

On the title page, the second paragraph after the title of IAS 14 is amended to read as follows:

Paragraphs 129 and 130 of IAS 36 *Impairment of Assets* set out disclosure requirements for reporting impairment losses by segment.

**Standard**

Paragraphs 19 and 21 are amended to read 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 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 can be allocated to a segment on a reasonable basis, and segment expense includes 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 an entity acquired in a business combination, even if those adjustments are made only for the purpose of preparing consolidated financial statements and are not recognised in either the parent's separate or the subsidiary's individual financial statements. Similarly, if property, plant or equipment has been revalued after acquisition in accordance with the revaluation model in IAS 16, then measurements of segment assets reflect those revaluations.

**IFRS 3**

- C6 In IAS 16 *Property, Plant and Equipment* (as revised in 2003), paragraph 64 is deleted.
- C7 IAS 19 *Employee Benefits* is amended as described below.

**Standard**

Paragraph 108 is amended to read as follows:

108. In a business combination, an 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 IFRS 3 *Business Combinations*). The present value of the obligation includes all of the following, even if the acquiree had not recognised them at the acquisition date:

- (a) actuarial gains and losses that arose before the acquisition date (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;

and

...

- C8 In IAS 27 *Consolidated and Separate Financial Statements*, paragraph 30 is amended to read as follows:
30. The income and expenses of a subsidiary are included in the consolidated financial statements from the acquisition date, as defined in IFRS 3. The income and expenses ...
- C9 IAS 28 *Investments in Associates* is amended as described below:

The definition of joint control in paragraph 2 is amended to read as follows:

***Joint control is the contractually agreed sharing of control over an economic activity, and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the venturers).***

In paragraph 15, the reference to IAS 22 *Business Combinations* is deleted. Following this change and changes made by IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, paragraph 15 reads as follows:

15. When an investment in an associate previously classified as held for sale no longer meets the criteria to be so classified, it shall be accounted for using the equity method as from the date of its classification as held for sale. Financial statements for the periods since classification as held for sale shall be amended accordingly.

Paragraphs 23 and 33 are amended to read as follows:

23. An investment in an associate is accounted for using the equity method from the date on which it becomes an associate. On acquisition of the investment any difference between the cost of the investment and the investor's share of the net fair value of the associate's identifiable assets, liabilities and contingent liabilities is accounted for in accordance with IFRS 3 *Business Combinations*. Therefore:
- (a) 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 example, for depreciation of the depreciable assets based on their fair values at the acquisition date. Similarly, appropriate adjustments to the investor's share of the associate's profits or losses after acquisition are made for impairment losses recognised by the associate, such as for goodwill or property, plant and equipment.

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, 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.

C10 IAS 31 *Interests in Joint Ventures* is amended as described below:

The definition of joint control in paragraph 3 is amended to read as follows:

***Joint control is the contractually agreed sharing of control over an economic activity, and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the venturers).***

Paragraph 11 is amended to read as follows:

11. The contractual arrangement establishes joint control over the joint venture. Such a requirement ensures that no single venturer is in a position to control the activity unilaterally.

In paragraph 43, the reference to IAS 22 *Business Combinations* is deleted. Following this change and changes made by IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, paragraph 43 reads as follows:

43. When an interest in a jointly controlled entity previously classified as held for sale no longer meets the criteria to be so classified, it shall be accounted for using proportionate consolidation or the equity method as from the date of its classification as held for sale. Financial statements for the periods since classification as held for sale shall be amended accordingly.

## IFRS 3

C11 In IAS 32 *Financial Instruments: Disclosure and Presentation* (as revised in 2003), paragraph 4(c) is renumbered as 4(d). Paragraph 4(d) is renumbered as 4(c) and amended to read as follows:

- (c) ***contracts for contingent consideration in a business combination (see IFRS 3 Business Combinations). This exemption applies only to the acquirer.***

Following this change and changes made by IFRS 4 *Insurance Contracts*, paragraph 4(c)-(e) reads as follows:

- (c) ***contracts for contingent consideration in a business combination (see IFRS 3 Business Combinations). This exemption applies only to the acquirer.***
- (d) ***insurance contracts as defined in IFRS 4 Insurance Contracts. However, this Standard applies to derivatives that are embedded in insurance contracts if IAS 39 requires the entity to account for them separately.***
- (e) ***financial instruments that are within the scope of IFRS 4 because they contain a discretionary participation feature. The issuer of these instruments is exempt from applying to these features paragraphs 15-32 and AG25-AG35 of this Standard regarding the distinction between financial liabilities and equity instruments. However, these instruments are subject to all other requirements of this Standard. Furthermore, this Standard applies to derivatives that are embedded in these instruments (see IAS 39).***

Paragraph 4(f), inserted by IFRS 2 *Share-based Payment*, remains unchanged.

C12 In IAS 33 *Earnings per Share*, paragraphs 22 and 64 are amended to read as follows:

22. Ordinary shares issued as part of the cost of a business combination are included in the weighted average number of shares from the acquisition date. This is because the acquirer incorporates into its income statement the acquiree's profits and losses from that date.
64. ***If... shall be disclosed. In addition, basic and diluted earnings per share of all periods presented shall be adjusted for the effects of errors and adjustments resulting from changes in accounting policies accounted for retrospectively.***

C13 In IAS 34 *Interim Financial Statements*, paragraphs 16(i) and 18 are amended to read as follows:

16. ...

- (i) ***the effect of changes in the composition of the 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 66-73 of IFRS 3 Business Combinations;***

***and***

...

18. Other 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 by paragraph 16(i), the disclosures required by those other Standards are not required if an entity's interim financial report includes only condensed financial statements and selected explanatory notes rather than a complete set of financial statements.

C14 In IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, paragraph 5 is amended to read as follows:

5. Where another Standard deals with a specific type of provision, contingent liability or contingent asset, an entity applies that Standard instead of this Standard. For example, IFRS 3 *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:

...

C15 In IAS 39 *Financial Instruments: Recognition and Measurement* (as revised in 2003), paragraph 2(f) and (h) is deleted by IFRS 4 *Insurance Contracts*. Paragraph 2(g) is renumbered as paragraph 2(f) and amended as set out below. Paragraph 2(g) is added as set out below. Following these changes and changes made by IFRS 4, paragraph 2(d)-(g) reads as follows:

- (d) ***financial instruments issued by the entity that meet the definition of an equity instrument in IAS 32 (including options and warrants). However, the holder of such equity instruments shall apply this Standard to those instruments, unless they meet the exception in (a) above.***
- (e) ***rights and obligations under an insurance contract as defined in IFRS 4 Insurance Contracts or under a contract that is within the scope of IFRS 4 because it contains a discretionary participation feature. However, this Standard applies to a derivative that is embedded in such a contract if the derivative is not itself a contract within the scope of IFRS 4 (see paragraphs 10-13 and Appendix A paragraphs AG23-AG33). Furthermore, if an insurance contract is a financial guarantee contract entered into, or retained, on transferring to another party financial assets or financial liabilities within the scope of this Standard, the issuer shall apply this Standard to the contract (see paragraph 3 and Appendix A paragraph AG4A).***
- (f) ***contracts for contingent consideration in a business combination (see IFRS 3 Business Combinations). This exemption applies only to the acquirer.***
- (g) ***contracts between an acquirer and a vendor in a business combination to buy or sell an acquiree at a future date.***

Paragraph 2(i) and (j) is renumbered as 2(h) and (i). Paragraph 2(i) was inserted by IFRS 2 *Share-based Payment*.

C16 [Amendment not applicable to bare Standards]

C17 [Amendment not applicable to bare Standards]

C18 SIC-32 *Intangible Assets — Web Site Costs* is amended as described below.

Paragraphs 8-10 are amended to read as follows:

8. A web site arising from development shall be recognised as an intangible asset if, and only if, in addition to complying with the general requirements described in IAS 38.21 for recognition and initial measurement, an entity can satisfy the requirements in IAS 38.57. In particular, an entity may be able to satisfy the requirement to demonstrate how its web site will generate probable future economic benefits in accordance with IAS 38.57(d) when, for example, the web site is capable of generating revenues, including direct revenues from enabling orders to be placed. An 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 shall be recognised as an expense when incurred.

**IFRS 3**

9. Any internal expenditure on the development and operation of an entity's own web site shall be accounted for in accordance with 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 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 IAS 38.54-.56. Expenditure incurred in this stage 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 entity's own products and services, are similar in nature to the development phase in IAS 38.57-.64. Expenditure incurred in these stages 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 and is necessary to creating, producing or preparing the web site for it to be capable of operating in the manner intended by management. For example, expenditure on purchasing or creating content (other than content that advertises and promotes an 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, shall be included in the cost of development when this condition is met. However, in accordance with IAS 38.71, expenditure on an intangible item that was initially recognised as an expense in previous financial statements shall not be recognised as part of the cost of an intangible asset at a later date (eg 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 entity's own products and services (eg digital photographs of products), shall be recognised as an expense when incurred in accordance with IAS 38.69(c). For example, when accounting for expenditure on professional services for taking digital photographs of an entity's own products and for enhancing their display, expenditure 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 shall be recognised as an expense when it is incurred unless it meets the recognition criteria in IAS 38.18.
10. A web site that is recognised as an intangible asset under paragraph 8 of this Interpretation shall be measured after initial recognition by applying the requirements of IAS 38.72-.87. The best estimate of a web site's useful life shall be short.

The Effective Date paragraph is amended to read as follows:

Effective Date: This Interpretation becomes effective on 25 March 2002. The effects of adopting this Interpretation shall be accounted for using the transitional requirements 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 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 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.

## INTERNATIONAL FINANCIAL REPORTING STANDARD 4

## IFRS 4

**Insurance contracts**

## SUMMARY

	Paragraphs
Objective	1
Scope	2-12
Embedded derivatives	7-9
Unbundling of deposit components	10-12
Recognition and measurement	13-35
Temporary exemption from some other IFRSs	13-20
Liability adequacy test	15-19
Impairment of reinsurance assets	20
Changes in accounting policies	21-30
Current market interest rates	24
Continuation of existing practices	25
Prudence	26
Future investment margins	27-29
Shadow accounting	30
Insurance contracts acquired in a business combination or portfolio transfer	31-33
Discretionary participation features	34-35
Discretionary participation features in insurance contracts	34
Discretionary participation features in financial instruments	35
Disclosure	36-39
Explanation of recognised amounts	36-37
Amount, timing and uncertainty of cash flows	38-39
Effective date and transition	40-45
Disclosure	42-44
Redesignation of financial assets	45

**OBJECTIVE**

1. The objective of this IFRS is to specify the financial reporting for *insurance contracts* by any entity that issues such contracts (described in this IFRS as an *insurer*) until the Board completes the second phase of its project on insurance contracts. In particular, this IFRS requires:
  - (a) limited improvements to accounting by insurers for insurance contracts.

**IFRS 4**

- (b) disclosure that identifies and explains the amounts in an insurer's financial statements arising from insurance contracts and helps users of those financial statements understand the amount, timing and uncertainty of future cash flows from insurance contracts.

**SCOPE**

2. An entity shall apply this IFRS to:
  - (a) insurance contracts (including *reinsurance contracts*) that it issues and reinsurance contracts that it holds.
  - (b) financial instruments that it issues with a *discretionary participation feature* (see paragraph 35). IAS 32 *Financial Instruments: Disclosure and Presentation* requires disclosure about financial instruments, including financial instruments that contain such features.
3. This IFRS does not address other aspects of accounting by insurers, such as accounting for financial assets held by insurers and financial liabilities issued by insurers (see IAS 32 and IAS 39 *Financial Instruments: Recognition and Measurement*), except in the transitional provisions in paragraph 45.
4. An entity shall not apply this IFRS to:
  - (a) product warranties issued directly by a manufacturer, dealer or retailer (see IAS 18 *Revenue* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*).
  - (b) employers' assets and liabilities under employee benefit plans (see IAS 19 *Employee Benefits* and IFRS 2 *Share-based Payment*) and retirement benefit obligations reported by defined benefit retirement plans (see IAS 26 *Accounting and Reporting by Retirement Benefit Plans*).
  - (c) contractual rights or contractual obligations that are contingent on the future use of, or right to use, a non-financial item (for example, some licence fees, royalties, contingent lease payments and similar items), as well as a lessee's residual value guarantee embedded in a finance lease (see IAS 17 *Leases*, IAS 18 *Revenue* and IAS 38 *Intangible Assets*).
  - (d) financial guarantees that an entity enters into or retains on transferring to another party financial assets or financial liabilities within the scope of IAS 39, regardless of whether the financial guarantees are described as financial guarantees, letters of credit or insurance contracts (see IAS 39).
  - (e) contingent consideration payable or receivable in a business combination (see IFRS 3 *Business Combinations*).
  - (f) *direct insurance contracts* that the entity holds (ie direct insurance contracts in which the entity is the *policyholder*). However, a *cedant* shall apply this IFRS to reinsurance contracts that it holds.
5. For ease of reference, this IFRS describes any entity that issues an insurance contract as an insurer, whether or not the issuer is regarded as an insurer for legal or supervisory purposes.
6. A reinsurance contract is a type of insurance contract. Accordingly, all references in this IFRS to insurance contracts also apply to reinsurance contracts.

*Embedded derivatives*

7. IAS 39 requires an entity to separate some embedded derivatives from their host contract, measure them at *fair value* and include changes in their fair value in profit or loss. IAS 39 applies to derivatives embedded in an insurance contract unless the embedded derivative is itself an insurance contract.
8. As an exception to the requirement in IAS 39, an insurer need not separate, and measure at fair value, a policyholder's option to surrender an insurance contract for a fixed amount (or for an amount based on a fixed amount and an interest rate), even if the exercise price differs from the carrying amount of the host *insurance liability*. However, the requirement in IAS 39 does apply to a put option or cash surrender option embedded in an insurance contract if the surrender value varies in response to the change in a financial variable (such as an equity or commodity price or index), or a nonfinancial variable that is not specific to a party to the contract. Furthermore, that requirement also applies if the holder's ability to exercise a put option or cash surrender option is triggered by a change in such a variable (for example, a put option that can be exercised if a stock market index reaches a specified level).
9. Paragraph 8 applies equally to options to surrender a financial instrument containing a discretionary participation feature.

*Unbundling of deposit components*

10. Some insurance contracts contain both an insurance component and a *deposit component*. In some cases, an insurer is required or permitted to *unbundle* those components:
  - (a) unbundling is required if both the following conditions are met:
    - (i) the insurer can measure the deposit component (including any embedded surrender options) separately (ie without considering the insurance component).
    - (ii) the insurer's accounting policies do not otherwise require it to recognise all obligations and rights arising from the deposit component.
  - (b) unbundling is permitted, but not required, if the insurer can measure the deposit component separately as in (a)(i) but its accounting policies require it to recognise all obligations and rights arising from the deposit component, regardless of the basis used to measure those rights and obligations.
  - (c) unbundling is prohibited if an insurer cannot measure the deposit component separately as in (a)(i).
11. The following is an example of a case when an insurer's accounting policies do not require it to recognise all obligations arising from a deposit component. A cedant receives compensation for losses from a *reinsurer*, but the contract obliges the cedant to repay the compensation in future years. That obligation arises from a deposit component. If the cedant's accounting policies would otherwise permit it to recognise the compensation as income without recognising the resulting obligation, unbundling is required.
12. To unbundle a contract, an insurer shall:
  - (a) apply this IFRS to the insurance component.
  - (b) apply IAS 39 to the deposit component.

## IFRS 4

## RECOGNITION AND MEASUREMENT

*Temporary exemption from some other IFRSs*

13. Paragraphs 10-12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* specify criteria for an entity to use in developing an accounting policy if no IFRS applies specifically to an item. However, this IFRS exempts an insurer from applying those criteria to its accounting policies for:
- (a) insurance contracts that it issues (including related acquisition costs and related intangible assets, such as those described in paragraphs 31 and 32);
- and
- (b) reinsurance contracts that it holds.
14. Nevertheless, this IFRS does not exempt an insurer from some implications of the criteria in paragraphs 10-12 of IAS 8. Specifically, an insurer:
- (a) shall not recognise as a liability any provisions for possible future claims, if those claims arise under insurance contracts that are not in existence at the reporting date (such as catastrophe provisions and equalisation provisions).
  - (b) shall carry out the *liability adequacy test* described in paragraphs 15-19.
  - (c) shall remove an insurance liability (or a part of an insurance liability) from its balance sheet when, and only when, it is extinguished — ie when the obligation specified in the contract is discharged or cancelled or expires.
  - (d) shall not offset:
    - (i) *reinsurance assets* against the related insurance liabilities;

or

    - (ii) income or expense from reinsurance contracts against the expense or income from the related insurance contracts.
  - (e) shall consider whether its reinsurance assets are impaired (see paragraph 20).

*Liability adequacy test*

15. **An insurer shall assess at each reporting date whether its recognised insurance liabilities are adequate, using current estimates of future cash flows under its insurance contracts. If that assessment shows that the carrying amount of its insurance liabilities (less related deferred acquisition costs and related intangible assets, such as those discussed in paragraphs 31 and 32) is inadequate in the light of the estimated future cash flows, the entire deficiency shall be recognised in profit or loss.**
16. If an insurer applies a liability adequacy test that meets specified minimum requirements, this IFRS imposes no further requirements. The minimum requirements are the following:
- (a) The test considers current estimates of all contractual cash flows, and of related cash flows such as claims handling costs, as well as cash flows resulting from embedded options and guarantees.
  - (b) If the test shows that the liability is inadequate, the entire deficiency is recognised in profit or loss.

17. If an insurer's accounting policies do not require a liability adequacy test that meets the minimum requirements of paragraph 16, the insurer shall:
- (a) determine the carrying amount of the relevant insurance liabilities (\*) less the carrying amount of:
    - (i) any related deferred acquisition costs;
    - and
    - (ii) any related intangible assets, such as those acquired in a business combination or portfolio transfer (see paragraphs 31 and 32). However, related reinsurance assets are not considered because an insurer accounts for them separately (see paragraph 20).
  - (b) determine whether the amount described in (a) is less than the carrying amount that would be required if the relevant insurance liabilities were within the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. If it is less, the insurer shall recognise the entire difference in profit or loss and decrease the carrying amount of the related deferred acquisition costs or related intangible assets or increase the carrying amount of the relevant insurance liabilities.
18. If an insurer's liability adequacy test meets the minimum requirements of paragraph 16, the test is applied at the level of aggregation specified in that test. If its liability adequacy test does not meet those minimum requirements, the comparison described in paragraph 17 shall be made at the level of a portfolio of contracts that are subject to broadly similar risks and managed together as a single portfolio.
19. The amount described in paragraph 17(b) (ie the result of applying IAS 37) shall reflect future investment margins (see paragraphs 27-29) if, and only if, the amount described in paragraph 17(a) also reflects those margins.

#### Impairment of reinsurance assets

20. If a cedant's reinsurance asset is impaired, the cedant shall reduce its carrying amount accordingly and recognise that impairment loss in profit or loss. A reinsurance asset is impaired if, and only if:
- (a) there is objective evidence, as a result of an event that occurred after initial recognition of the reinsurance asset, that the cedant may not receive all amounts due to it under the terms of the contract;
  - and
  - (b) that event has a reliably measurable impact on the amounts that the cedant will receive from the reinsurer.

#### Changes in accounting policies

21. Paragraphs 22-30 apply both to changes made by an insurer that already applies IFRSs and to changes made by an insurer adopting IFRSs for the first time.
22. **An insurer may change its accounting policies for insurance contracts if, and only if, the change makes the financial statements more relevant to the economic decision-making needs of users and no less reliable, or more reliable and no less relevant to those needs. An insurer shall judge relevance and reliability by the criteria in IAS 8.**

(\*) The relevant insurance liabilities are those insurance liabilities (and related deferred acquisition costs and related intangible assets) for which the insurer's accounting policies do not require a liability adequacy test that meets the minimum requirements of paragraph 16.

**IFRS 4**

23. To justify changing its accounting policies for insurance contracts, an insurer shall show that the change brings its financial statements closer to meeting the criteria in IAS 8, but the change need not achieve full compliance with those criteria. The following specific issues are discussed below:
- (a) current interest rates (paragraph 24);
  - (b) continuation of existing practices (paragraph 25);
  - (c) prudence (paragraph 26);
  - (d) future investment margins (paragraphs 27-29);
- and
- (e) shadow accounting (paragraph 30).

**Current market interest rates**

24. An insurer is permitted, but not required, to change its accounting policies so that it remeasures designated insurance liabilities (\*) to reflect current market interest rates and recognises changes in those liabilities in profit or loss. At that time, it may also introduce accounting policies that require other current estimates and assumptions for the designated liabilities. The election in this paragraph permits an insurer to change its accounting policies for designated liabilities, without applying those policies consistently to all similar liabilities as IAS 8 would otherwise require. If an insurer designates liabilities for this election, it shall continue to apply current market interest rates (and, if applicable, the other current estimates and assumptions) consistently in all periods to all these liabilities until they are extinguished.

**Continuation of existing practices**

25. An insurer may continue the following practices, but the introduction of any of them does not satisfy paragraph 22:
- (a) measuring insurance liabilities on an undiscounted basis.
  - (b) measuring contractual rights to future investment management fees at an amount that exceeds their fair value as implied by a comparison with current fees charged by other market participants for similar services. It is likely that the fair value at inception of those contractual rights equals the origination costs paid, unless future investment management fees and related costs are out of line with market comparables.
  - (c) using non-uniform accounting policies for the insurance contracts (and related deferred acquisition costs and related intangible assets, if any) of subsidiaries, except as permitted by paragraph 24. If those accounting policies are not uniform, an insurer may change them if the change does not make the accounting policies more diverse and also satisfies the other requirements in this IFRS.

**Prudence**

26. An insurer need not change its accounting policies for insurance contracts to eliminate excessive prudence. However, if an insurer already measures its insurance contracts with sufficient prudence, it shall not introduce additional prudence.

(\*) In this paragraph, insurance liabilities include related deferred acquisition costs and related intangible assets, such as those discussed in paragraphs 31 and 32.

## Future investment margins

27. An insurer need not change its accounting policies for insurance contracts to eliminate future investment margins. However, there is a rebuttable presumption that an insurer's financial statements will become less relevant and reliable if it introduces an accounting policy that reflects future investment margins in the measurement of insurance contracts, unless those margins affect the contractual payments. Two examples of accounting policies that reflect those margins are:
- (a) using a discount rate that reflects the estimated return on the insurer's assets;
- or
- (b) projecting the returns on those assets at an estimated rate of return, discounting those projected returns at a different rate and including the result in the measurement of the liability.
28. An insurer may overcome the rebuttable presumption described in paragraph 27 if, and only if, the other components of a change in accounting policies increase the relevance and reliability of its financial statements sufficiently to outweigh the decrease in relevance and reliability caused by the inclusion of future investment margins. For example, suppose that an insurer's existing accounting policies for insurance contracts involve excessively prudent assumptions set at inception and a discount rate prescribed by a regulator without direct reference to market conditions, and ignore some embedded options and guarantees. The insurer might make its financial statements more relevant and no less reliable by switching to a comprehensive investor-oriented basis of accounting that is widely used and involves:
- (a) current estimates and assumptions;
  - (b) a reasonable (but not excessively prudent) adjustment to reflect risk and uncertainty;
  - (c) measurements that reflect both the intrinsic value and time value of embedded options and guarantees;
- and
- (d) a current market discount rate, even if that discount rate reflects the estimated return on the insurer's assets.
29. In some measurement approaches, the discount rate is used to determine the present value of a future profit margin. That profit margin is then attributed to different periods using a formula. In those approaches, the discount rate affects the measurement of the liability only indirectly. In particular, the use of a less appropriate discount rate has a limited or no effect on the measurement of the liability at inception. However, in other approaches, the discount rate determines the measurement of the liability directly. In the latter case, because the introduction of an asset-based discount rate has a more significant effect, it is highly unlikely that an insurer could overcome the rebuttable presumption described in paragraph 27.

## Shadow accounting

30. In some accounting models, realised gains or losses on an insurer's assets have a direct effect on the measurement of some or all of (a) its insurance liabilities, (b) related deferred acquisition costs and (c) related intangible assets, such as those described in paragraphs 31 and 32. An insurer is permitted, but not required, to change its accounting policies so that a recognised but unrealised gain or loss on an asset affects those measurements in the same way that a realised gain or loss does. The related adjustment to the insurance liability (or deferred acquisition costs or intangible assets) shall be recognised in equity if, and only if, the unrealised gains or losses are recognised directly in equity. This practice is sometimes described as 'shadow accounting'.

**IFRS 4***Insurance contracts acquired in a business combination or portfolio transfer*

31. To comply with IFRS 3 *Business Combinations*, an insurer shall, at the acquisition date, measure at fair value the insurance liabilities assumed and *insurance assets* acquired in a business combination. However, an insurer is permitted, but not required, to use an expanded presentation that splits the fair value of acquired insurance contracts into two components:
- (a) a liability measured in accordance with the insurer's accounting policies for insurance contracts that it issues;
- and
- (b) an intangible asset, representing the difference between (i) the fair value of the contractual insurance rights acquired and insurance obligations assumed and (ii) the amount described in (a). The subsequent measurement of this asset shall be consistent with the measurement of the related insurance liability.
32. An insurer acquiring a portfolio of insurance contracts may use the expanded presentation described in paragraph 31.
33. The intangible assets described in paragraphs 31 and 32 are excluded from the scope of IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets*. However, IAS 36 and IAS 38 apply to customer lists and customer relationships reflecting the expectation of future contracts that are not part of the contractual insurance rights and contractual insurance obligations that existed at the date of a business combination or portfolio transfer.

*Discretionary participation features*

## Discretionary participation features in insurance contracts

34. Some insurance contracts contain a discretionary participation feature as well as a *guaranteed element*. The issuer of such a contract:
- (a) may, but need not, recognise the guaranteed element separately from the discretionary participation feature. If the issuer does not recognise them separately, it shall classify the whole contract as a liability. If the issuer classifies them separately, it shall classify the guaranteed element as a liability.
  - (b) shall, if it recognises the discretionary participation feature separately from the guaranteed element, classify that feature as either a liability or a separate component of equity. This IFRS does not specify how the issuer determines whether that feature is a liability or equity. The issuer may split that feature into liability and equity components and shall use a consistent accounting policy for that split. The issuer shall not classify that feature as an intermediate category that is neither liability nor equity.
  - (c) may recognise all premiums received as revenue without separating any portion that relates to the equity component. The resulting changes in the guaranteed element and in the portion of the discretionary participation feature classified as a liability shall be recognised in profit or loss. If part or all of the discretionary participation feature is classified in equity, a portion of profit or loss may be attributable to that feature (in the same way that a portion may be attributable to minority interests). The issuer shall recognise the portion of profit or loss attributable to any equity component of a discretionary participation feature as an allocation of profit or loss, not as expense or income (see IAS 1 *Presentation of Financial Statements*).
  - (d) shall, if the contract contains an embedded derivative within the scope of IAS 39, apply IAS 39 to that embedded derivative.
  - (e) shall, in all respects not described in paragraphs 14-20 and 34(a)-(d), continue its existing accounting policies for such contracts, unless it changes those accounting policies in a way that complies with paragraphs 21-30.

## Discretionary participation features in financial instruments

IFRS 4

35. The requirements in paragraph 34 also apply to a financial instrument that contains a discretionary participation feature. In addition:
- (a) if the issuer classifies the entire discretionary participation feature as a liability, it shall apply the liability adequacy test in paragraphs 15-19 to the whole contract (ie both the guaranteed element and the discretionary participation feature). The issuer need not determine the amount that would result from applying IAS 39 to the guaranteed element.
  - (b) if the issuer classifies part or all of that feature as a separate component of equity, the liability recognised for the whole contract shall not be less than the amount that would result from applying IAS 39 to the guaranteed element. That amount shall include the intrinsic value of an option to surrender the contract, but need not include its time value if paragraph 9 exempts that option from measurement at fair value. The issuer need not disclose the amount that would result from applying IAS 39 to the guaranteed element, nor need it present that amount separately. Furthermore, the issuer need not determine that amount if the total liability recognised is clearly higher.
  - (c) although these contracts are financial instruments, the issuer may continue to recognise the premiums for those contracts as revenue and recognise as an expense the resulting increase in the carrying amount of the liability.

## DISCLOSURE

*Explanation of recognised amounts*

36. **An insurer shall disclose information that identifies and explains the amounts in its financial statements arising from insurance contracts.**
37. To comply with paragraph 36, an insurer shall disclose:
- (a) its accounting policies for insurance contracts and related assets, liabilities, income and expense.
  - (b) the recognised assets, liabilities, income and expense (and, if it presents its cash flow statement using the direct method, cash flows) arising from insurance contracts. Furthermore, if the insurer is a cedant, it shall disclose:
    - (i) gains and losses recognised in profit or loss on buying reinsurance;
    - and
    - (ii) if the cedant defers and amortises gains and losses arising on buying reinsurance, the amortisation for the period and the amounts remaining unamortised at the beginning and end of the period.
  - (c) the process used to determine the assumptions that have the greatest effect on the measurement of the recognised amounts described in (b). When practicable, an insurer shall also give quantified disclosure of those assumptions.
  - (d) the effect of changes in assumptions used to measure insurance assets and insurance liabilities, showing separately the effect of each change that has a material effect on the financial statements.
  - (e) reconciliations of changes in insurance liabilities, reinsurance assets and, if any, related deferred acquisition costs.

**IFRS 4***Amount, timing and uncertainty of cash flows*

38. **An insurer shall disclose information that helps users to understand the amount, timing and uncertainty of future cash flows from insurance contracts.**
39. To comply with paragraph 38, an insurer shall disclose:
- (a) its objectives in managing risks arising from insurance contracts and its policies for mitigating those risks.
  - (b) those terms and conditions of insurance contracts that have a material effect on the amount, timing and uncertainty of the insurer's future cash flows.
  - (c) information about *insurance risk* (both before and after risk mitigation by reinsurance), including information about:
    - (i) the sensitivity of profit or loss and equity to changes in variables that have a material effect on them.
    - (ii) concentrations of insurance risk.
    - (iii) actual claims compared with previous estimates (ie claims development). The disclosure about claims development shall go back to the period when the earliest material claim arose for which there is still uncertainty about the amount and timing of the claims payments, but need not go back more than ten years. An insurer need not disclose this information for claims for which uncertainty about the amount and timing of claims payments is typically resolved within one year.
  - (d) the information about interest rate risk and credit risk that IAS 32 would require if the insurance contracts were within the scope of IAS 32.
  - (e) information about exposures to interest rate risk or market risk under embedded derivatives contained in a host insurance contract if the insurer is not required to, and does not, measure the embedded derivatives at fair value.

**EFFECTIVE DATE AND TRANSITION**

40. The transitional provisions in paragraphs 41-45 apply both to an entity that is already applying IFRSs when it first applies this IFRS and to an entity that applies IFRSs for the first-time (a first-time adopter).
41. An entity shall apply this IFRS for annual periods beginning on or after 1 January 2005. Earlier application is encouraged. If an entity applies this IFRS for an earlier period, it shall disclose that fact.

*Disclosure*

42. An entity need not apply the disclosure requirements in this IFRS to comparative information that relates to annual periods beginning before 1 January 2005, except for the disclosures required by paragraph 37(a) and (b) about accounting policies, and recognised assets, liabilities, income and expense (and cash flows if the direct method is used).
43. If it is impracticable to apply a particular requirement of paragraphs 10-35 to comparative information that relates to annual periods beginning before 1 January 2005, an entity shall disclose that fact. Applying the liability adequacy test (paragraphs 15-19) to such comparative information might sometimes be impracticable, but it is highly unlikely to be impracticable to apply other requirements of paragraphs 10-35 to such comparative information. IAS 8 explains the term 'impracticable'.

44. In applying paragraph 39(c)(iii), an entity need not disclose information about claims development that occurred earlier than five years before the end of the first financial year in which it applies this IFRS. Furthermore, if it is impracticable, when an entity first applies this IFRS, to prepare information about claims development that occurred before the beginning of the earliest period for which an entity presents full comparative information that complies with this IFRS, the entity shall disclose that fact.

*Redesignation of financial assets*

45. When an insurer changes its accounting policies for insurance liabilities, it is permitted, but not required, to reclassify some or all of its financial assets as 'at fair value through profit or loss'. This reclassification is permitted if an insurer changes accounting policies when it first applies this IFRS and if it makes a subsequent policy change permitted by paragraph 22. The reclassification is a change in accounting policy and IAS 8 applies.
-

## IFRS 4

## APPENDIX A

## Defined terms

*This appendix is an integral part of the IFRS.*

<b>cedant</b>	The <b>policyholder</b> under a <b>reinsurance contract</b> .
<b>deposit component</b>	A contractual component that is not accounted for as a derivative under IAS 39 and would be within the scope of IAS 39 if it were a separate instrument.
<b>direct insurance contract</b>	An <b>insurance contract</b> that is not a <b>reinsurance contract</b> .
<b>discretionary participation feature</b>	A contractual right to receive, as a supplement to <b>guaranteed benefits</b> , additional benefits: <ul style="list-style-type: none"> <li>(a) that are likely to be a significant portion of the total contractual benefits;</li> <li>(b) whose amount or timing is contractually at the discretion of the issuer;</li> </ul> <p style="text-align: center;">and</p> <ul style="list-style-type: none"> <li>(c) that are contractually based on: <ul style="list-style-type: none"> <li>(i) the performance of a specified pool of contracts or a specified type of contract;</li> <li>(ii) realised and/or unrealised investment returns on a specified pool of assets held by the issuer;</li> </ul> <p style="text-align: center;">or</p> <ul style="list-style-type: none"> <li>(iii) the profit or loss of the company, fund or other entity that issues the contract.</li> </ul> </li> </ul>
<b>fair value</b>	The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
<b>financial risk</b>	The risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract.
<b>guaranteed benefits</b>	Payments or other benefits to which a particular <b>policyholder</b> or investor has an unconditional right that is not subject to the contractual discretion of the issuer.
<b>guaranteed element</b>	An obligation to pay <b>guaranteed benefits</b> , included in a contract that contains a discretionary participation feature.
<b>insurance asset</b>	An <b>insurer's</b> net contractual rights under an <b>insurance contract</b> .
<b>insurance contract</b>	A contract under which one party (the <b>insurer</b> ) accepts significant <b>insurance risk</b> from another party (the <b>policyholder</b> ) by agreeing to compensate the policyholder if a specified uncertain future event (the <b>insured event</b> ) adversely affects the policyholder. (See Appendix B for guidance on this definition.)
<b>insurance liability</b>	An <b>insurer's</b> net contractual obligations under an <b>insurance contract</b> .
<b>insurance risk</b>	Risk, other than <b>financial risk</b> , transferred from the holder of a contract to the issuer.
<b>insured event</b>	An uncertain future event that is covered by an <b>insurance contract</b> and creates <b>insurance risk</b> .

<b>insurer</b>	The party that has an obligation under an <b>insurance contract</b> to compensate a <b>policyholder</b> if an <b>insured event</b> occurs.	<b>IFRS 4</b>
<b>liability adequacy test</b>	An assessment of whether the carrying amount of an <b>insurance liability</b> needs to be increased (or the carrying amount of related deferred acquisition costs or related intangible assets decreased), based on a review of future cash flows.	
<b>policyholder</b>	A party that has a right to compensation under an <b>insurance contract</b> if an <b>insured event</b> occurs.	
<b>reinsurance assets</b>	A <b>cedant's</b> net contractual rights under a <b>reinsurance contract</b> .	
<b>reinsurance contract</b>	An <b>insurance contract</b> issued by one <b>insurer</b> (the <b>reinsurer</b> ) to compensate another insurer (the <b>cedant</b> ) for losses on one or more contracts issued by the cedant.	
<b>reinsurer</b>	The party that has an obligation under a <b>reinsurance contract</b> to compensate a <b>cedant</b> if an <b>insured event</b> occurs.	
<b>unbundle</b>	Account for the components of a contract as if they were separate contracts.	

---

## IFRS 4

## APPENDIX B

**Definition of an insurance contract**

*This appendix is an integral part of the IFRS.*

B1 This appendix gives guidance on the definition of an insurance contract in Appendix A. It addresses the following issues:

- (a) the term 'uncertain future event' (paragraphs B2-B4);
  - (b) payments in kind (paragraphs B5-B7);
  - (c) insurance risk and other risks (paragraphs B8-B17);
  - (d) examples of insurance contracts (paragraphs B18-B21);
  - (e) significant insurance risk (paragraphs B22-B28);
- and
- (f) changes in the level of insurance risk (paragraphs B29 and B30).

**Uncertain future event**

B2 Uncertainty (or risk) is the essence of an insurance contract. Accordingly, at least one of the following is uncertain at the inception of an insurance contract:

- (a) whether an *insured event* will occur;
  - (b) when it will occur;
- or
- (c) how much the insurer will need to pay if it occurs.

B3 In some insurance contracts, the insured event is the discovery of a loss during the term of the contract, even if the loss arises from an event that occurred before the inception of the contract. In other insurance contracts, the insured event is an event that occurs during the term of the contract, even if the resulting loss is discovered after the end of the contract term.

B4 Some insurance contracts cover events that have already occurred, but whose financial effect is still uncertain. An example is a reinsurance contract that covers the direct insurer against adverse development of claims already reported by policyholders. In such contracts, the insured event is the discovery of the ultimate cost of those claims.

**Payments in kind**

B5 Some insurance contracts require or permit payments to be made in kind. An example is when the insurer replaces a stolen article directly, instead of reimbursing the policyholder. Another example is when an insurer uses its own hospitals and medical staff to provide medical services covered by the contracts.

- B6 Some fixed-fee service contracts in which the level of service depends on an uncertain event meet the definition of an insurance contract in this IFRS but are not regulated as insurance contracts in some countries. One example is a maintenance contract in which the service provider agrees to repair specified equipment after a malfunction. The fixed service fee is based on the expected number of malfunctions, but it is uncertain whether a particular machine will break down. The malfunction of the equipment adversely affects its owner and the contract compensates the owner (in kind, rather than cash). Another example is a contract for car breakdown services in which the provider agrees, for a fixed annual fee, to provide roadside assistance or tow the car to a nearby garage. The latter contract could meet the definition of an insurance contract even if the provider does not agree to carry out repairs or replace parts.
- B7 Applying the IFRS to the contracts described in paragraph B6 is likely to be no more burdensome than applying the IFRSs that would be applicable if such contracts were outside the scope of this IFRS:
- (a) There are unlikely to be material liabilities for malfunctions and breakdowns that have already occurred.
  - (b) If IAS 18 *Revenue* applied, the service provider would recognise revenue by reference to the stage of completion (and subject to other specified criteria). That approach is also acceptable under this IFRS, which permits the service provider (i) to continue its existing accounting policies for these contracts unless they involve practices prohibited by paragraph 14 and (ii) to improve its accounting policies if so permitted by paragraphs 22-30.
  - (c) The service provider considers whether the cost of meeting its contractual obligation to provide services exceeds the revenue received in advance. To do this, it applies the liability adequacy test described in paragraphs 15-19 of this IFRS. If this IFRS did not apply to these contracts, the service provider would apply IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* to determine whether the contracts are onerous.
  - (d) For these contracts, the disclosure requirements in this IFRS are unlikely to add significantly to disclosures required by other IFRSs.

#### **Distinction between insurance risk and other risks**

- B8 The definition of an insurance contract refers to insurance risk, which this IFRS defines as risk, other than *financial risk*, transferred from the holder of a contract to the issuer. A contract that exposes the issuer to financial risk without significant insurance risk is not an insurance contract.
- B9 The definition of financial risk in Appendix A includes a list of financial and non-financial variables. That list includes non-financial variables that are not specific to a party to the contract, such as an index of earthquake losses in a particular region or an index of temperatures in a particular city. It excludes nonfinancial variables that are specific to a party to the contract, such as the occurrence or nonoccurrence of a fire that damages or destroys an asset of that party. Furthermore, the risk of changes in the fair value of a nonfinancial asset is not a financial risk if the fair value reflects not only changes in market prices for such assets (a financial variable) but also the condition of a specific non-financial asset held by a party to a contract (a nonfinancial variable). For example, if a guarantee of the residual value of a specific car exposes the guarantor to the risk of changes in the car's physical condition, that risk is insurance risk, not financial risk.
- B10 Some contracts expose the issuer to financial risk, in addition to significant insurance risk. For example, many life insurance contracts both guarantee a minimum rate of return to policyholders (creating financial risk) and promise death benefits that at some times significantly exceed the policyholder's account balance (creating insurance risk in the form of mortality risk). Such contracts are insurance contracts.

**IFRS 4**

- B11 Under some contracts, an insured event triggers the payment of an amount linked to a price index. Such contracts are insurance contracts, provided the payment that is contingent on the insured event can be significant. For example, a life-contingent annuity linked to a cost-of-living index transfers insurance risk because payment is triggered by an uncertain event — the survival of the annuitant. The link to the price index is an embedded derivative, but it also transfers insurance risk. If the resulting transfer of insurance risk is significant, the embedded derivative meets the definition of an insurance contract, in which case it need not be separated and measured at fair value (see paragraph 7 of this IFRS).
- B12 The definition of insurance risk refers to risk that the insurer accepts from the policyholder. In other words, insurance risk is a pre-existing risk transferred from the policyholder to the insurer. Thus, a new risk created by the contract is not insurance risk.
- B13 The definition of an insurance contract refers to an adverse effect on the policyholder. The definition does not limit the payment by the insurer to an amount equal to the financial impact of the adverse event. For example, the definition does not exclude 'new-for-old' coverage that pays the policyholder sufficient to permit replacement of a damaged old asset by a new asset. Similarly, the definition does not limit payment under a term life insurance contract to the financial loss suffered by the deceased's dependants, nor does it preclude the payment of predetermined amounts to quantify the loss caused by death or an accident.
- B14 Some contracts require a payment if a specified uncertain event occurs, but do not require an adverse effect on the policyholder as a precondition for payment. Such a contract is not an insurance contract even if the holder uses the contract to mitigate an underlying risk exposure. For example, if the holder uses a derivative to hedge an underlying nonfinancial variable that is correlated with cash flows from an asset of the entity, the derivative is not an insurance contract because payment is not conditional on whether the holder is adversely affected by a reduction in the cash flows from the asset. Conversely, the definition of an insurance contract refers to an uncertain event for which an adverse effect on the policyholder is a contractual precondition for payment. This contractual precondition does not require the insurer to investigate whether the event actually caused an adverse effect, but permits the insurer to deny payment if it is not satisfied that the event caused an adverse effect.
- B15 Lapse or persistency risk (ie the risk that the counterparty will cancel the contract earlier or later than the issuer had expected in pricing the contract) is not insurance risk because the payment to the counterparty is not contingent on an uncertain future event that adversely affects the counterparty. Similarly, expense risk (ie the risk of unexpected increases in the administrative costs associated with the servicing of a contract, rather than in costs associated with insured events) is not insurance risk because an unexpected increase in expenses does not adversely affect the counterparty.
- B16 Therefore, a contract that exposes the issuer to lapse risk, persistency risk or expense risk is not an insurance contract unless it also exposes the issuer to insurance risk. However, if the issuer of that contract mitigates that risk by using a second contract to transfer part of that risk to another party, the second contract exposes that other party to insurance risk.
- B17 An insurer can accept significant insurance risk from the policyholder only if the insurer is an entity separate from the policyholder. In the case of a mutual insurer, the mutual accepts risk from each policyholder and pools that risk. Although policyholders bear that pooled risk collectively in their capacity as owners, the mutual has still accepted the risk that is the essence of an insurance contract.

**Examples of insurance contracts**

- B18 The following are examples of contracts that are insurance contracts, if the transfer of insurance risk is significant:
- (a) insurance against theft or damage to property.
  - (b) insurance against product liability, professional liability, civil liability or legal expenses.

- (c) life insurance and prepaid funeral plans (although death is certain, it is uncertain when death will occur or, for some types of life insurance, whether death will occur within the period covered by the insurance).
- (d) life-contingent annuities and pensions (ie contracts that provide compensation for the uncertain future event — the survival of the annuitant or pensioner — to assist the annuitant or pensioner in maintaining a given standard of living, which would otherwise be adversely affected by his or her survival).
- (e) disability and medical cover.
- (f) surety bonds, fidelity bonds, performance bonds and bid bonds (ie contracts that provide compensation if another party fails to perform a contractual obligation, for example an obligation to construct a building).
- (g) credit insurance that provides for specified payments to be made to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due under the original or modified terms of a debt instrument. These contracts could have various legal forms, such as that of a financial guarantee, letter of credit, credit derivative default product or insurance contract. However, these contracts are outside the scope of this IFRS if the entity entered into them, or retained them, on transferring to another party financial assets or financial liabilities within the scope of IAS 39 (see paragraph 4(d)).
- (h) product warranties. Product warranties issued by another party for goods sold by a manufacturer, dealer or retailer are within the scope of this IFRS. However, product warranties issued directly by a manufacturer, dealer or retailer are outside its scope, because they are within the scope of IAS 18 *Revenue* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.
- (i) title insurance (ie insurance against the discovery of defects in title to land that were not apparent when the insurance contract was written). In this case, the insured event is the discovery of a defect in the title, not the defect itself.
- (j) travel assistance (ie compensation in cash or in kind to policyholders for losses suffered while they are travelling). Paragraphs B6 and B7 discuss some contracts of this kind.
- (k) catastrophe bonds that provide for reduced payments of principal, interest or both if a specified event adversely affects the issuer of the bond (unless the specified event does not create significant insurance risk, for example if the event is a change in an interest rate or foreign exchange rate).
- (l) insurance swaps and other contracts that require a payment based on changes in climatic, geological or other physical variables that are specific to a party to the contract.
- (m) reinsurance contracts.

B19 The following are examples of items that are not insurance contracts:

- (a) investment contracts that have the legal form of an insurance contract but do not expose the insurer to significant insurance risk, for example life insurance contracts in which the insurer bears no significant mortality risk (such contracts are non-insurance financial instruments or service contracts, see paragraphs B20 and B21).
- (b) contracts that have the legal form of insurance, but pass all significant insurance risk back to the policyholder through noncancellable and enforceable mechanisms that adjust future payments by the policyholder as a direct result of insured losses, for example some financial reinsurance contracts or some group contracts (such contracts are normally noninsurance financial instruments or service contracts, see paragraphs B20 and B21).

**IFRS 4**

- (c) self-insurance, in other words retaining a risk that could have been covered by insurance (there is no insurance contract because there is no agreement with another party).
  - (d) contracts (such as gambling contracts) that require a payment if a specified uncertain future event occurs, but do not require, as a contractual precondition for payment, that the event adversely affects the policyholder. However, this does not preclude the specification of a predetermined payout to quantify the loss caused by a specified event such as death or an accident (see also paragraph B13).
  - (e) derivatives that expose one party to financial risk but not insurance risk, because they require that party to make payment based solely on changes in one or more of a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (see IAS 39).
  - (f) a financial guarantee contract (or letter of credit, credit derivative default product or credit insurance contract) that requires payments even if the holder has not incurred a loss on the failure of the debtor to make payments when due (see IAS 39).
  - (g) contracts that require a payment based on a climatic, geological or other physical variable that is not specific to a party to the contract (commonly described as weather derivatives).
  - (h) catastrophe bonds that provide for reduced payments of principal, interest or both, based on a climatic, geological or other physical variable that is not specific to a party to the contract.
- B20 If the contracts described in paragraph B19 create financial assets or financial liabilities, they are within the scope of IAS 39. Among other things, this means that the parties to the contract use what is sometimes called deposit accounting, which involves the following:
- (a) one party recognises the consideration received as a financial liability, rather than as revenue.
  - (b) the other party recognises the consideration paid as a financial asset, rather than as an expense.
- B21 If the contracts described in paragraph B19 do not create financial assets or financial liabilities, IAS 18 applies. Under IAS 18, revenue associated with a transaction involving the rendering of services is recognised by reference to the stage of completion of the transaction if the outcome of the transaction can be estimated reliably.

**Significant insurance risk**

- B22 A contract is an insurance contract only if it transfers significant insurance risk. Paragraphs B8-B21 discuss insurance risk. The following paragraphs discuss the assessment of whether insurance risk is significant.
- B23 Insurance risk is significant if, and only if, an insured event could cause an insurer to pay significant additional benefits in any scenario, excluding scenarios that lack commercial substance (ie have no discernible effect on the economics of the transaction). If significant additional benefits would be payable in scenarios that have commercial substance, the condition in the previous sentence may be met even if the insured event is extremely unlikely or even if the expected (ie probability-weighted) present value of contingent cash flows is a small proportion of the expected present value of all the remaining contractual cash flows.

- B24 The additional benefits described in paragraph B23 refer to amounts that exceed those that would be payable if no insured event occurred (excluding scenarios that lack commercial substance). Those additional amounts include claims handling and claims assessment costs, but exclude:
- (a) the loss of the ability to charge the policyholder for future services. For example, in an investment-linked life insurance contract, the death of the policyholder means that the insurer can no longer perform investment management services and collect a fee for doing so. However, this economic loss for the insurer does not reflect insurance risk, just as a mutual fund manager does not take on insurance risk in relation to the possible death of the client. Therefore, the potential loss of future investment management fees is not relevant in assessing how much insurance risk is transferred by a contract.
  - (b) waiver on death of charges that would be made on cancellation or surrender. Because the contract brought those charges into existence, the waiver of these charges does not compensate the policyholder for a pre-existing risk. Hence, they are not relevant in assessing how much insurance risk is transferred by a contract.
  - (c) a payment conditional on an event that does not cause a significant loss to the holder of the contract. For example, consider a contract that requires the issuer to pay one million currency units if an asset suffers physical damage causing an insignificant economic loss of one currency unit to the holder. In this contract, the holder transfers to the insurer the insignificant risk of losing one currency unit. At the same time, the contract creates non-insurance risk that the issuer will need to pay 999 999 currency units if the specified event occurs. Because the issuer does not accept significant insurance risk from the holder, this contract is not an insurance contract.
  - (d) possible reinsurance recoveries. The insurer accounts for these separately.
- B25 An insurer shall assess the significance of insurance risk contract by contract, rather than by reference to materiality to the financial statements. (\*) Thus, insurance risk may be significant even if there is a minimal probability of material losses for a whole book of contracts. This contract-by-contract assessment makes it easier to classify a contract as an insurance contract. However, if a relatively homogeneous book of small contracts is known to consist of contracts that all transfer insurance risk, an insurer need not examine each contract within that book to identify a few non-derivative contracts that transfer insignificant insurance risk.
- B26 It follows from paragraphs B23-B25 that if a contract pays a death benefit exceeding the amount payable on survival, the contract is an insurance contract unless the additional death benefit is insignificant (judged by reference to the contract rather than to an entire book of contracts). As noted in paragraph B24(b), the waiver on death of cancellation or surrender charges is not included in this assessment if this waiver does not compensate the policyholder for a pre-existing risk. Similarly, an annuity contract that pays out regular sums for the rest of a policyholder's life is an insurance contract, unless the aggregate lifecontingent payments are insignificant.
- B27 Paragraph B23 refers to additional benefits. These additional benefits could include a requirement to pay benefits earlier if the insured event occurs earlier and the payment is not adjusted for the time value of money. An example is whole life insurance for a fixed amount (in other words, insurance that provides a fixed death benefit whenever the policyholder dies, with no expiry date for the cover). It is certain that the policyholder will die, but the date of death is uncertain. The insurer will suffer a loss on those individual contracts for which policyholders die early, even if there is no overall loss on the whole book of contracts.
- B28 If an insurance contract is unbundled into a deposit component and an insurance component, the significance of insurance risk transfer is assessed by reference to the insurance component. The significance of insurance risk transferred by an embedded derivative is assessed by reference to the embedded derivative.

(\*) For this purpose, contracts entered into simultaneously with a single counterparty (or contracts that are otherwise interdependent) form a single contract.

**IFRS 4****Changes in the level of insurance risk**

- B29 Some contracts do not transfer any insurance risk to the issuer at inception, although they do transfer insurance risk at a later time. For example, consider a contract that provides a specified investment return and includes an option for the policyholder to use the proceeds of the investment on maturity to buy a life-contingent annuity at the current annuity rates charged by the insurer to other new annuitants when the policyholder exercises the option. The contract transfers no insurance risk to the issuer until the option is exercised, because the insurer remains free to price the annuity on a basis that reflects the insurance risk transferred to the insurer at that time. However, if the contract specifies the annuity rates (or a basis for setting the annuity rates), the contract transfers insurance risk to the issuer at inception.
- B30 A contract that qualifies as an insurance contract remains an insurance contract until all rights and obligations are extinguished or expire.
-

## APPENDIX C

## IFRS 4

**Amendments to other IFRSs**

*The amendments in this appendix shall be applied for annual periods beginning on or after 1 January 2005. If an entity adopts this IFRS for an earlier period, these amendments shall be applied for that earlier period.*

**Amendments to IAS 32 and IAS 39**

- C1 In IAS 32 *Financial Instruments: Disclosure and Presentation* (as revised in 2003), paragraph 4(d) is renumbered as 4(c). Paragraph 4(c) is renumbered as 4(d) and amended as set out in paragraph C4.

Paragraph 6 is deleted.

The following sentence is added to the end of paragraph AG8:

Some of these contingent rights and obligations may be insurance contracts within the scope of IFRS 4.

- C2 In IAS 39 *Financial Instruments: Recognition and Measurement* (as revised in 2003), paragraph 2(e) is renumbered as paragraph 2(d). Paragraph 2(d) is renumbered as 2(e) and amended as set out in paragraph C5. Paragraph AG4 is amended to read as follows:

AG4. This Standard applies to the financial assets and financial liabilities of insurers, other than rights and obligations that paragraph 2(e) excludes because they arise under contracts within the scope of IFRS 4.

- C3 Paragraphs 4(e) of IAS 32 and 2(h) of IAS 39 contain scope exclusions for derivatives based on climatic, geological, or other physical variables. Those paragraphs are deleted. As a result, such derivatives are within the scope of IAS 32 and IAS 39, unless they meet the definition of an insurance contract and are within the scope of IFRS 4. Furthermore, paragraph AG1 of IAS 39 is amended to read as follows:

AG1. Some contracts require a payment based on climatic, geological or other physical variables. (Those based on climatic variables are sometimes referred to as 'weather derivatives'.) If those contracts are not within the scope of IFRS 4 *Insurance Contracts*, they are within the scope of this Standard.

- C4 In IAS 32, a new paragraph 4(e) is inserted. Following this change and changes made by paragraphs C1 and C3, and by IFRS 3 *Business Combinations*, paragraph 4(c)-(e) reads as follows:

- (c) **contracts for contingent consideration in a business combination (see IFRS 3 Business Combinations). This exemption applies only to the acquirer.**
- (d) **insurance contracts as defined in IFRS 4 Insurance Contracts. However, this Standard applies to derivatives that are embedded in insurance contracts if IAS 39 requires the entity to account for them separately.**
- (e) **financial instruments that are within the scope of IFRS 4 because they contain a discretionary participation feature. The issuer of these instruments is exempt from applying to these features paragraphs 15-32 and AG25-AG35 of this Standard regarding the distinction between financial liabilities and equity instruments. However, these instruments are subject to all other requirements of this Standard. Furthermore, this Standard applies to derivatives that are embedded in these instruments (see IAS 39).**

Paragraph 4(f), inserted by IFRS 2 *Share-based Payment*, remains unchanged.

## IFRS 4

C5 In IAS 39, paragraph 2(f) is deleted. Following this change and changes made by paragraphs C2 and C3, and by IFRS 3 *Business Combinations*, paragraph 2(d)-(g) reads as follows:

- (d) *financial instruments issued by the entity that meet the definition of an equity instrument in IAS 32 (including options and warrants). However, the holder of such equity instruments shall apply this Standard to those instruments, unless they meet the exception in (a) above.*
- (e) *rights and obligations under an insurance contract as defined in IFRS 4 Insurance Contracts or under a contract that is within the scope of IFRS 4 because it contains a discretionary participation feature. However, this Standard applies to a derivative that is embedded in such a contract if the derivative is not itself a contract within the scope of IFRS 4 (see paragraphs 10-13 and Appendix A paragraphs AG23-AG33). Furthermore, if an insurance contract is a financial guarantee contract entered into, or retained, on transferring to another party financial assets or financial liabilities within the scope of this Standard, the issuer shall apply this Standard to the contract (see paragraph 3 and Appendix A paragraph AG4A).*
- (f) *contracts for contingent consideration in a business combination (see IFRS 3 Business Combinations). This exemption applies only to the acquirer.*
- (g) *contracts between an acquirer and a vendor in a business combination to buy or sell an acquiree at a future date.*

Paragraph 2(i) and (j) is renumbered as 2(h) and (i). Paragraph 2(i) was inserted by IFRS 2 *Share-based Payment*.

Paragraph 3 is deleted and replaced by a new paragraph 3 and paragraph AG4A is added, as follows:

3. Some financial guarantee contracts require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due under the original or modified terms of a debt instrument. If that requirement transfers significant risk to the issuer, the contract is an insurance contract as defined in IFRS 4 (see paragraphs 2(e) and AG4A). Other financial guarantee contracts require payments to be made in response to changes in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract. Such contracts are within the scope of this Standard.

AG4A. Financial guarantee contracts may have various legal forms, such as a financial guarantee, letter of credit, credit default contract or insurance contract. Their accounting treatment does not depend on their legal form. The following are examples of the appropriate treatment (see paragraphs 2(e) and 3):

- (a) If the contract is not an insurance contract, as defined in IFRS 4, the issuer applies this Standard. Thus, a financial guarantee contract that requires payments if the credit rating of a debtor falls below a particular level is within the scope of this Standard.
- (b) If the issuer incurred or retained the financial guarantee on transferring to another party financial assets or financial liabilities within the scope of this Standard, the issuer applies this Standard.
- (c) If the contract is an insurance contract, as defined in IFRS 4, the issuer applies IFRS 4 unless (b) applies.
- (d) If the issuer gave a financial guarantee in connection with the sale of goods, the issuer applies IAS 18 in determining when it recognises the resulting revenue.

- C6 In IAS 39, paragraph 9, the phrase 'other variable' in the definition of a derivative is replaced by the phrase 'other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract'. The same change is made in paragraph 10 of IAS 39. The following new paragraph AG12A is added to IAS 39:

AG12A. The definition of a derivative refers to non-financial variables that are not specific to a party to the contract. These include an index of earthquake losses in a particular region and an index of temperatures in a particular city. Non-financial variables specific to a party to the contract include the occurrence or non-occurrence of a fire that damages or destroys an asset of a party to the contract. A change in the fair value of a nonfinancial asset is specific to the owner if the fair value reflects not only changes in market prices for such assets (a financial variable) but also the condition of the specific nonfinancial asset held (a nonfinancial variable). For example, if a guarantee of the residual value of a specific car exposes the guarantor to the risk of changes in the car's physical condition, the change in that residual value is specific to the owner of the car.

- C7 In IAS 32, the following new paragraph 91A is inserted, and in paragraph 86 the cross-reference to paragraph 90 is extended to include paragraph 91A:

91A. ***Some financial assets and financial liabilities contain a discretionary participation feature as described in IFRS 4 Insurance Contracts. If an entity cannot measure reliably the fair value of that feature, the entity shall disclose that fact together with a description of the contract, its carrying amount, an explanation of why fair value cannot be measured reliably and, if possible, the range of estimates within which fair value is highly likely to lie.***

In paragraph 49(e), 'insurance policy' is replaced by 'insurance contract'.

- C8 In IAS 39, paragraph AG30 gives examples of embedded derivatives that are regarded as not closely related to a host contract, and paragraph AG33 gives examples of embedded derivatives that are regarded as closely related to a host contract. Paragraphs AG30(g) and AG33 (a), (b) and (d) are amended by the insertion of references to insurance contracts as follows and in paragraph AG33, (g) and (h) are added:

AG30 (g) A call, put, or prepayment option embedded in a host debt contract or host insurance contract is not closely related to the host contract unless the option's exercise price is approximately equal on each exercise date to the amortised cost of the host debt instrument or the carrying amount of the host insurance contract. From the perspective of the issuer of a convertible debt instrument with an embedded call or put option feature, the assessment of whether the call or put option is closely related to the host debt contract is made before separating the equity element under IAS 32.

AG33 (a) An embedded derivative in which the underlying is an interest rate or interest rate index that can change the amount of interest that would otherwise be paid or received on an interest-bearing host debt contract or insurance contract is closely related to the host contract unless the combined contract can be settled in such a way that the holder would not recover substantially all of its recognised investment or the embedded derivative could at least double the holder's initial rate of return on the host contract and could result in a rate of return that is at least twice what the market return would be for a contract with the same terms as the host contract.

(b) An embedded floor or cap on the interest rate on a debt contract or insurance contract is closely related to the host contract, provided the cap is at or above the market rate of interest and the floor is at or below the market rate of interest when the contract is issued, and the cap or floor is not leveraged in relation to the host contract. Similarly, provisions included in a contract to purchase or sell an asset (eg a commodity) that establish a cap and a floor on the price to be paid or received for the asset are closely related to the host contract if both the cap and floor were out of the money at inception and are not leveraged.

## IFRS 4

- (d) An embedded foreign currency derivative in a host contract that is an insurance contract or not a financial instrument (such as a contract for the purchase or sale of a non-financial item where the price is denominated in a foreign currency) is closely related to the host contract provided it is not leveraged, does not contain an option feature, and requires payments denominated in one of the following currencies:
- (i) the functional currency of any substantial party to that contract;
  - (ii) the currency in which the price of the related good or service that is acquired or delivered is routinely denominated in commercial transactions around the world (such as the US dollar for crude oil transactions);
- or
- (iii) a currency that is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place (eg a relatively stable and liquid currency that is commonly used in local business transactions or external trade).
- (g) A unit-linking feature embedded in a host financial instrument or host insurance contract is closely related to the host instrument or host contract if the unit-denominated payments are measured at current unit values that reflect the fair values of the assets of the fund. A unit-linking feature is a contractual term that requires payments denominated in units of an internal or external investment fund.
- (h) A derivative embedded in an insurance contract is closely related to the host insurance contract if the embedded derivative and host insurance contract are so interdependent that an entity cannot measure the embedded derivative separately (ie without considering the host contract).

**Amendments to other IFRSs**

C9 IAS 18 *Revenue* is amended as described below.

Paragraph 6(c) is amended to read as follows:

- (c) insurance contracts within the scope of IFRS 4 *Insurance Contracts*;

C10 In IAS 19 *Employee Benefits*, the following footnote is added to the definition in paragraph 7 of a qualifying insurance policy, after the first occurrence of the word 'policy':

- (<sup>1</sup>) A qualifying insurance policy is not necessarily an insurance contract, as defined in IFRS 4 *Insurance Contracts*.

C11 In IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, paragraphs 1(b) and 4 are deleted and a new paragraph 5(e) is inserted as follows:

- (e) insurance contracts (see IFRS 4 *Insurance Contracts*). However, this Standard applies to provisions, contingent liabilities and contingent assets of an insurer, other than those arising from its contractual obligations and rights under insurance contracts within the scope of IFRS 4.

In paragraph 2 (as amended in 2003 by IAS 39), the last sentence is deleted.

C12 In IAS 40 *Investment Property* (as revised in 2003), paragraphs 32A-32C and 75(f)(iv) are added and a cross-reference to paragraph 32A is included in paragraph 30 as follows:

- 30. **With the exceptions noted in paragraphs 32A and 34, an entity shall choose as its accounting policy either the fair value model in paragraphs 33-55 or the cost model in paragraph 56 and shall apply that policy to all of its investment property.**

**Investment property linked to liabilities**

IFRS 4

32A. *An entity may:*

(a) *choose either the fair value model or the cost model for all investment property backing liabilities that pay a return linked directly to the fair value of, or returns from, specified assets including that investment property;*

*and*

(b) *choose either the fair value model or the cost model for all other investment property, regardless of the choice made in (a).*

32B. Some insurers and other entities operate an internal property fund that issues notional units, with some units held by investors in linked contracts and others held by the entity. Paragraph 32A does not permit an entity to measure the property held by the fund partly at cost and partly at fair value.

32C. If an entity chooses different models for the two categories described in paragraph 32A, sales of investment property between pools of assets measured using different models shall be recognised at fair value and the cumulative change in fair value shall be recognised in profit or loss. Accordingly, if an investment property is sold from a pool in which the fair value model is used into a pool in which the cost model is used, the property's fair value at the date of the sale becomes its deemed cost.

75(f)(iv) *the cumulative change in fair value recognised in profit or loss on a sale of investment property from a pool of assets in which the cost model is used into a pool in which the fair value model is used (see paragraph 32C).*

C13 IFRS 1 *First-time Adoption of International Financial Reporting Standards* is amended as described below.

In paragraph 12, the reference to paragraphs 13-25C is amended to refer to paragraphs 13-25D.

Paragraph 13(g) and (h) is amended and a new subparagraph (i) is inserted, as follows:

(g) designation of previously recognised financial instruments (paragraph 25A);

(h) share-based payment transactions (paragraphs 25B and 25C);

*and*

(i) insurance contracts (paragraph 25D).

After paragraph 25C, a new heading and paragraph 25D are added, as follows:

**Insurance contracts**

25D A first-time adopter may apply the transitional provisions in IFRS 4 *Insurance Contracts*. IFRS 4 restricts changes in accounting policies for insurance contracts, including changes made by a first-time adopter.

**IFRS 4**

Paragraph 36A and the preceding heading are amended by inserting references to IFRS 4, to read as follows:

*Exemption from the requirement to restate comparative information for IAS 39 and IFRS 4*

36A In its first IFRS financial statements, an entity that adopts IFRSs before 1 January 2006 shall present at least one year of comparative information, but this comparative information need not comply with IAS 32, IAS 39 and IFRS 4. An entity that chooses to present comparative information that does not comply with IAS 32, IAS 39 and IFRS 4 in its first year of transition shall:

- (a) apply its previous GAAP in the comparative information to financial instruments within the scope of IAS 32 and IAS 39 and to insurance contracts within the scope of IFRS 4;
- (b) disclose this fact, together with the basis used to prepare this information;

and

- (c) disclose the nature of the main adjustments that would make the information comply with IAS 32, IAS 39 and IFRS 4. The entity need not quantify those adjustments. However, the entity shall treat any adjustment between the balance sheet at the comparative period's reporting date (ie the balance sheet that includes comparative information under previous GAAP) and the balance sheet at the start of the first IFRS reporting period (ie the first period that includes information that complies with IAS 32, IAS 39 and IFRS 4) as arising from a change in accounting policy and give the disclosures required by paragraph 28(a)-(e) and (f)(i) of IAS 8.

Paragraph 28(f)(i) applies only to amounts presented in the balance sheet at the comparative period's reporting date.

In the case of an entity that chooses to present comparative information that does not comply with IAS 32, IAS 39 and IFRS 4, references to the 'date of transition to IFRSs' shall mean, in the case of those Standards only, the beginning of the first IFRS reporting period.

C14 SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease* (as amended by IAS 39) is amended as described below.

Paragraph 7 is amended as follows:

7. Other obligations of an arrangement, including any guarantees provided and obligations incurred upon early termination, should be accounted for under IAS 37, or IAS 39 or IFRS 4, depending on the terms.

---

## INTERNATIONAL FINANCIAL REPORTING STANDARD 5

## IFRS 5

**Non-current assets held for sale and discontinued operations**

SUMMARY	Paragraphs
Objective	1
Scope	2-5
Classification of non-current assets (or disposal groups) as held for sale	6-14
Non-current assets that are to be abandoned	13-14
Measurement of non-current assets (or disposal groups) classified as held for sale	15-29
Measurement of a non-current asset (or disposal group)	15-19
Recognition of impairment losses and reversals	20-25
Changes to a plan of sale	26-29
Presentation and disclosure	30-42
Presenting discontinued operations	31-36
Gains or losses relating to continuing operations	37
Presentation of a non-current asset or disposal group classified as held for sale	38-40
Additional disclosures	41-42
Transitional provisions	43
Effective date	44
Withdrawal of IAS 35	45

## OBJECTIVE

1. The objective of this IFRS is to specify the accounting for assets held for sale, and the presentation and disclosure of *discontinued operations*. In particular, the IFRS requires:
  - (a) assets that meet the criteria to be classified as held for sale to be measured at the lower of carrying amount and *fair value less costs to sell*, and depreciation on such assets to cease;

and

  - (b) assets that meet the criteria to be classified as held for sale to be presented separately on the face of the balance sheet and the results of discontinued operations to be presented separately in the income statement.

## IFRS 5

## SCOPE

2. The classification and presentation requirements of this IFRS apply to all recognised *non-current assets* (\*) and to all *disposal groups* of an entity. The measurement requirements of this IFRS apply to all recognised noncurrent assets and disposal groups (as set out in paragraph 4), except for those assets listed in paragraph 5 which shall continue to be measured in accordance with the Standard noted.
3. Assets classified as non-current in accordance with IAS 1 *Presentation of Financial Statements* (as revised in 2003) shall not be reclassified as *current assets* until they meet the criteria to be classified as held for sale in accordance with this IFRS. Assets of a class that an entity would normally regard as non-current that are acquired exclusively with a view to resale shall not be classified as current unless they meet the criteria to be classified as held for sale in accordance with this IFRS.
4. Sometimes an entity disposes of a group of assets, possibly with some directly associated liabilities, together in a single transaction. Such a disposal group may be a group of *cash-generating units*, a single cash-generating unit, or part of a cash-generating unit. (\*\*) The group may include any assets and any liabilities of the entity, including current assets, current liabilities and assets excluded by paragraph 5 from the measurement requirements of this IFRS. If a non-current asset within the scope of the measurement requirements of this IFRS is part of a disposal group, the measurement requirements of this IFRS apply to the group as a whole, so that the group is measured at the lower of its carrying amount and fair value less costs to sell. The requirements for measuring the individual assets and liabilities within the disposal group are set out in paragraphs 18, 19 and 23.
5. The measurement provisions of this IFRS (\*\*\*) do not apply to the following assets, which are covered by the Standards listed, either as individual assets or as part of a disposal group:
  - (a) deferred tax assets (IAS 12 *Income Taxes*).
  - (b) assets arising from employee benefits (IAS 19 *Employee Benefits*).
  - (c) financial assets within the scope of IAS 39 *Financial Instruments: Recognition and Measurement*.
  - (d) non-current assets that are accounted for in accordance with the fair value model in IAS 40 *Investment Property*.
  - (e) non-current assets that are measured at fair value less estimated point-of-sale costs in accordance with IAS 41 *Agriculture*.
  - (f) contractual rights under insurance contracts as defined in IFRS 4 *Insurance Contracts*.

## CLASSIFICATION OF NON-CURRENT ASSETS (OR DISPOSAL GROUPS) AS HELD FOR SALE

6. **An entity shall classify a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use.**

(\*) For assets classified according to a liquidity presentation, non-current assets are assets that include amounts expected to be recovered more than twelve months after the balance sheet date. Paragraph 3 applies to the classification of such assets.

(\*\*) However, once the cash flows from an asset or group of assets are expected to arise principally from sale rather than continuing use, they become less dependent on cash flows arising from other assets, and a disposal group that was part of a cash-generating unit becomes a separate cash-generating unit.

(\*\*\*) Other than paragraphs 18 and 19, which require the assets in question to be measured in accordance with other applicable IFRSs.

7. For this to be the case, the asset (or disposal group) must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups) and its sale must be *highly probable*.
8. For the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset (or disposal group), and an active programme to locate a buyer and complete the plan must have been initiated. Further, the asset (or disposal group) must be actively marketed for sale at a price that is reasonable in relation to its current fair value. In addition, the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification, except as permitted by paragraph 9, and actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.
9. Events or circumstances may extend the period to complete the sale beyond one year. An extension of the period required to complete a sale does not preclude an asset (or disposal group) from being classified as held for sale if the delay is caused by events or circumstances beyond the entity's control and there is sufficient evidence that the entity remains committed to its plan to sell the asset (or disposal group). This will be the case when the criteria in Appendix B are met.
10. Sale transactions include exchanges of non-current assets for other noncurrent assets when the exchange has commercial substance in accordance with IAS 16 *Property, Plant and Equipment*.
11. When an entity acquires a non-current asset (or disposal group) exclusively with a view to its subsequent disposal, it shall classify the non-current asset (or disposal group) as held for sale at the acquisition date only if the oneyear requirement in paragraph 8 is met (except as permitted by paragraph 9) and it is highly probable that any other criteria in paragraphs 7 and 8 that are not met at that date will be met within a short period following the acquisition (usually within three months).
12. If the criteria in paragraphs 7 and 8 are met after the balance sheet date, an entity shall not classify a non-current asset (or disposal group) as held for sale in those financial statements when issued. However, when those criteria are met after the balance sheet date but before the authorisation of the financial statements for issue, the entity shall disclose the information specified in paragraph 41(a), (b) and (d) in the notes.

#### **Non-current assets that are to be abandoned**

13. An entity shall not classify as held for sale a non-current asset (or disposal group) that is to be abandoned. This is because its carrying amount will be recovered principally through continuing use. However, if the disposal group to be abandoned meets the criteria in paragraph 32(a)-(c), the entity shall present the results and cash flows of the disposal group as discontinued operations in accordance with paragraphs 33 and 34 at the date on which it ceases to be used. Non-current assets (or disposal groups) to be abandoned include non-current assets (or disposal groups) that are to be used to the end of their economic life and non-current assets (or disposal groups) that are to be closed rather than sold.
14. An entity shall not account for a non-current asset that has been temporarily taken out of use as if it had been abandoned.

#### MEASUREMENT OF NON-CURRENT ASSETS (OR DISPOSAL GROUPS) CLASSIFIED AS HELD FOR SALE

#### **Measurement of a non-current asset(or disposal group)**

15. **An entity shall measure a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell.**

**IFRS 5**

16. If a newly acquired asset (or disposal group) meets the criteria to be classified as held for sale (see paragraph 11), applying paragraph 15 will result in the asset (or disposal group) being measured on initial recognition at the lower of its carrying amount had it not been so classified (for example, cost) and fair value less costs to sell. Hence, if the asset (or disposal group) is acquired as part of a business combination, it shall be measured at fair value less costs to sell.
17. When the sale is expected to occur beyond one year, the entity shall measure the costs to sell at their present value. Any increase in the present value of the costs to sell that arises from the passage of time shall be presented in profit or loss as a financing cost.
18. Immediately before the initial classification of the asset (or disposal group) as held for sale, the carrying amounts of the asset (or all the assets and liabilities in the group) shall be measured in accordance with applicable IFRSs.
19. On subsequent remeasurement of a disposal group, the carrying amounts of any assets and liabilities that are not within the scope of the measurement requirements of this IFRS, but are included in a disposal group classified as held for sale, shall be remeasured in accordance with applicable IFRSs before the fair value less costs to sell of the disposal group is remeasured.

**Recognition of impairment losses and reversals**

20. An entity shall recognise an impairment loss for any initial or subsequent write-down of the asset (or disposal group) to fair value less costs to sell, to the extent that it has not been recognised in accordance with paragraph 19.
21. An entity shall recognise a gain for any subsequent increase in fair value less costs to sell of an asset, but not in excess of the cumulative impairment loss that has been recognised either in accordance with this IFRS or previously in accordance with IAS 36 *Impairment of Assets*.
22. An entity shall recognise a gain for any subsequent increase in fair value less costs to sell of a disposal group:
  - (a) to the extent that it has not been recognised in accordance with paragraph 19;  
  
but
  - (b) not in excess of the cumulative impairment loss that has been recognised, either in accordance with this IFRS or previously in accordance with IAS 36, on the non-current assets that are within the scope of the measurement requirements of this IFRS.
23. The impairment loss (or any subsequent gain) recognised for a disposal group shall reduce (or increase) the carrying amount of the non-current assets in the group that are within the scope of the measurement requirements of this IFRS, in the order of allocation set out in paragraphs 104(a) and (b) and 122 of IAS 36 (as revised in 2004).
24. A gain or loss not previously recognised by the date of the sale of a noncurrent asset (or disposal group) shall be recognised at the date of derecognition. Requirements relating to derecognition are set out in:
  - (a) paragraphs 67-72 of IAS 16 (as revised in 2003) for property, plant and equipment,  
  
and
  - (b) paragraphs 112-117 of IAS 38 *Intangible Assets* (as revised in 2004) for intangible assets.
25. An entity shall not depreciate (or amortise) a non-current asset while it is classified as held for sale or while it is part of a disposal group classified as held for sale. Interest and other expenses attributable to the liabilities of a disposal group classified as held for sale shall continue to be recognised.

**Changes to a plan of sale**

26. If an entity has classified an asset (or disposal group) as held for sale, but the criteria in paragraphs 7-9 are no longer met, the entity shall cease to classify the asset (or disposal group) as held for sale.
27. The entity shall measure a non-current asset that ceases to be classified as held for sale (or ceases to be included in a disposal group classified as held for sale) at the lower of:
- (a) its carrying amount before the asset (or disposal group) was classified as held for sale, adjusted for any depreciation, amortisation or revaluations that would have been recognised had the asset (or disposal group) not been classified as held for sale,
- and
- (b) its *recoverable amount* at the date of the subsequent decision not to sell. (\*)
28. The entity shall include any required adjustment to the carrying amount of a non-current asset that ceases to be classified as held for sale in income (\*\*) from continuing operations in the period in which the criteria in paragraphs 7-9 are no longer met. The entity shall present that adjustment in the same income statement caption used to present a gain or loss, if any, recognised in accordance with paragraph 37.
29. If an entity removes an individual asset or liability from a disposal group classified as held for sale, the remaining assets and liabilities of the disposal group to be sold shall continue to be measured as a group only if the group meets the criteria in paragraphs 7-9. Otherwise, the remaining non-current assets of the group that individually meet the criteria to be classified as held for sale shall be measured individually at the lower of their carrying amounts and fair values less costs to sell at that date. Any non-current assets that do not meet the criteria shall cease to be classified as held for sale in accordance with paragraph 26.

**PRESENTATION AND DISCLOSURE**

30. **An entity shall present and disclose information that enables users of the financial statements to evaluate the financial effects of discontinued operations and disposals of non-current assets (or disposal groups).**

**Presenting discontinued operations**

31. A *component* of an entity comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. In other words, a component of an entity will have been a cash-generating unit or a group of cash-generating units while being held for use.
32. A discontinued operation is a component of an entity that either has been disposed of, or is classified as held for sale,
- and
- (a) represents a separate major line of business or geographical area of operations,

(\*) If the non-current asset is part of a cash-generating unit, its recoverable amount is the carrying amount that would have been recognised after the allocation of any impairment loss arising on that cash-generating unit in accordance with IAS 36.

(\*\*) Unless the asset is property, plant and equipment or an intangible asset that had been revalued in accordance with IAS 16 or IAS 38 before classification as held for sale, in which case the adjustment shall be treated as a revaluation increase or decrease.

**IFRS 5**

- (b) is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations

or

- (c) is a subsidiary acquired exclusively with a view to resale.

33. An entity shall disclose:

- (a) a single amount on the face of the income statement comprising the total of:

- (i) the post-tax profit or loss of discontinued operations

and

- (ii) the post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation.

- (b) an analysis of the single amount in (a) into:

- (i) the revenue, expenses and pre-tax profit or loss of discontinued operations;

- (ii) the related income tax expense as required by paragraph 81(h) of IAS 12;

- (iii) the gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation;

and

- (iv) the related income tax expense as required by paragraph 81(h) of IAS 12.

The analysis may be presented in the notes or on the face of the income statement. If it is presented on the face of the income statement it shall be presented in a section identified as relating to discontinued operations, ie separately from continuing operations. The analysis is not required for disposal groups that are newly acquired subsidiaries that meet the criteria to be classified as held for sale on acquisition (see paragraph 11).

- (c) the net cash flows attributable to the operating, investing and financing activities of discontinued operations. These disclosures may be presented either in the notes or on the face of the financial statements. These disclosures are not required for disposal groups that are newly acquired subsidiaries that meet the criteria to be classified as held for sale on acquisition (see paragraph 11).

34. An entity shall re-present the disclosures in paragraph 33 for prior periods presented in the financial statements so that the disclosures relate to all operations that have been discontinued by the balance sheet date for the latest period presented.

35. Adjustments in the current period to amounts previously presented in discontinued operations that are directly related to the disposal of a discontinued operation in a prior period shall be classified separately in discontinued operations. The nature and amount of such adjustments shall be disclosed. Examples of circumstances in which these adjustments may arise include the following:

- (a) the resolution of uncertainties that arise from the terms of the disposal transaction, such as the resolution of purchase price adjustments and indemnification issues with the purchaser.

- (b) the resolution of uncertainties that arise from and are directly related to the operations of the component before its disposal, such as environmental and product warranty obligations retained by the seller.
  - (c) the settlement of employee benefit plan obligations, provided that the settlement is directly related to the disposal transaction.
36. If an entity ceases to classify a component of an entity as held for sale, the results of operations of the component previously presented in discontinued operations in accordance with paragraphs 33-35 shall be reclassified and included in income from continuing operations for all periods presented. The amounts for prior periods shall be described as having been re-presented.

#### **Gains or losses relating to continuing operations**

37. Any gain or loss on the remeasurement of a non-current asset (or disposal group) classified as held for sale that does not meet the definition of a discontinued operation shall be included in profit or loss from continuing operations.

#### **Presentation of a non-current asset or disposal group classified as held for sale**

38. An entity shall present a non-current asset classified as held for sale and the assets of a disposal group classified as held for sale separately from other assets in the balance sheet. The liabilities of a disposal group classified as held for sale shall be presented separately from other liabilities in the balance sheet. Those assets and liabilities shall not be offset and presented as a single amount. The major classes of assets and liabilities classified as held for sale shall be separately disclosed either on the face of the balance sheet or in the notes, except as permitted by paragraph 39. An entity shall present separately any cumulative income or expense recognised directly in equity relating to a non-current asset (or disposal group) classified as held for sale.
39. If the disposal group is a newly acquired subsidiary that meets the criteria to be classified as held for sale on acquisition (see paragraph 11), disclosure of the major classes of assets and liabilities is not required.
40. An entity shall not reclassify or re-present amounts presented for non-current assets or for the assets and liabilities of disposal groups classified as held for sale in the balance sheets for prior periods to reflect the classification in the balance sheet for the latest period presented.

#### **Additional disclosures**

41. An entity shall disclose the following information in the notes in the period in which a non-current asset (or disposal group) has been either classified as held for sale or sold:
- (a) a description of the non-current asset (or disposal group);
  - (b) a description of the facts and circumstances of the sale, or leading to the expected disposal, and the expected manner and timing of that disposal;
  - (c) the gain or loss recognised in accordance with paragraphs 20-22 and, if not separately presented on the face of the income statement, the caption in the income statement that includes that gain or loss;

**IFRS 5**

(d) if applicable, the segment in which the non-current asset (or disposal group) is presented in accordance with IAS 14 *Segment Reporting*.

42. If either paragraph 26 or paragraph 29 applies, an entity shall disclose, in the period of the decision to change the plan to sell the non-current asset (or disposal group), a description of the facts and circumstances leading to the decision and the effect of the decision on the results of operations for the period and any prior periods presented.

## TRANSITIONAL PROVISIONS

43. The IFRS shall be applied prospectively to non-current assets (or disposal groups) that meet the criteria to be classified as held for sale and operations that meet the criteria to be classified as discontinued after the effective date of the IFRS. An entity may apply the requirements of the IFRS to all non-current assets (or disposal groups) that meet the criteria to be classified as held for sale and operations that meet the criteria to be classified as discontinued after any date before the effective date of the IFRS, provided the valuations and other information needed to apply the IFRS were obtained at the time those criteria were originally met.

## EFFECTIVE DATE

44. An entity shall apply this IFRS for annual periods beginning on or after 1 January 2005. Earlier application is encouraged. If an entity applies the IFRS for a period beginning before 1 January 2005, it shall disclose that fact.

## WITHDRAWAL OF IAS 35

45. This IFRS supersedes IAS 35 *Discontinuing Operations*.
-

## APPENDIX A

IFRS 5

**Defined terms**

*This appendix is an integral part of the IFRS.*

<b>cash-generating unit</b>	The smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.
<b>component of an entity</b>	Operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity.
<b>costs to sell</b>	The incremental costs directly attributable to the disposal of an asset (or <b>disposal group</b> ), excluding finance costs and income tax expense.
<b>current asset</b>	An asset that satisfies any of the following criteria:  (a) it is expected to be realised in, or is intended for sale or consumption in, the entity's normal operating cycle;  (b) it is held primarily for the purpose of being traded;  (c) it is expected to be realised within twelve months after the balance sheet date;  or  (d) it is cash or a cash equivalent asset unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the balance sheet date.
<b>discontinued operation</b>	A <b>component of an entity</b> that either has been disposed of or is classified as held for sale and:  (a) represents a separate major line of business or geographical area of operations,  (b) is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations  or  (c) is a subsidiary acquired exclusively with a view to resale.
<b>disposal group</b>	A group of assets to be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction. The group includes goodwill acquired in a business combination if the group is a <b>cash-generating unit</b> to which goodwill has been allocated in accordance with the requirements of paragraphs 80-87 of IAS 36 <i>Impairment of Assets</i> (as revised in 2004) or if it is an operation within such a cash-generating unit.
<b>fair value</b>	The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
<b>firm purchase commitment</b>	An agreement with an unrelated party, binding on both parties and usually legally enforceable, that (a) specifies all significant terms, including the price and timing of the transactions, and (b) includes a disincentive for non-performance that is sufficiently large to make performance <b>highly probable</b> .

## IFRS 5

<b>highly probable</b>	Significantly more likely than <b>probable</b> .
<b>non-current asset</b>	An asset that does not meet the definition of a <b>current asset</b> .
<b>probable</b>	More likely than not.
<b>recoverable amount</b>	The higher of an asset's <b>fair value</b> less <b>costs to sell</b> and its <b>value in use</b> .
<b>value in use</b>	The present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life.

---

## APPENDIX B

## IFRS 5

**Application supplement**

*This appendix is an integral part of the IFRS.*

**EXTENSION OF THE PERIOD REQUIRED TO COMPLETE A SALE**

- B1 As noted in paragraph 9, an extension of the period required to complete a sale does not preclude an asset (or disposal group) from being classified as held for sale if the delay is caused by events or circumstances beyond the entity's control and there is sufficient evidence that the entity remains committed to its plan to sell the asset (or disposal group). An exception to the one-year requirement in paragraph 8 shall therefore apply in the following situations in which such events or circumstances arise:
- (a) at the date an entity commits itself to a plan to sell a non-current asset (or disposal group) it reasonably expects that others (not a buyer) will impose conditions on the transfer of the asset (or disposal group) that will extend the period required to complete the sale, and:
    - (i) actions necessary to respond to those conditions cannot be initiated until after a *firm purchase commitment* is obtained,
    - and
    - (ii) a firm purchase commitment is highly probable within one year.
  - (b) an entity obtains a firm purchase commitment and, as a result, a buyer or others unexpectedly impose conditions on the transfer of a non-current asset (or disposal group) previously classified as held for sale that will extend the period required to complete the sale, and:
    - (i) timely actions necessary to respond to the conditions have been taken,
    - and
    - (ii) a favourable resolution of the delaying factors is expected.
  - (c) during the initial one-year period, circumstances arise that were previously considered unlikely and, as a result, a non-current asset (or disposal group) previously classified as held for sale is not sold by the end of that period, and:
    - (i) during the initial one-year period the entity took action necessary to respond to the change in circumstances,
    - (ii) the non-current asset (or disposal group) is being actively marketed at a price that is reasonable, given the change in circumstances,
    - and
    - (iii) the criteria in paragraphs 7 and 8 are met.
-

## IFRS 5

## APPENDIX C

**Amendments to other IFRSs**

The amendments in this appendix shall be applied for annual periods beginning on or after 1 January 2005. If an entity applies this IFRS for an earlier period, these amendments shall be applied for that earlier period.

C1 IAS 1 *Presentation of Financial Statements* (as revised in 2003), is amended as described below.

Paragraph 68 is amended to read as follows:

68. **As a minimum, the face of the balance sheet shall include line items that present the following amounts to the extent that they are not presented in accordance with paragraph 68A:**

(a) ...

Paragraph 68A is added as follows:

68A. **The face of the balance sheet shall also include line items that present the following amounts:**

(a) **the total of assets classified as held for sale and assets included in disposal groups classified as held for sale in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations;**

**and**

(b) **liabilities included in disposal groups classified as held for sale in accordance with IFRS 5.**

Paragraph 81 is amended to read as follows:

81. **As a minimum, the face of the income statement shall include line items that present the following amounts for the period:**

...

(d) **tax expense;**

(e) **a single amount comprising the total of (i) the post-tax profit or loss of discontinued operations and (ii) the post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation;**

**and**

(f) **profit or loss.**

Paragraph 87(e) is amended to read as follows:

(e) discontinued operations;

C2 In IAS 10 *Events after the Balance Sheet Date*, paragraph 22(b) and (c) is amended to read as follows:

(b) announcing a plan to discontinue an operation;

- (c) major purchases of assets, classification of assets as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, other disposals of assets, or expropriation of major assets by government;

C3 IAS 14 *Segment Reporting* is amended as described below.

Paragraph 52 is amended to read as follows:

52. ***An entity shall disclose segment result for each reportable segment, presenting the result from continuing operations separately from the result from discontinued operations.***

Paragraph 52A is added as follows:

- 52A. ***An entity shall restate segment results in prior periods presented in the financial statements so that the disclosures required by paragraph 52 relating to discontinued operations relate to all operations that had been classified as discontinued at the balance sheet date of the latest period presented.***

Paragraph 67 is amended to read as follows:

67. ***An entity shall present a reconciliation between the information disclosed for reportable segments and the aggregated information in the consolidated or individual financial statements. In presenting the reconciliation, the entity shall reconcile segment revenue to entity revenue from external customers (including disclosure of the amount of entity revenue from external customers not included in any segment); segment result from continuing operations shall be reconciled to a comparable measure of entity operating profit or loss from continuing operations as well as to entity profit and loss from continuing operations; segment result from discontinued operations shall be reconciled to entity profit or loss from discontinued operations; segment assets shall be...***

C4 IAS 16 *Property, Plant and Equipment*, as revised in 2003, is amended as described below.

Paragraph 3 is amended to read as follows:

3. This Standard does not apply to:

- (a) property, plant and equipment classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*;

- (b) biological assets...;

or

- (c) mineral rights...

However, this Standard applies to property, plant and equipment used to develop or maintain the assets described in (b) and (c).

Paragraph 55 is amended to read as follows:

55. ... Depreciation of an asset ceases at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5 and the date that the asset is derecognised. Therefore, depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated. However, ...

**IFRS 5**

Paragraph 73(e)(ii) is amended to read as follows:

- (ii) ***assets classified as held for sale or included in a disposal group classified as held for sale in accordance with IFRS 5 and other disposals;***

Paragraph 79(c) is amended to read as follows:

- (c) the carrying amount of property, plant and equipment retired from active use and not classified as held for sale in accordance with IFRS 5;

C5 In IAS 17 *Leases*, as revised in 2003, paragraph 41A is added as follows:

- 41A. An asset under a finance lease that is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5 shall be accounted for in accordance with that IFRS.

C6 IAS 27 *Consolidated and Separate Financial Statements* is amended as described below.

Paragraph 12 is amended to read as follows:

12. ***Consolidated financial statements shall include all subsidiaries of the parent<sup>(\*)</sup>.***

A footnote is added to paragraph 12, as follows:

- (<sup>\*</sup>) If on acquisition a subsidiary meets the criteria to be classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, it shall be accounted for in accordance with that Standard.

Paragraphs 16-18 are deleted.

Paragraph 37 is amended to read as follows:

37. ***When separate financial statements are prepared, investments in subsidiaries, jointly controlled entities and associates that are not classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5 shall be accounted for either:***

(a) ***at cost, or***

(b) ***in accordance with IAS 39.***

***The same accounting shall be applied for each category of investments. Investments in subsidiaries, jointly controlled entities and associates that are classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5 shall be accounted for in accordance with that IFRS.***

Paragraph 39 is amended to read as follows:

39. ***Investments in jointly controlled entities and associates that are accounted for in accordance with IAS 39 in the consolidated financial statements shall be accounted for in the same way in the investor's separate financial statements.***

Paragraph 40(a) and (b) is deleted.

C7 IAS 28 *Investments in Associates* is amended as described below.

Paragraph 13 is amended to read as follows:

13. **An investment in an associate shall be accounted for using the equity method except when:**

(a) **the investment is classified as held for sale in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations;**

(b) ...

Paragraph 14 is amended to read as follows:

14. **Investments described in paragraph 13(a) shall be accounted for in accordance with IFRS 5.**

Paragraph 15 is amended so that, after the deletion of the reference to IAS 22 *Business Combinations* made by IFRS 3 *Business Combinations*, it reads as follows:

15. When an investment in an associate previously classified as held for sale no longer meets the criteria to be so classified, it shall be accounted for using the equity method as from the date of its classification as held for sale. Financial statements for the periods since classification as held for sale shall be amended accordingly.

Paragraph 16 is deleted.

Paragraph 38 is amended to read as follows:

38. **...disclosed. The investor's share of any discontinued operations of such associates shall also be separately disclosed.**

C8 IAS 31 *Interests in Joint Ventures* is amended as described below.

Paragraph 2(a) is amended to read as follows:

(a) **the interest is classified as held for sale in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations;**

Paragraph 42 is amended to read as follows:

42. **Interests in jointly controlled entities that are classified as held for sale in accordance with IFRS 5 shall be accounted for in accordance with that IFRS.**

Paragraph 43 is amended so that, after the deletion of the reference to IAS 22 *Business Combinations* made by IFRS 3, it reads as follows:

43. When an interest in a jointly controlled entity previously classified as held for sale no longer meets the criteria to be so classified, it shall be accounted for using proportionate consolidation or the equity method as from the date of its classification as held for sale. Financial statements for the periods since classification as held for sale shall be amended accordingly.

Paragraph 44 is deleted.

## IFRS 5

C9 IAS 36 *Impairment of Assets* (issued in 1998) is amended as described below.

Paragraph 1 is amended to read as follows:

1. ***This Standard shall be applied in accounting for the impairment of all assets, other than:***

(a) ...

(f) ... (see IAS 40 *Investment Property*);

(g) ... (see IAS 41 *Agriculture*);

***and***

(h) ***non-current assets (or disposal groups) classified as held for sale in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations.***

Paragraph 2 is amended to read as follows:

2. This Standard does not apply to inventories, assets arising from construction contracts, deferred tax assets, assets arising from employee benefits or assets classified as held for sale (or included in a disposal group that is classified as held for sale) because existing Standards applicable to these assets already contain specific requirements for recognising and measuring these assets.

In paragraph 5 the definition of a cash-generating unit is amended to read as follows:

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

A footnote is added to the last sentence of paragraph 9(f), as follows:

(<sup>†</sup>) Once an asset meets the criteria to be classified as held for sale (or is included in a disposal group that is classified as held for sale), it is excluded from the scope of IAS 36 and is accounted for in accordance with IFRS 5.

C10 IAS 36 *Impairment of Assets* (as revised in 2004) is amended as described below.

**All references to 'net selling price' are replaced by 'fair value less costs to sell'.**

Paragraph 2 is amended to read as follows:

2. ***This Standard shall be applied in accounting for the impairment of all assets, other than:***

(a) ...

(i) ***non-current assets (or disposal groups) classified as held for sale in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations.***

Paragraph 3 is amended to read as follows:

3. This Standard does not apply to inventories, assets arising from construction contracts, deferred tax assets, assets arising from employee benefits, or assets classified as held for sale (or included in a disposal group that is classified as held for sale) because existing Standards applicable to these assets contain requirements for recognising and measuring these assets.

In paragraph 6 the definition of a cash-generating unit is amended to read as follows:

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

A footnote is added to the last sentence of paragraph 12(f), as follows:

- (<sup>\*</sup>) Once an asset meets the criteria to be classified as held for sale (or is included in a disposal group that is classified as held for sale), it is excluded from the scope of the Standard and is accounted for in accordance with IFRS 5.

C11 In IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, paragraph 9 is amended to read as follows:

9. This Standard applies to provisions for restructurings (including discontinued operations). When a restructuring meets the definition of a discontinued operation, additional disclosures may be required by IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

C12 IAS 38 *Intangible Assets* (issued in 1998) (<sup>\*</sup>) is amended as described below.

Paragraph 2 is amended to read as follows:

2. ...For example, this Standard does not apply to:

- (a) ...

- (e) ...;

- (f) ... and Measurement);

and

- (g) non-current intangible assets classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

Paragraph 79 is amended to read as follows:

79. ... ***Amortisation shall cease at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations and the date that the asset is derecognised.***

Paragraph 106 is amended to read as follows:

106. Amortisation does not cease when the intangible asset is no longer used, unless the asset has been fully depreciated or is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5.

(<sup>\*</sup>) As amended by IAS 16 in 2003.

**IFRS 5**

Paragraph 107(e)(ii) is amended to read as follows:

- (ii) assets classified as held for sale or included in a disposal group classified as held for sale in accordance with IFRS 5 and other disposals;

C13 IAS 38 *Intangible Assets* (as revised in 2004) is amended as described below.

Paragraph 3 is amended to read as follows:

- 3. ... For example, this Standard does not apply to:

- (a) ...

- (h) non-current intangible assets classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

Paragraph 97 is amended to read as follows:

- 97. ... ***Amortisation shall cease at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations and the date that the asset is derecognised...***

Paragraph 117 is amended to read as follows:

- 117. Amortisation of an intangible asset with a finite useful life does not cease when the intangible asset is no longer used, unless the asset has been fully depreciated or is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5.

Paragraph 118(e)(ii) is amended to read as follows:

- (ii) assets classified as held for sale or included in a disposal group classified as held for sale in accordance with IFRS 5 and other disposals;

C14 IAS 40 *Investment Properties*, as revised in 2003, is amended as described below.

Paragraph 9(a) is amended to read as follows:

- (a) property intended for sale in the ordinary course of business...

Paragraph 56 is amended to read as follows:

- 56. ***After initial recognition, an entity that chooses the cost model shall measure all of its investment properties in accordance with IAS 16's requirements for that model other than those that meet the criteria to be classified as held for sale (or are included in a disposal group that is classified as held for sale) in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations. Investment properties that meet the criteria to be classified as held for sale (or are included in a disposal group that is classified as held for sale) shall be measured in accordance with IFRS 5.***

Paragraph 76(c) is amended to read as follows:

- (c) ***assets classified as held for sale or included in a disposal group classified as held for sale in accordance with IFRS 5 and other disposals;***

Paragraph 79(d)(iii) is amended to read as follows:

- (iii) assets classified as held for sale or included in a disposal group classified as held for sale in accordance with IFRS 5 and other disposals;**

C15 IAS 41 *Agriculture* is amended as described below.

Paragraph 30 is amended to read as follows:

30. ***There is a presumption that fair value can be measured reliably for a biological asset. However, that presumption can be rebutted only on initial recognition for a biological asset for which market-determined prices or values are not available and for which alternative estimates of fair value are determined to be clearly unreliable. In such a case, that biological asset shall be measured at its cost less any accumulated depreciation and any accumulated impairment losses. Once the fair value of such a biological asset becomes reliably measurable, an entity shall measure it at its fair value less estimated point-of-sale costs. Once a non-current biological asset meets the criteria to be classified as held for sale (or is included in a disposal group that is classified as held for sale) in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations, it is presumed that fair value can be measured reliably.***

Paragraph 50(c) is amended to read as follows:

- (c) decreases attributable to sales and biological assets classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5;**

C16 IFRS 1 *First-time Adoption of International Financial Reporting Standards* is amended as described below.

Paragraph 12(b) is amended to read as follows:

- (b) paragraphs 26-34B prohibit retrospective application of some aspects of other IFRSs.

Paragraph 26 is amended to read as follows:

26. This IFRS prohibits retrospective application of some aspects of other IFRSs relating to:

- (a) ...
- (b) hedge accounting (paragraphs 28-30);
- (c) estimates (paragraphs 31-34);

and

- (d) assets classified as held for sale and discontinued operations.

Paragraph 34A is added as follows:

- 34A. IFRS 5 requires that it shall be applied prospectively to non-current assets (or disposal groups) that meet the criteria to be classified as held for sale and operations that meet the criteria to be classified as discontinued after the effective date of the IFRS. IFRS 5 permits an entity to apply the requirements of the IFRS to all non-current assets (or disposal groups) that meet the criteria to be classified as held for sale and operations that meet the criteria to be classified as discontinued after any date before the effective date of the IFRS, provided the valuations and other information needed to apply the IFRS were obtained at the time those criteria were originally met.

**IFRS 5**

Paragraph 34B is added as follows:

- 34B. An entity with a date of transition to IFRSs before 1 January 2005 shall apply the transitional provisions of IFRS 5. An entity with a date of transition to IFRSs on or after 1 January 2005 shall apply IFRS 5 retrospectively.

C17 IFRS 3 *Business Combinations* is amended as described below

Paragraph 36 is amended to read as follows:

36. **The acquirer shall, at the acquisition date, allocate the cost of a business combination by recognising the acquiree's identifiable assets, liabilities and contingent liabilities that satisfy the recognition criteria in paragraph 37 at their fair values at that date, except for non-current assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 *Noncurrent Assets Held for Sale and Discontinued Operations*, which shall be recognised at fair value less costs to sell. Any difference...**

Paragraph 75(b) and (d) is amended to read as follows:

- (b) additional goodwill recognised during the period except goodwill included in a disposal group that, on acquisition, meets the criteria to be classified as held for sale in accordance with IFRS 5;
- (d) goodwill included in a disposal group classified as held for sale in accordance with IFRS 5 and goodwill derecognised during the period without having previously been included in a disposal group classified as held for sale;

C18 In International Financial Reporting Standards, including International Accounting Standards and Interpretations, applicable at 31 March 2004, references to 'discontinuing operations' are amended to 'discontinued operations'.

---

**Impairment of assets**

## SUMMARY

	Paragraphs
Objective	1
Scope	2-5
Definitions	6
Identifying an asset that may be impaired	7-17
Measuring recoverable amount	18-57
Measuring the recoverable amount of an intangible asset with an indefinite useful life	24
Fair value less costs to sell	25-29
Value in use	30-57
Basis for estimates of future cash flows	33-38
Composition of estimates of future cash flows	39-53
Foreign currency future cash flows	54
Discount rate	55-57
Recognising and measuring an impairment loss	58-64
Cash-generating units and goodwill	65-108
Identifying the cash-generating unit to which an asset belongs	66-73
Recoverable amount and carrying amount of a cash-generating unit	74-103
Goodwill	80-99
Allocating goodwill to cash-generating units	80-87
Testing cash-generating units with goodwill for impairment	88-90
Minority interest	91-95
Timing of impairment tests	96-99
Corporate assets	100-103
Impairment loss for a cash-generating unit	104-108
Reversing an impairment loss	109-125
Reversing an impairment loss for an individual asset	117-121
Reversing an impairment loss for a cash-generating unit	122-123
Reversing an impairment loss for goodwill	124-125

**IAS 36**

	Paragraphs
Disclosure	126-137
Estimates used to measure recoverable amounts of cash-generating units containing goodwill or intangible assets with indefinite useful lives	134-137
Transitional provisions and effective date	138-140
Withdrawal of IAS 36 (issued 1998)	141

This revised standard supersedes IAS 36 (1998) *Impairment of assets* and should be applied:

- (a) on acquisition to goodwill and intangible assets acquired in business combinations for which the agreement date is on or after 31 March 2004.
- (b) to all other assets, for annual periods beginning on or after 31 March 2004.

Earlier application is encouraged.

**OBJECTIVE**

1. The objective of this Standard is to prescribe the procedures that an 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 entity to recognise an impairment loss. The Standard also specifies when an entity should reverse an impairment loss and prescribes disclosures.

**SCOPE**

2. *This Standard shall be applied in accounting for the impairment of all assets, other than:*
  - (a) *inventories (see 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 within the scope of IAS 39 Financial Instruments: Recognition and Measurement;*
  - (f) *investment property that is measured at fair value (see IAS 40 Investment Property);*
  - (g) *biological assets related to agricultural activity that are measured at fair value less estimated point-of-sale costs (see IAS 41 Agriculture);*

(h) *deferred acquisition costs, and intangible assets, arising from an insurer's contractual rights under insurance contracts within the scope of IFRS 4 Insurance Contracts;*

*and*

(i) *non-current assets (or disposal groups) classified as held for sale in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations.*

3. This Standard does not apply to inventories, assets arising from construction contracts, deferred tax assets, assets arising from employee benefits, or assets classified as held for sale (or included in a disposal group that is classified as held for sale) because existing Standards applicable to these assets contain requirements for recognising and measuring these assets.

4. This Standard applies to financial assets classified as:

(a) subsidiaries, as defined in IAS 27 *Consolidated and Separate Financial Statements*;

(b) associates, as defined in IAS 28 *Investments in Associates*;

*and*

(c) joint ventures, as defined in IAS 31 *Interests in Joint Ventures*.

For impairment of other financial assets, refer to IAS 39.

5. This Standard does not apply to financial assets within the scope of IAS 39, investment property measured at fair value in accordance with IAS 40, or biological assets related to agricultural activity measured at fair value less estimated point-of-sale costs in accordance with IAS 41. However, this Standard applies to assets that are carried at revalued amount (ie fair value) in accordance with other Standards, such as the revaluation model in IAS 16 *Property, Plant and Equipment*. Identifying whether 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 fair value less costs to sell 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 (ie 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.

(ii) if the disposal costs are not negligible, the fair value less costs to sell 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 (ie fair value). In this case, after the revaluation requirements have been applied, an entity applies this Standard to determine whether the asset may be impaired.

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

## DEFINITIONS

6. *The following terms are used in this Standard with the meanings specified:*

*An active market is a market in which 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.*

*Carrying amount is the amount at which an asset is recognised after deducting any accumulated depreciation (amortisation) and accumulated impairment losses thereon.*

*A cash-generating unit is the smallest identifiable group of assets that generates cash inflows 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.*

*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.*

*Depreciable amount is the cost of an asset, or other amount substituted for cost in the financial statements, less its residual value.*

*Depreciation (Amortisation) is the systematic allocation of the depreciable amount of an asset over its useful life. (\*)*

*Fair value less costs to sell 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.*

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

*The recoverable amount of an asset or a cash-generating unit is the higher of its fair value less costs to sell and its value in use.*

(\*) In the case of an intangible asset, the term 'amortisation' is generally used instead of 'depreciation'. The two terms have the same meaning.

*Useful life is either:*

*(a) the period of time over which an asset is expected to be used by the entity;*

*or*

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

*Value in use is the present value of the future cash flows expected to be derived from an asset or cash-generating unit.*

#### IDENTIFYING AN ASSET THAT MAY BE IMPAIRED

7. Paragraphs 8-17 specify when recoverable amount 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 Standard is structured as follows:
- (a) paragraphs 18-57 set out the requirements for measuring recoverable amount. These requirements also use the term 'an asset' but apply equally to an individual asset and a cash-generating unit.
  - (b) paragraphs 58-108 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 58-64. Paragraphs 65-108 deal with the recognition and measurement of impairment losses for cash-generating units and goodwill.
  - (c) paragraphs 109-116 set out the requirements for reversing an impairment loss recognised in prior periods 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 for an individual asset are set out in paragraphs 117-121, for a cash-generating unit in paragraphs 122 and 123, and for goodwill in paragraphs 124 and 125.
  - (d) paragraphs 126-133 specify the information to be disclosed about impairment losses and reversals of impairment losses for assets and cash-generating units. Paragraphs 134-137 specify additional disclosure requirements for cash-generating units to which goodwill or intangible assets with indefinite useful lives have been allocated for impairment testing purposes.
8. An asset is impaired when its carrying amount exceeds its recoverable amount. Paragraphs 12-14 describe some indications that an impairment loss may have occurred. If any of those indications is present, an entity is required to make a formal estimate of recoverable amount. Except as described in paragraph 10, this Standard does not require an entity to make a formal estimate of recoverable amount if no indication of an impairment loss is present.
9. ***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.***
10. ***Irrespective of whether there is any indication of impairment, an entity shall also:***
- (a) test an intangible asset with an indefinite useful life or an intangible asset not yet available for use for impairment annually by comparing its carrying amount with its recoverable amount. This impairment test may be performed at any time during an annual period, provided it is performed at the same time every year. Different intangible assets may be tested for impairment at different times. However, if such an intangible asset was initially recognised during the current annual period, that intangible asset shall be tested for impairment before the end of the current annual period.***

## IAS 36

(b) *test goodwill acquired in a business combination for impairment annually in accordance with paragraphs 80-99.*

11. The ability of an intangible asset to generate sufficient future economic benefits to recover its carrying amount is usually subject to greater uncertainty before the asset is available for use than after it is available for use. Therefore, this 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.
12. ***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 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 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.*
13. The list in paragraph 12 is not exhaustive. An entity may identify other indications that an asset may be impaired and these would also require the entity to determine the asset's recoverable amount or, in the case of goodwill, perform an impairment test in accordance with paragraphs 80-99.
14. 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;

(\*) Once an asset meets the criteria to be classified as held for sale (or is included in a disposal group that is classified as held for sale), it is excluded from the scope of this Standard and is accounted for in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

- (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 amounts are aggregated with budgeted amounts for the future.
15. As indicated in paragraph 10, this Standard requires an intangible asset with an indefinite useful life or not yet available for use and goodwill to be tested for impairment, at least annually. Apart from when the requirements in paragraph 10 apply, 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 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 12.
16. As an illustration of paragraph 15, if market interest rates or other market rates of return on investments have increased during the period, an 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.
- (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 (eg in some cases, an 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.
17. 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 needs to be reviewed and adjusted in accordance with the Standard applicable to the asset, even if no impairment loss is recognised for the asset.

#### MEASURING RECOVERABLE AMOUNT

18. This Standard defines recoverable amount as the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use. Paragraphs 19-57 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.
19. 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.

**IAS 36**

20. It may be possible to determine fair value less costs to sell, even if an asset is not traded in an active market. However, sometimes it will not be possible to determine fair value less costs to sell 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 entity may use the asset's value in use as its recoverable amount.
21. If there is no reason to believe that an asset's value in use materially exceeds its fair value less costs to sell, the asset's fair value less costs to sell may be used as its recoverable amount. 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, as the future cash flows from continuing use of the asset until its disposal are likely to be negligible.
22. Recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows 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 65-103), unless either:
  - (a) the asset's fair value less costs to sell is higher than its carrying amount;
  - or
  - (b) the asset's value in use can be estimated to be close to its fair value less costs to sell and fair value less costs to sell can be determined.
23. In some cases, estimates, averages and computational short cuts may provide reasonable approximations of the detailed computations illustrated in this Standard for determining fair value less costs to sell or value in use.

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

24. Paragraph 10 requires an intangible asset with an indefinite useful life to be tested for impairment annually by comparing its carrying amount with its recoverable amount, 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.

*Fair Value less Costs to Sell*

25. The best evidence of an asset's fair value less costs to sell 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.

26. If there is no binding sale agreement but an asset is traded in an active market, fair value less costs to sell 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 fair value less costs to sell, provided that there has not been a significant change in economic circumstances between the transaction date and the date as at which the estimate is made.
27. 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 balance sheet date, 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.
28. Costs of disposal, other than those that have been recognised as liabilities, are deducted in determining fair value less costs to sell. 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.
29. Sometimes, the disposal of an asset would require the buyer to assume a liability and only a single fair value less costs to sell is available for both the asset and the liability. Paragraph 78 explains how to deal with such cases.

#### Value in Use

30. ***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.***
31. 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 those future cash flows.

## IAS 36

32. The elements identified in paragraph 30(b), (d) and (e) can be reflected either as adjustments to the future cash flows or as adjustments to the discount rate. Whichever approach an entity adopts to reflect expectations about possible variations in the amount or timing of future cash flows, the result shall be to reflect the expected present value of the future cash flows, ie the weighted average of all possible outcomes. Appendix A 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

33. **In measuring value in use an entity shall:**
- (a) **base cash flow projections on reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions that will exist over the remaining useful life of the asset. Greater weight shall be given to external evidence.**
  - (b) **base cash flow projections on the most recent financial budgets/forecasts approved by management, but shall exclude any estimated future cash inflows or outflows expected to arise from future restructurings or from improving or enhancing the asset's performance. Projections based on these budgets/forecasts shall cover a maximum period of five years, unless a longer period can be justified.**
  - (c) **estimate cash flow projections beyond the period covered by the most recent budgets/forecasts 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 shall not exceed the long-term average growth rate for the products, industries, or country or countries in which the entity operates, or for the market in which the asset is used, unless a higher rate can be justified.**
34. Management assesses the reasonableness of the assumptions on which its current cash flow projections are based by examining the causes of differences between past cash flow projections and actual cash flows. Management shall ensure that the assumptions on which its current cash flow projections are based are consistent with past actual outcomes, provided the effects of subsequent events or circumstances that did not exist when those actual cash flows were generated make this appropriate.
35. 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 it 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.
36. 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.
37. When conditions are favourable, competitors are likely to enter the market and restrict growth. Therefore, 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 entity operates, or for the market in which the asset is used.
38. In using information from financial budgets/forecasts, an 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

IAS 36

39. *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, to be received (or paid) for the disposal of the asset at the end of its useful life.*

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

41. Projections of cash outflows include those for the day-to-day servicing of the asset as well as future overheads that can be attributed directly, or allocated on a reasonable and consistent basis, to the use of the asset.

42. 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.

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

- (a) cash inflows from assets that generate cash inflows 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 been recognised as liabilities (for example, payables, pensions or provisions).

44. ***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.***

45. 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 entity is not yet committed; or

## IAS 36

- (b) future cash outflows that will improve or enhance the asset's performance or the related cash inflows that are expected to arise from such outflows.

46. A restructuring is a programme that is planned and controlled by management and materially changes either the scope of the business undertaken by an entity or the manner in which the business is conducted. IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* contains guidance clarifying when an entity is committed to a restructuring.

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

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

and

- (b) its estimates of future cash outflows for the restructuring are included in a restructuring provision in accordance with IAS 37.

Illustrative Example 5 illustrates the effect of a future restructuring on a value in use calculation.

48. Until an entity incurs cash outflows that improve or enhance the asset's performance, estimates of future cash flows do not include the estimated future cash inflows that are expected to arise from the increase in economic benefits associated with the cash outflow (see Illustrative Example 6).

49. Estimates of future cash flows include future cash outflows necessary to maintain the level of economic benefits expected to arise from the asset in its current condition. When a cash-generating unit consists of assets with different estimated useful lives, all of which are essential to the ongoing operation of the unit, the replacement of assets with shorter lives is considered to be part of the day-to-day servicing of the unit when estimating the future cash flows associated with the unit. Similarly, when a single asset consists of components with different estimated useful lives, the replacement of components with shorter lives is considered to be part of the day-to-day servicing of the asset when estimating the future cash flows generated by the asset.

50. ***Estimates of future cash flows shall not include:***

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

***or***

- (b) ***income tax receipts or payments.***

51. 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, because the discount rate is determined on a pretax basis, future cash flows are also estimated on a pre-tax basis.

52. ***The estimate of net cash flows to be received (or paid) for the disposal of an asset at the end of its useful life shall be the amount that an 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.***

53. 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 fair value less costs to sell, except that, in estimating those net cash flows:

- (a) an entity uses prices prevailing at the date of the estimate for similar assets that have reached the end of their useful life and have operated under conditions similar to those in which the asset will be used.

- (b) the entity adjusts those prices for the effect of both future price increases due to general inflation and specific future price increases or decreases. However, if estimates of future cash flows from the asset's continuing use and the discount rate exclude the effect of general inflation, the entity also excludes this effect from the estimate of net cash flows on disposal.

#### Foreign Currency Future Cash Flows

54. 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 entity translates the present value using the spot exchange rate at the date of the value in use calculation.

#### Discount Rate

55. ***The discount rate (rates) 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.***

56. 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 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 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 shall not reflect risks for which the future cash flow estimates have been adjusted. Otherwise, the effect of some assumptions will be double-counted.
57. When an asset-specific rate is not directly available from the market, an entity uses surrogates to estimate the discount rate. Appendix A provides additional guidance on estimating the discount rate in such circumstances.

#### RECOGNISING AND MEASURING AN IMPAIRMENT LOSS

58. Paragraphs 59-64 set out the requirements for recognising and measuring impairment losses for an individual asset other than goodwill. Recognising and measuring impairment losses for cash-generating units and goodwill are dealt with in paragraphs 65-108.
59. ***If, and only if, the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset shall be reduced to its recoverable amount. That reduction is an impairment loss.***
60. ***An impairment loss shall be recognised immediately in profit or loss, unless the asset is carried at revalued amount in accordance with another Standard (for example, in accordance with the revaluation model in IAS 16 Property, Plant and Equipment). Any impairment loss of a revalued asset shall be treated as a revaluation decrease in accordance with that other Standard.***
61. An impairment loss on a non-revalued asset is recognised 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 in the revaluation surplus for that same asset.

## IAS 36

62. ***When the amount estimated for an impairment loss is greater than the carrying amount of the asset to which it relates, an entity shall recognise a liability if, and only if, that is required by another Standard.***
63. ***After the recognition of an impairment loss, 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.***
64. If an impairment loss is recognised, any related deferred tax assets or liabilities are determined in accordance with IAS 12 *Income Taxes* by comparing the revised carrying amount of the asset with its tax base (see Illustrative Example 3).

## CASH-GENERATING UNITS AND GOODWILL

65. Paragraphs 66-108 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.

*identifying the cash-generating unit to which an asset belongs*

66. ***If there is any indication that an asset may be impaired, recoverable amount shall be estimated for the individual asset. 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).***

67. 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 fair value less costs to sell (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 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 entity owns a private railway to support its mining activities. The private railway could be sold only for scrap value and it does not generate cash inflows that are largely independent of the cash inflows from the other assets of the mine.

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

68. As defined in paragraph 6, an asset's cash-generating unit is the smallest 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. Identification of an asset's cash-generating unit involves judgement. If recoverable amount cannot be determined for an individual asset, an entity identifies the lowest aggregation of assets that generate largely independent cash inflows.

**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 entity does not have the option to curtail any one bus route, the lowest level of identifiable cash inflows 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.*

69. Cash inflows are inflows of cash and cash equivalents received from parties external to the 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 entity considers various factors including how management monitors the entity's operations (such as by product lines, businesses, individual locations, districts or regional areas) or how management makes decisions about continuing or disposing of the entity's assets and operations. Illustrative Example 1 gives examples of identification of a cash-generating unit.

70. ***If an active market exists for the output produced by an asset or group of assets, that asset or group of assets shall be identified as a cash-generating unit, even if some or all of the output is used internally. If the cash inflows generated by any asset or cash-generating unit are affected by internal transfer pricing, an entity shall use management's best estimate of future price(s) that could be achieved in arm's length transactions in estimating:***

***(a) the future cash inflows used to determine the asset's or cash-generating unit's value in use;***

***and***

***(b) the future cash outflows used to determine the value in use of any other assets or cash-generating units that are affected by the internal transfer pricing.***

71. Even if part or all of the output produced by an asset or a group of assets is used by other units of the 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 entity could sell the output on an active market. This is because the asset or group of assets could generate cash inflows 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, or to any other asset or cash-generating unit affected by internal transfer pricing, an entity adjusts this information if internal transfer prices do not reflect management's best estimate of future prices that could be achieved in arm's length transactions.

## IAS 36

72. **Cash-generating units shall be identified consistently from period to period for the same asset or types of assets, unless a change is justified.**
73. If an entity determines that an asset belongs to a cash-generating unit different from that in previous periods, or that the types of assets aggregated for the asset's cash-generating unit have changed, paragraph 130 requires disclosures about the cash-generating unit, if an impairment loss is recognised or reversed for the cash-generating unit.

*Recoverable Amount and Carrying Amount of a Cash-generating Unit*

74. The recoverable amount of a cash-generating unit is the higher of the cash-generating unit's fair value less costs to sell and its value in use. For the purpose of determining the recoverable amount of a cash-generating unit, any reference in paragraphs 19-57 to 'an asset' is read as a reference to 'a cash-generating unit'.
75. **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.**
76. 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 will generate the future cash inflows used 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 fair value less costs to sell 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 been recognised (see paragraphs 28 and 43).

77. When assets are grouped for recoverability assessments, it is important to include in the cash-generating unit all assets that generate or are used to generate the relevant stream of cash inflows. Otherwise, the cash-generating unit may appear to be fully recoverable when in fact an impairment loss has occurred. In some cases, although some 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 80-103 explain how to deal with these assets in testing a cash-generating unit for impairment.
78. It may be necessary to consider some recognised liabilities 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 assume the liability. In this case, the fair value less costs to sell (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. 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 CU500, (\*) which is equal to the present value of the restoration costs.

The entity is testing the mine for impairment. The cash-generating unit for the mine is the mine as a whole. The entity has received various offers to buy the mine at a price of around CU800. This price reflects the fact that the buyer will assume the obligation to restore the overburden. Disposal costs for the mine are negligible. The value in use of the mine is approximately CU1 200, excluding restoration costs. The carrying amount of the mine is CU1 000.

*The cash-generating unit's fair value less costs to sell is CU800. 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 CU700 (CU1 200 less CU500). The carrying amount of the cash-generating unit is CU500, which is the carrying amount of the mine (CU1 000) less the carrying amount of the provision for restoration costs (CU500). Therefore, the recoverable amount of the cash-generating unit exceeds its carrying amount.*

79. 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.

## Goodwill

## Allocating Goodwill to Cash-generating Units

80. ***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 are 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. Each unit or group of units to which the goodwill is so allocated shall:***
- (a) ***represent the lowest level within the entity at which the goodwill is monitored for internal management purposes;***
- and***
- (b) ***not be larger than a segment based on either the entity's primary or the entity's secondary reporting format determined in accordance with IAS 14 Segment Reporting.***
81. 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 often contributes to the cash flows of multiple cash-generating units. Goodwill sometimes cannot be allocated on a non-arbitrary basis to individual cash-generating units, but only to groups of cash-generating units. As a result, the lowest level within the entity at which the goodwill is monitored for internal management purposes sometimes comprises a number of cash-generating units to which the goodwill relates, but to which it cannot be allocated. References in paragraphs 83-99 to a cash-generating unit to which goodwill is allocated should be read as references also to a group of cash-generating units to which goodwill is allocated.

(\*) In this Standard, monetary amounts are denominated in 'currency units' (CU).

## IAS 36

82. Applying the requirements in paragraph 80 results in goodwill being tested for impairment at a level that reflects the way an entity manages its operations and with which the goodwill would naturally be associated. Therefore, the development of additional reporting systems is typically not necessary.
83. A cash-generating unit to which goodwill is allocated for the purpose of impairment testing may not coincide with the level at which goodwill is allocated in accordance with IAS 21 *The Effects of Changes in Foreign Exchange Rates* for the purpose of measuring foreign currency gains and losses. For example, if an entity is required by IAS 21 to allocate goodwill to relatively low levels for the purpose of measuring foreign currency gains and losses, it is not required to test the goodwill for impairment at that same level unless it also monitors the goodwill at that level for internal management purposes.
84. ***If the initial allocation of goodwill acquired in a business combination cannot be completed before the end of the annual period in which the business combination is effected, that initial allocation shall be completed before the end of the first annual period beginning after the acquisition date.***
85. In accordance with IFRS 3 *Business Combinations*, if the initial accounting for a business combination can be determined only provisionally by the end of the 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, it might also not be possible to complete the initial allocation of the goodwill acquired in the combination before the end of the annual period in which the combination is effected. When this is the case, the entity discloses the information required by paragraph 133.

86. ***If goodwill has been allocated to a cash-generating unit and the entity disposes of an operation within that 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, unless the entity can demonstrate that some other method better reflects the goodwill associated with the operation disposed of.***

**Example**

An entity sells for CU100 an operation that was part of a cash-generating unit to which goodwill has been allocated. The goodwill allocated to the unit cannot be identified or associated with an asset group at a level lower than that unit, except arbitrarily. The recoverable amount of the portion of the cash-generating unit retained is CU300.

*Because the goodwill allocated to the cash-generating unit cannot be non-arbitrarily identified or associated with an asset group at a level lower than that unit, the goodwill associated with the operation disposed of is measured on the basis of the relative values of the operation disposed of and the portion of the unit retained. Therefore, 25 per cent of the goodwill allocated to the cash-generating unit is included in the carrying amount of the operation that is sold.*

87. ***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. This reallocation shall be performed using a relative value approach similar to that used when an entity disposes of an operation within a cash-generating unit, unless the entity can demonstrate that some other method better reflects the goodwill associated with the reorganised units.***

#### Example

Goodwill had previously been allocated to cash-generating unit A. The goodwill allocated to A cannot be identified or associated with an asset group at a level lower than A, except arbitrarily. A is to be divided and integrated into three other cash-generating units, B, C and D.

*Because the goodwill allocated to A cannot be non-arbitrarily identified or associated with an asset group at a level lower than A, it is reallocated to units B, C and D on the basis of the relative values of the three portions of A before those portions are integrated with B, C and D.*

#### Testing Cash-generating Units with Goodwill for Impairment

88. ***When, as described in paragraph 81, goodwill relates to a cash-generating unit but has not been allocated to that unit, the unit shall be tested for impairment, whenever there is an indication that the unit may be impaired, by comparing the unit's carrying amount, excluding any goodwill, with its recoverable amount. Any impairment loss shall be recognised in accordance with paragraph 104.***
89. If a cash-generating unit described in paragraph 88 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 10 requires the unit also to be tested for impairment annually.
90. ***A cash-generating unit to which goodwill has been allocated shall be tested for impairment annually, and whenever there is an indication that the unit may be impaired, by comparing the carrying amount of the unit, including the goodwill, with the recoverable amount of the unit. If the recoverable amount of the unit exceeds the carrying amount of the unit, the unit and the goodwill allocated to that unit shall be regarded as not impaired. If the carrying amount of the unit exceeds the recoverable amount of the unit, the entity shall recognise the impairment loss in accordance with paragraph 104.***

#### Minority Interest

91. In accordance with IFRS 3, 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 Standard is attributable to the minority interest in goodwill.

## IAS 36

92. 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. This is accomplished 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 104 first to reduce the carrying amount of goodwill allocated to the unit.
93. 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 as a goodwill impairment loss.
94. 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 104 requires the remaining excess to be allocated to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit.
95. Illustrative Example 7 illustrates the impairment testing of a nonwholly-owned cash-generating unit with goodwill.

## Timing of Impairment Tests

96. ***The annual impairment test for a cash-generating unit to which goodwill has been allocated may be performed at any time during an annual 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 period, that unit shall be tested for impairment before the end of the current annual period.***
97. ***If the assets constituting the cash-generating unit to which goodwill has been allocated are tested for impairment at the same time as the unit containing the goodwill, they shall be tested for impairment before the unit containing the goodwill. Similarly, if the cash-generating units constituting a group of cash-generating units to which goodwill has been allocated are tested for impairment at the same time as the group of units containing the goodwill, the individual units shall be tested for impairment before the group of units containing the goodwill.***
98. At the time of impairment testing a cash-generating unit to which goodwill has been allocated, there may be an indication of an impairment of an asset within the unit containing the goodwill. In such circumstances, the entity tests the asset for impairment first, and recognises any impairment loss for that asset before testing for impairment the cash-generating unit containing the goodwill. Similarly, there may be an indication of an impairment of a cash-generating unit within a group of units containing the goodwill. In such circumstances, the entity tests the cash-generating unit for impairment first, and recognises any impairment loss for that unit, before testing for impairment the group of units to which the goodwill is allocated.
99. ***The most recent detailed calculation made in a preceding 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 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 carrying amount of the unit 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 unit is remote.*

#### Corporate Assets

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

101. 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 or group of cash-generating units to which the corporate asset belongs, and is compared with the carrying amount of this cash-generating unit or group of cash-generating units. Any impairment loss is recognised in accordance with paragraph 104.

102. *In testing a cash-generating unit for impairment, an entity shall identify all the corporate assets that relate to the cash-generating unit under review. If a portion of the carrying amount of a corporate asset:*

- (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 104.*

- (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 104;*

- (ii) *identify the smallest group of cash-generating units 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;*

*and*

- (iii) *compare the carrying amount of that group of cash-generating units, including the portion of the carrying amount of the corporate asset allocated to that group of units, with the recoverable amount of the group of units. Any impairment loss shall be recognised in accordance with paragraph 104.*

103. Illustrative Example 8 illustrates the application of these requirements to corporate assets.

## IAS 36

*Impairment Loss for a Cash-generating Unit*

104. **An impairment loss shall be recognised for a cash-generating unit (the smallest group of cash-generating units to which goodwill or a corporate asset has been allocated) if, and only if, the recoverable amount of the unit (group of units) is less than the carrying amount of the unit (group of units). 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 (group of units);**

**and**

(b) **then, to the other assets of the unit (group of units) pro rata on the basis of the carrying amount of each asset in the unit (group of units).**

**These reductions in carrying amounts shall be treated as impairment losses on individual assets and recognised in accordance with paragraph 60.**

105. **In allocating an impairment loss in accordance with paragraph 104, an entity shall not reduce the carrying amount of an asset below the highest of:**

(a) **its fair value less costs to sell (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 shall be allocated pro rata to the other assets of the unit (group of units).**

106. If it is not practicable to estimate the recoverable amount of each individual asset of a cash-generating unit, this 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.

107. If the recoverable amount of an individual asset cannot be determined (see paragraph 67):

(a) an impairment loss is recognised for the asset if its carrying amount is greater than the higher of its fair value less costs to sell and the results of the allocation procedures described in paragraphs 104 and 105;

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 fair value less costs to sell is less than its carrying amount.

**Example**

A machine has suffered physical damage but is still working, although not as well as before it was damaged. The machine's fair value less costs to sell is less than its carrying amount. The machine does not generate independent cash inflows. The smallest identifiable group of assets that includes the machine and generates cash inflows 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 because the machine's value in use:*

(a) *may differ from its fair value less costs to sell;*

*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 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 expected to be consumed by the 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 fair value less costs to sell. 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 (ie the production line). Because the machine's fair value less costs to sell is less than its carrying amount, an impairment loss is recognised for the machine.*

108. **After the requirements in paragraphs 104 and 105 have been applied, a liability shall be recognised for any remaining amount of an impairment loss for a cash-generating unit if, and only if, that is required by another Standard.**

**REVERSING AN IMPAIRMENT LOSS**

109. Paragraphs 110-116 set out the requirements for reversing an impairment loss recognised for an asset or a cash-generating unit in prior periods. These requirements use the term 'an asset' but apply equally to an individual asset or a cash-generating unit. Additional requirements for an individual asset are set out in paragraphs 117-121, for a cash-generating unit in paragraphs 122 and 123 and for goodwill in paragraphs 124 and 125.
110. **An entity shall assess at each reporting date whether there is any indication that an impairment loss recognised in prior periods for an asset other than goodwill may no longer exist or may have decreased. If any such indication exists, the entity shall estimate the recoverable amount of that asset.**
111. **In assessing whether there is any indication that an impairment loss recognised in prior periods for an asset other than goodwill may no longer exist or may have decreased, an entity shall consider, as a minimum, the following indications:**

## IAS 36

*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 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 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 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 costs incurred during the period to improve or enhance the asset's performance or restructure the operation to which the asset belongs.*
  - (e) *evidence is available from internal reporting that indicates that the economic performance of the asset is, or will be, better than expected.*
112. Indications of a potential decrease in an impairment loss in paragraph 111 mainly mirror the indications of a potential impairment loss in paragraph 12.
113. 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 Standard applicable to the asset, even if no impairment loss is reversed for the asset.
114. ***An impairment loss recognised in prior periods for an asset other than goodwill 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 shall, except as described in paragraph 117, be increased to its recoverable amount. That increase is a reversal of an impairment loss.***
115. A reversal of an impairment loss reflects an increase in the estimated service potential of an asset, either from use or from sale, since the date when an entity last recognised an impairment loss for that asset. Paragraph 130 requires an entity 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 (ie whether recoverable amount is based on fair value less costs to sell 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 fair value less costs to sell, a change in estimate of the components of fair value less costs to sell.

116. 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.

*Reversing an Impairment Loss for an Individual Asset*

117. ***The increased carrying amount of an asset other than goodwill attributable to a reversal of an impairment loss 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.***
118. 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 entity applies the Standard applicable to the asset.
119. ***A reversal of an impairment loss for an asset other than goodwill shall be recognised immediately in profit or loss, unless the asset is carried at revalued amount in accordance with another Standard (for example, the revaluation model in IAS 16 Property, Plant and Equipment). Any reversal of an impairment loss of a revalued asset shall be treated as a revaluation increase in accordance with that other Standard.***
120. 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 in profit or loss, a reversal of that impairment loss is also recognised in profit or loss.
121. ***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.***

*Reversing an Impairment Loss for a Cash-generating Unit*

122. ***A reversal of an impairment loss for a cash-generating unit shall be allocated to the assets of the unit, except for goodwill, pro rata with the carrying amounts of those assets. These increases in carrying amounts shall be treated as reversals of impairment losses for individual assets and recognised in accordance with paragraph 119.***
123. ***In allocating a reversal of an impairment loss for a cash-generating unit in accordance with paragraph 122, the carrying amount of an asset 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 periods.*

***The amount of the reversal of the impairment loss that would otherwise have been allocated to the asset shall be allocated pro rata to the other assets of the unit, except for goodwill.***

## IAS 36

## Reversing an Impairment Loss for Goodwill

124. **An impairment loss recognised for goodwill shall not be reversed in a subsequent period.**
125. IAS 38 *Intangible Assets* prohibits the recognition of internally generated goodwill. 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.

## DISCLOSURE

126. **An entity shall disclose the following for each class of assets:**
- (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.**
  - (c) **the amount of impairment losses on revalued assets recognised directly in equity during the period.**
  - (d) **the amount of reversals of impairment losses on revalued assets recognised directly in equity during the period.**
127. A class of assets is a grouping of assets of similar nature and use in an entity's operations.
128. The information required in paragraph 126 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 by IAS 16 *Property, Plant and Equipment*.
129. **An entity that reports segment information in accordance with IAS 14 Segment Reporting shall disclose the following for each reportable segment based on an entity's primary reporting format:**
- (a) **the amount of impairment losses recognised in profit or loss and directly in equity during the period.**
  - (b) **the amount of reversals of impairment losses recognised in profit or loss and directly in equity during the period.**
130. **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 entity's primary reporting format.*

(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, or a reportable segment as defined in IAS 14);*

(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 entity's primary reporting format;*

*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), 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 fair value less costs to sell or its value in use.*

(f) *if recoverable amount is fair value less costs to sell, the basis used to determine fair value less costs to sell (such as whether fair value was determined by reference to an active market).*

(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.*

131. *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 in accordance with paragraph 130:*

(a) *the main classes of assets affected by impairment losses and the main classes of assets affected by reversals of impairment losses.*

(b) *the main events and circumstances that led to the recognition of these impairment losses and reversals of impairment losses.*

132. *An entity is encouraged to disclose assumptions used to determine the recoverable amount of assets (cash-generating units) during the period. However, paragraph 134 requires an entity 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.*

133. *If, in accordance with paragraph 84, any portion of the goodwill acquired in a business combination during the period has not been allocated to a cash-generating unit (group of units) at the reporting date, the amount of the unallocated goodwill shall be disclosed together with the reasons why that amount remains unallocated.*

## IAS 36

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

134. An entity shall disclose the information required by (a)-(f) for each cash-generating unit (group of units) for which the carrying amount of goodwill or intangible assets with indefinite useful lives allocated to that unit (group of units) is significant in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite useful lives:
- (a) the carrying amount of goodwill allocated to the unit (group of units).
  - (b) the carrying amount of intangible assets with indefinite useful lives allocated to the unit (group of units).
  - (c) the basis on which the unit's (group of units') recoverable amount has been determined (ie value in use or fair value less costs to sell).
  - (d) if the unit's (group of units') recoverable amount is based on value in use:
    - (i) a description of each key assumption on which management has based its cash flow projections for the period covered by the most recent budgets/forecasts. Key assumptions are those to which the unit's (group of units') recoverable amount is most sensitive.
    - (ii) a description of management's approach to determining the value(s) assigned to each key assumption, whether those value(s) reflect past experience or, if appropriate, are consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information.
    - (iii) 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 (group of units), an explanation of why that longer period is justified.
    - (iv) 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 (group of units) is dedicated.
    - (v) the discount rate(s) applied to the cash flow projections.
  - (e) if the unit's (group of units') recoverable amount is based on fair value less costs to sell, the methodology used to determine fair value less costs to sell. If fair value less costs to sell is not determined using an observable market price for the unit (group of units), the following information shall also be disclosed:
    - (i) a description of each key assumption on which management has based its determination of fair value less costs to sell. Key assumptions are those to which the unit's (group of units') recoverable amount is most sensitive.
    - (ii) a description of management's approach to determining the value(s) assigned to each key assumption, whether those value(s) reflect past experience or, if appropriate, are consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information.

- (f) *if a reasonably possible change in a key assumption on which management has based its determination of the unit's (group of units') recoverable amount would cause the unit's (group of units') carrying amount to exceed its recoverable amount:*
- (i) *the amount by which the unit's (group of units') recoverable amount exceeds its carrying amount.*
  - (ii) *the value assigned to the key assumption.*
  - (iii) *the amount by which the value assigned to the key assumption must change, after incorporating any consequential effects of that change on the other variables used to measure recoverable amount, in order for the unit's (group of units') recoverable amount to be equal to its carrying amount.*
135. *If some or all of the carrying amount of goodwill or intangible assets with indefinite useful lives is allocated across multiple cash-generating units (groups of units), and the amount so allocated to each unit (group of units) is not significant in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite useful lives, that fact shall be disclosed, together with the aggregate carrying amount of goodwill or intangible assets with indefinite useful lives allocated to those units (groups of units). In addition, if the recoverable amounts of any of those units (groups of units) are based on the same key assumption(s) and the aggregate carrying amount of goodwill or intangible assets with indefinite useful lives allocated to them is significant in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite useful lives, an entity shall disclose that fact, together with:*
- (a) *the aggregate carrying amount of goodwill allocated to those units (groups of units).*
  - (b) *the aggregate carrying amount of intangible assets with indefinite useful lives allocated to those units (groups of units).*
  - (c) *a description of the key assumption(s).*
  - (d) *a description of management's approach to determining the value(s) assigned to the key assumption(s), whether those value(s) reflect past experience or, if appropriate, are consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information.*
  - (e) *if a reasonably possible change in the key assumption(s) would cause the aggregate of the units' (groups of units') carrying amounts to exceed the aggregate of their recoverable amounts:*
    - (i) *the amount by which the aggregate of the units' (groups of units') recoverable amounts exceeds the aggregate of their carrying amounts.*
    - (ii) *the value(s) assigned to the key assumption(s).*
    - (iii) *the amount by which the value(s) assigned to the key assumption(s) must change, after incorporating any consequential effects of the change on the other variables used to measure recoverable amount, in order for the aggregate of the units' (groups of units') recoverable amounts to be equal to the aggregate of their carrying amounts.*
136. The most recent detailed calculation made in a preceding period of the recoverable amount of a cash-generating unit (group of units) may, in accordance with paragraph 24 or 99, be carried forward and used in the impairment test for that unit (group of units) in the current period provided specified criteria are met. When this is the case, the information for that unit (group of units) that is incorporated into the disclosures required by paragraphs 134 and 135 relate to the carried forward calculation of recoverable amount.

**IAS 36**

137. Illustrative Example 9 illustrates the disclosures required by paragraphs 134 and 135.

**TRANSITIONAL PROVISIONS AND EFFECTIVE DATE**

138. *If an entity elects in accordance with paragraph 85 of IFRS 3 Business Combinations to apply IFRS 3 from any date before the effective dates set out in paragraphs 78-84 of IFRS 3, it also shall apply this Standard prospectively from that same date.*
139. *Otherwise, an entity shall apply this Standard:*
- (a) to goodwill and intangible assets acquired in business combinations for which the agreement date is on or after 31 March 2004;*
  - and*
  - (b) to all other assets prospectively from the beginning of the first annual period beginning on or after 31 March 2004.*
140. *Entities to which paragraph 139 applies are encouraged to apply the requirements of this Standard before the effective dates specified in paragraph 139. However, if an entity applies this Standard before those effective dates, it also shall apply IFRS 3 and IAS 38 Intangible Assets (as revised in 2004) at the same time.*

**WITHDRAWAL OF IAS 36 (ISSUED 1998)**

141. This Standard supersedes IAS 36 *Impairment of Assets* (issued in 1998).
-

## APPENDIX A

IAS 36

**Using Present Value Techniques to Measure Value in Use**

*This appendix is an integral part of the 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**

A1. The following elements together capture the economic differences between 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 or timing of those cash flows;
  - (c) the time value of money, represented by the current market riskfree 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.

A2. 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 A1 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 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**

A3. 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*

- A4. 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.
- A5. 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'.
- A6. However, the traditional approach may not appropriately address some complex measurement problems, such as the measurement of nonfinancial 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 (ie vary) in a similar fashion in changing economic conditions.

*Expected Cash Flow Approach*

- A7. 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 CU100, CU200 or CU300 with probabilities of 10 per cent, 60 per cent and 30 per cent, respectively. The expected cash flow is CU220. 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.

- A8. 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 CU1 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 CU1 000 in 1 year at 5 %	CU952.38	
Probability	10.00 %	CU95.24
Present value of CU1 000 in 2 years at 5.25 %	CU902.73	
Probability	60.00 %	CU541.64
Present value of CU1 000 in 3 years at 5.50 %	CU851.61	
Probability	30.00 %	CU255.48
	Expected present value	CU892.36

- A9. The expected present value of CU892.36 differs from the traditional notion of a best estimate of CU902.73 (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.

- A10. 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 A6) requires the same estimates and subjectivity without providing the computational transparency of the expected cash flow approach.

- A11. 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 CU50 and CU250, but no amount in the range is more likely than any other amount. Based on that limited information, the estimated expected cash flow is CU150  $[(50 + 250)/2]$ .
- (b) the estimated amount falls somewhere between CU50 and CU250, and the most likely amount is CU100. However, the probabilities attached to each amount are unknown. Based on that limited information, the estimated expected cash flow is CU133.33  $[(50 + 100 + 250)/3]$ .
- (c) the estimated amount will be CU50 (10 per cent probability), CU250 (30 per cent probability), or CU100 (60 per cent probability). Based on that limited information, the estimated expected cash flow is CU140  $[(50 \times 0.10) + (250 \times 0.30) + (100 \times 0.60)]$ .

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.

- A12. The application of an expected cash flow approach is subject to a costbenefit 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.

**IAS 36**

- A13. 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 CU10 and a 10 per cent probability that the cash flow will be CU1 000. They observe that the expected cash flow in that example is CU109 and criticise that result as not representing either of the amounts that may ultimately be paid.
- A14. 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, this Standard is concerned with measuring the recoverable amount of an asset. The recoverable amount of the asset in this example is not likely to be CU10, even though that is the most likely cash flow. This is because a measurement of CU10 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 CU10.

**Discount Rate**

- A15. 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.
- A16. 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 A1, to the extent those factors have not caused adjustments in arriving at estimated cash flows.
- A17. 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.
- A18. However, these rates must be adjusted:
- (a) to reflect the way that the market would assess the specific risks associated with the asset's estimated cash flows;
- and
- (b) to 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.

- A19. 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.
- A20. Paragraph 55 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.
- A21. 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.
-

## IAS 36

## APPENDIX B

## Amendment to IAS 16

The amendment in this appendix shall be applied when an entity applies IAS 16 Property, Plant and Equipment (as revised in 2003). It is superseded when IAS 36 Impairment of Assets (as revised in 2004) becomes effective. This appendix replaces the consequential amendments made by IAS 16 (as revised in 2003) to IAS 36 Impairment of Assets (issued in 1998). IAS 36 (as revised in 2004) incorporates the requirements of the paragraphs in this appendix. Consequently, the amendments from IAS 16 (as revised in 2003) are not necessary once an entity is subject to IAS 36 (as revised in 2004). Accordingly, this appendix is applicable only to entities that elect to apply IAS 16 (as revised in 2003) before its effective date.

B1. IAS 16 Property, Plant and Equipment is amended as described below.

In the Appendix, paragraph A4 is amended to read as follows:

A4. IAS 36 Impairment of Assets (issued in 1998) is amended as described below.

In the Standard, paragraphs 4, 9, 34, 37, 38, 41, 42, 59, 96 and 104 are amended to read as follows:

4. This Standard applies to assets that are carried at revalued amount (fair value) under other Standards, such as the revaluation model in IAS 16 Property, Plant and Equipment. However, identifying whether a revalued asset may be impaired depends on the basis used to determine fair value:

...

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

...

**Internal sources of information**

...

- (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, and plans to dispose of an asset before the previously expected date;**

**and**

...

34. Projections of cash outflows include those for the day-to-day servicing of the asset as well as future overheads that can be attributed directly, or allocated on a reasonable and consistent basis, to the use of the asset.

37. **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:**

...

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

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

(b) future cash outflows that will improve or enhance the asset's performance or the related cash inflows that are expected to arise from such outflows.

41. Until an entity incurs cash outflows that improve or enhance the asset's performance, estimates of future cash flows do not include the estimated future cash inflows that are expected to arise from the increase in economic benefits associated with the cash outflow (see Appendix A, Example 6).

42. Estimates of future cash flows include future cash outflows necessary to maintain the level of economic benefits expected to arise from the asset in its current condition. When a cash-generating unit consists of assets with different estimated useful lives, all of which are essential to the ongoing operation of the unit, the replacement of assets with shorter lives is considered to be part of the day-to-day servicing of the unit when estimating the future cash flows associated with the unit. Similarly, when a single asset consists of components with different estimated useful lives, the replacement of components with shorter lives is considered to be part of the day-to-day servicing of the asset when estimating the future cash flows generated by the asset.

59. ***An impairment loss shall be recognised as an expense in the income statement immediately, unless the asset is carried at revalued amount under another Standard (for example, in accordance with the revaluation model in IAS 16 Property, Plant and Equipment). Any impairment loss of a revalued asset shall be treated as a revaluation decrease under that other Standard.***

96. ***In assessing whether there is any indication that an impairment loss recognised for an asset in prior years may no longer exist or may have decreased, an entity shall consider, as a minimum, the following indications:***

...

***Internal sources of information***

(d) ***significant changes with a favourable 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, the asset is used or is expected to be used. These changes include costs incurred during the period to improve or enhance the asset's performance or restructure the operation to which the asset belongs;***

***and***

...

104. ***A reversal of an impairment loss for an asset shall be recognised as income immediately in the income statement, unless the asset is carried at revalued amount under another Standard (for example, in accordance with the revaluation model in IAS 16 Property, Plant and Equipment). Any reversal of an impairment loss of a revalued asset shall be treated as a revaluation increase under that other Standard.***
-

**Intangible assets**

## SUMMARY

	Paragraphs
Objective	1
Scope	2-7
Definitions	8-17
Intangible assets	9-17
Identifiability	11-12
Control	13-16
Future economic benefits	17
Recognition and measurement	18-67
Separate acquisition	25-32
Acquisition as part of a business combination	33-43
Measuring the fair value of an intangible asset acquired in a business combination	35-41
Subsequent expenditure on an acquired in-process research and development project	42-43
Acquisition by way of a government grant	44
Exchanges of assets	45-47
Internally generated goodwill	48-50
Internally generated intangible assets	51-67
Research phase	54-56
Development phase	57-64
Cost of an internally generated intangible asset	65-67
Recognition of an expense	68-71
Past expenses not to be recognised as an asset	71
Measurement after recognition	72-87
Cost model	74
Revaluation model	75-87
Useful life	88-96
Intangible assets with finite useful lives	97-106
Amortisation period and amortisation method	97-99
Residual value	100-103
Review of amortisation period and amortisation method	104-106

	Paragraphs
Intangible assets with indefinite useful lives	107-110
Review of useful life assessment	109-110
Recoverability of the carrying amount - impairment losses	111
Retirements and disposals	112-117
Disclosure	118-128
General	118-123
Intangible assets measured after recognition using the revaluation model	124-125
Research and development expenditure	126-127
Other information	128
Transitional provisions and effective date	129-132
Exchanges of similar assets	131
Early application	132
Withdrawal of IAS 38 (issued 1998)	133

This revised standard supersedes IAS 38 (1998) *intangible assets* and should be applied:

- (a) on acquisition to intangible assets acquired in business combinations for which the agreement date is on or after 31 March 2004.
- (b) to all other intangible assets, for annual periods beginning on or after 31 March 2004.

Earlier application is encouraged.

#### OBJECTIVE

1. The objective of this Standard is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another Standard. This Standard requires an entity to recognise an intangible asset if, and only if, specified criteria are met. The Standard also specifies how to measure the carrying amount of intangible assets and requires specified disclosures about intangible assets.

#### SCOPE

2. *This Standard shall be applied in accounting for intangible assets, except:*

- (a) *intangible assets that are within the scope of another Standard;*

## IAS 38

(b) **financial assets, as defined in IAS 39 Financial Instruments: Recognition and Measurement;**

**and**

(c) **mineral rights and expenditure on the exploration for, or development and extraction of, minerals, oil, natural gas and similar non-regenerative resources.**

3. If another Standard prescribes the accounting for a specific type of intangible asset, an entity applies that Standard instead of this Standard. For example, this Standard does not apply to:
- (a) intangible assets held by an entity for sale in the ordinary course of business (see IAS 2 *Inventories* and IAS 11 *Construction Contracts*).
  - (b) deferred tax assets (see IAS 12 *Income Taxes*).
  - (c) leases that are within the scope of IAS 17 *Leases*.
  - (d) assets arising from employee benefits (see IAS 19 *Employee Benefits*).
  - (e) financial assets as defined in IAS 39. The recognition and measurement of some financial assets are covered by IAS 27 *Consolidated and Separate Financial Statements*, IAS 28 *Investments in Associates* and IAS 31 *Interests in Joint Ventures*.
  - (f) goodwill acquired in a business combination (see IFRS 3 *Business Combinations*).
  - (g) deferred acquisition costs, and intangible assets, arising from an insurer's contractual rights under insurance contracts within the scope of IFRS 4 *Insurance Contracts*. IFRS 4 sets out specific disclosure requirements for those deferred acquisition costs but not for those intangible assets. Therefore, the disclosure requirements in this Standard apply to those intangible assets.
  - (h) non-current intangible assets classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.
4. Some intangible assets may be contained in or on a physical substance such as a compact 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 IAS 16 *Property, Plant and Equipment* or as an intangible asset under this Standard, an entity uses judgement 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. When the software is not an integral part of the related hardware, computer software is treated as an intangible asset.
5. This 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 (eg a prototype), the physical element of the asset is secondary to its intangible component, ie the knowledge embodied in it.
6. In the case of a finance lease, the underlying asset may be either tangible or intangible. After initial recognition, a lessee accounts for an intangible asset held under a finance lease in accordance with this 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 IAS 17 and are within the scope of this Standard.

7. Exclusions from the scope of a Standard may occur if 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 accounting for expenditure on the exploration for, or development and extraction of, oil, gas and mineral deposits in extractive industries and in the case of insurance contracts. Therefore, this Standard does not apply to expenditure on such activities and contracts. However, this Standard applies to other intangible assets used (such as computer software), and other expenditure incurred (such as start-up costs), in extractive industries or by insurers.

#### DEFINITIONS

8. *The following terms are used in this Standard with the meanings specified:*

*An active market is a market in which all the following conditions exist:*

- (a) the items traded in 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.*

*Amortisation is the systematic allocation of the depreciable amount of an intangible asset over its useful life.*

*An asset is a resource:*

- (a) controlled by an entity as a result of past events;*

*and*

- (b) from which future economic benefits are expected to flow to the entity.*

*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.*

*Cost is the amount of cash or cash equivalents paid or the fair value of other consideration given to acquire an asset at the time of its acquisition or construction, or, when applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other IFRSs, eg IFRS 2 Share-based Payment.*

*Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value.*

*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 before the start of commercial production or use.*

## IAS 38

**Entity-specific value is the present value of the cash flows an entity expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability.**

**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 impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount.**

**An intangible asset is an identifiable non-monetary asset without physical substance.**

**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.**

**The residual value of an intangible asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.**

**Useful life is:**

**(a) the period over which an asset is expected to be available for use by an entity;**

**or**

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

#### Intangible Assets

9. 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.
10. Not all the items described in paragraph 9 meet the definition of an intangible asset, ie identifiability, control over a resource and existence of future economic benefits. If an item within the scope of this 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, it forms part of the goodwill recognised at the acquisition date (see paragraph 68).

#### Identifiability

11. The definition of an intangible asset requires an intangible asset to be identifiable to distinguish it from goodwill. Goodwill acquired in a business combination 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 that, individually, do not qualify for recognition in the financial statements but for which the acquirer is prepared to make a payment in the business combination.

12. **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.**

**Control**

13. An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits. The capacity of an 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 because an entity may be able to control the future economic benefits in some other way.
14. Market and technical knowledge may give rise to future economic benefits. An 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. An 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 entity may also expect that the staff will continue to make their skills available to the entity. However, an entity usually has insufficient control over the expected future economic benefits arising from a team of skilled staff and from training for these items to 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. An entity may have a portfolio of customers or a market share and expect that, because of its efforts in building customer relationships and loyalty, the customers will continue to trade with the 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 entity, the entity usually has insufficient control over the expected economic benefits from customer relationships and loyalty for such items (eg portfolio of customers, market shares, customer relationships and customer loyalty) to meet the definition of intangible assets. In the absence of legal rights to protect customer relationships, exchange transactions for the same or similar non-contractual customer relationships (other than as part of a business combination) provide evidence that the entity is nonetheless able to control the expected future economic benefits flowing from the customer relationships. Because such exchange transactions also provide evidence that the customer relationships are separable, those customer relationships meet the definition of an intangible asset.

**Future Economic Benefits**

17. 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 entity. For example, the use of intellectual property in a production process may reduce future production costs rather than increase future revenues.

## IAS 38

## RECOGNITION AND MEASUREMENT

18. The recognition of an item as an intangible asset requires an entity to demonstrate that the item meets:

(a) the definition of an intangible asset (see paragraphs 8-17);

and

(b) the recognition criteria (see paragraphs 21-23).

This requirement applies to costs incurred initially to acquire or internally generate an intangible asset and those incurred subsequently to add to, replace part of, or service it.

19. Paragraphs 25-32 deal with the application of the recognition criteria to separately acquired intangible assets, and paragraphs 33-43 deal with their application to intangible assets acquired in a business combination. Paragraph 44 deals with the initial measurement of intangible assets acquired by way of a government grant, paragraphs 45-47 with exchanges of intangible assets, and paragraphs 48-50 with the treatment of internally generated goodwill. Paragraphs 51-67 deal with the initial recognition and measurement of internally generated intangible assets.

20. The nature of intangible assets is such that, in many cases, there are no additions to such an asset or replacements of part of it. Accordingly, most subsequent expenditures are likely to maintain the expected future economic benefits embodied in an existing intangible asset rather than meet the definition of an intangible asset and the recognition criteria in this Standard. In addition, it is often difficult to attribute subsequent expenditure directly to a particular intangible asset rather than to the business as a whole. Therefore, only rarely will subsequent expenditure — expenditure incurred after the initial recognition of an acquired intangible asset or after completion of an internally generated intangible asset — be recognised in the carrying amount of an asset. Consistently with paragraph 63, subsequent expenditure on brands, mastheads, publishing titles, customer lists and items similar in substance (whether externally acquired or internally generated) is always recognised in profit or loss as incurred. This is because such expenditure cannot be distinguished from expenditure to develop the business as a whole.

21. ***An intangible asset shall be recognised if, and only if:***

(a) ***it is probable that the expected 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.***

22. ***An entity shall assess the probability of expected 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.***

23. An 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.

24. ***An intangible asset shall be measured initially at cost.***

*Separate Acquisition*

25. Normally, the price an entity pays to acquire separately an intangible asset reflects expectations about the probability that the expected 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 21(a) is always considered to be satisfied for separately acquired intangible assets.
26. In addition, the cost of 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.
27. The cost of a separately acquired intangible asset comprises:
- (a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates;
  - and
  - (b) any directly attributable cost of preparing the asset for its intended use.
28. Examples of directly attributable costs are:
- (a) costs of employee benefits (as defined in IAS 19 *Employee Benefits*) arising directly from bringing the asset to its working condition;
  - (b) professional fees arising directly from bringing the asset to its working condition;
  - and
  - (c) costs of testing whether the asset is functioning properly.
29. Examples of expenditures that are not part of the cost of an intangible asset are:
- (a) costs of introducing a new product or service (including costs of advertising and promotional activities);
  - (b) costs of conducting business in a new location or with a new class of customer (including costs of staff training);
  - and
  - (c) administration and other general overhead costs.
30. Recognition of costs in the carrying amount of an intangible asset ceases when the asset is in the condition necessary for it to be capable of operating in the manner intended by management. Therefore, costs incurred in using or redeploying an intangible asset are not included in the carrying amount of that asset. For example, the following costs are not included in the carrying amount of an intangible asset:
- (a) costs incurred while an asset capable of operating in the manner intended by management has yet to be brought into use;
  - and
  - (b) initial operating losses, such as those incurred while demand for the asset's output builds up.

**IAS 38**

31. Some operations occur in connection with the development of an intangible asset, but are not necessary to bring the asset to the 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 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 immediately in profit or loss, and included in their respective classifications of income and expense.
32. 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 in accordance with the capitalisation treatment permitted in IAS 23 *Borrowing Costs*.

*Acquisition as Part of a Business Combination*

33. In accordance with IFRS 3 *Business Combinations*, if an intangible asset is acquired in a business combination, the cost of that intangible asset is its fair value at the acquisition date. 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 21(a) is always considered to be satisfied for intangible assets acquired in business combinations.
34. Therefore, in accordance with this Standard and IFRS 3, an acquirer recognises at the acquisition date separately from goodwill an intangible asset of the acquiree if the asset's fair value can be measured reliably, irrespective of whether the asset had been recognised by the acquiree before the business combination. This means that the acquirer recognises as an asset separately from goodwill an in-process research and development project of the acquiree if the project meets the definition of an intangible asset and its fair value can be measured reliably. An acquiree's in-process research and development project meets the definition of an intangible asset when it:
  - (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*

35. The fair value of intangible assets acquired in business combinations can normally be measured with sufficient reliability to be recognised separately from goodwill. When, for the estimates used to measure an intangible asset's fair value, there is a range of possible outcomes with different probabilities, that uncertainty enters into the measurement of the asset's fair value, rather than demonstrates an inability to measure fair value reliably. If an intangible asset acquired in a business combination has a finite useful life, there is a rebuttable presumption that its fair value can be measured reliably.
36. An intangible asset acquired in a business combination might be separable, but only together with a related tangible or intangible asset. For example, a magazine's publishing title might not be able to be sold separately from a related subscriber database, or a trademark for natural spring water might relate to a particular spring and could not be sold separately from the spring. In such cases, the acquirer recognises the group of assets as a single asset separately from goodwill if the individual fair values of the assets in the group are not reliably measurable.

37. Similarly, the terms 'brand' and 'brand name' are often used as synonyms for trademarks and other marks. However, the former are general marketing terms that are typically used to refer to a group of complementary assets such as a trademark (or service mark) and its related trade name, formulas, recipes and technological expertise. The acquirer recognises as a single asset a group of complementary intangible assets comprising a brand if the individual fair values of the complementary assets are not reliably measurable. If the individual fair values of the complementary assets are reliably measurable, an acquirer may recognise them as a single asset provided the individual assets have similar useful lives.
38. The only circumstances in which it might not be possible to measure reliably the fair value of an intangible asset acquired in a business combination are when the intangible asset arises from legal or other contractual rights and either:
- (a) is not separable;
- or
- (b) is separable, but there is no history or evidence of exchange transactions for the same or similar assets, and otherwise estimating fair value would be dependent on immeasurable variables.
39. Quoted market prices in an active market provide the most reliable estimate of the fair value of an intangible asset (see also paragraph 78). 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.
40. If no active market exists for an intangible asset, its fair value is the amount that the entity would have paid for the asset, at the acquisition date, in an arm's length transaction between knowledgeable and willing parties, on the basis of the best information available. In determining this amount, an entity considers the outcome of recent transactions for similar assets.
41. Entities that are regularly involved in the purchase and sale of unique intangible assets may 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 if their objective is to estimate fair value and if they reflect current transactions and practices in the industry to which the asset belongs. These techniques include, when appropriate:
- (a) applying multiples reflecting current market transactions to indicators that drive the profitability of the asset (such as revenue, market shares and operating profit) or to the royalty stream that could be obtained from licensing the intangible asset to another party in an arm's length transaction (as in the 'relief from royalty' approach);
- or
- (b) discounting estimated future net cash flows from the asset.

#### Subsequent Expenditure on an Acquired In-process Research and Development Project

42. **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 54-62.**

**IAS 38**

43. Applying the requirements in paragraphs 54-62 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 research expenditure;
  - (b) recognised as an expense when incurred if it is development expenditure that does not satisfy the criteria for recognition as an intangible asset in paragraph 57;
- and
- (c) added to the carrying amount of the acquired in-process research or development project if it is development expenditure that satisfies the recognition criteria in paragraph 57.

*Acquisition by way of a Government Grant*

44. In some cases, an intangible asset may be acquired free of charge, or for nominal consideration, by way of a government grant. This may happen when a government transfers or allocates to an 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. In accordance with IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, an entity may choose to recognise both the intangible asset and the grant initially at fair value. If an entity chooses not to recognise the asset initially at fair value, the entity recognises the asset initially at a nominal amount (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*

45. One or more intangible assets may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. The following discussion refers simply to an exchange of one non-monetary asset for another, but it also applies to all exchanges described in the preceding sentence. The cost of such an intangible asset is measured at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. The acquired asset is measured in this way even if an entity cannot immediately derecognise the asset given up. If the acquired asset is not measured at fair value, its cost is measured at the carrying amount of the asset given up.
46. An entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction has commercial substance if:
- (a) the configuration (ie risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred;
- or
- (b) the entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange;
- and
- (c) the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

For the purpose of determining whether an exchange transaction has commercial substance, the entity-specific value of the portion of the entity's operations affected by the transaction shall reflect post-tax cash flows. The result of these analyses may be clear without an entity having to perform detailed calculations.

47. Paragraph 21(b) specifies that a condition for the recognition of an intangible asset is that the cost of the asset can be measured reliably. The fair value of an intangible asset for which comparable market transactions do not exist is reliably measurable if (a) the variability in the range of reasonable fair value estimates is not significant for that asset or (b) the probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value. If an entity is able to determine reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure cost unless the fair value of the asset received is more clearly evident.

#### *Internally Generated Goodwill*

48. ***Internally generated goodwill shall not be recognised as an asset.***
49. 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 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 (ie it is not separable nor does it arise from contractual or other legal rights) controlled by the entity that can be measured reliably at cost.
50. Differences between the market value of an entity and the carrying amount of its identifiable net assets at any time may capture a range of factors that affect the value of the entity. However, such differences do not represent the cost of intangible assets controlled by the entity.

#### *Internally Generated Intangible Assets*

51. It is sometimes difficult to assess whether an internally generated intangible asset qualifies for recognition because of problems in:
- (a) identifying whether and when there is an identifiable asset that will generate expected future economic benefits;
- and
- (b) determining 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 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 entity applies the requirements and guidance in paragraphs 52-67 to all internally generated intangible assets.

52. To assess whether an internally generated intangible asset meets the criteria for recognition, an 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 Standard.

53. If an entity cannot distinguish the research phase from the development phase of an internal project to create an intangible asset, the entity treats the expenditure on that project as if it were incurred in the research phase only.

## IAS 38

## Research Phase

54. **No intangible asset arising from research (or from the research phase of an internal project) shall be recognised. Expenditure on research (or on the research phase of an internal project) shall be recognised as an expense when it is incurred.**
55. In the research phase of an internal project, an entity cannot demonstrate that an intangible asset exists that will generate probable future economic benefits. Therefore, this expenditure is recognised as an expense when it is incurred.
56. 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

57. **An intangible asset arising from development (or from the development phase of an internal project) shall be recognised if, and only if, an 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 entity can 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.**
  - (f) **its ability to measure reliably the expenditure attributable to the intangible asset during its development.**
58. In the development phase of an internal project, an 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.

59. 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.
60. To demonstrate how an intangible asset will generate probable future economic benefits, an entity assesses the future economic benefits to be received from the asset using the principles in IAS 36 *Impairment of Assets*. If the asset will generate economic benefits only in combination with other assets, the entity applies the concept of cash-generating units in IAS 36.
61. 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 entity's ability to secure those resources. In some cases, an entity demonstrates the availability of external finance by obtaining a lender's indication of its willingness to fund the plan.
62. An 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.
63. ***Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance shall not be recognised as intangible assets.***
64. 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

65. The cost of an internally generated intangible asset for the purpose of paragraph 24 is the sum of expenditure incurred from the date when the intangible asset first meets the recognition criteria in paragraphs 21, 22 and 57. Paragraph 71 prohibits reinstatement of expenditure previously recognised as an expense.
66. The cost of an internally generated intangible asset comprises all directly attributable costs necessary to create, produce, and prepare the asset to be capable of operating in the manner intended by management. Examples of directly attributable costs are:
- (a) costs of materials and services used or consumed in generating the intangible asset;
  - (b) costs of employee benefits (as defined in IAS 19 *Employee Benefits*) arising from the generation of the intangible asset;

## IAS 38

- (c) fees to register a legal right;

and

- (d) amortisation of patents and licences that are used to generate the intangible asset.

IAS 23 *Borrowing Costs* specifies criteria for the recognition of interest as an element of the cost of an internally generated intangible asset.

67. 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) identified inefficiencies and initial operating losses incurred before the asset achieves planned performance;

and

- (c) expenditure on training staff to operate the asset.

**Example illustrating paragraph 65**

An entity is developing a new production process. During 20X5, expenditure incurred was CU1 000 (\*), of which CU900 was incurred before 1 December 20X5 and CU100 was incurred between 1 December 20X5 and 31 December 20X5. The 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 CU500.

*At the end of 20X5, the production process is recognised as an intangible asset at a cost of CU100 (expenditure incurred since the date when the recognition criteria were met, ie 1 December 20X5). The CU900 expenditure incurred before 1 December 20X5 is recognised as an expense because the recognition criteria were not met until 1 December 20X5. This expenditure does not form part of the cost of the production process recognised in the balance sheet.*

During 20X6, expenditure incurred is CU2 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 CU1 900.

*At the end of 20X6, the cost of the production process is CU2 100 (CU100 expenditure recognised at the end of 20X5 plus CU2 000 expenditure recognised in 20X6). The entity recognises an impairment loss of CU200 to adjust the carrying amount of the process before impairment loss (CU2 100) to its recoverable amount (CU1 900). This impairment loss will be reversed in a subsequent period if the requirements for the reversal of an impairment loss in IAS 36 are met.*

**RECOGNITION OF AN EXPENSE**

68. ***Expenditure on an intangible item 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 18-67);***

***or***

- (b) the item is acquired in a business combination and cannot be recognised as an intangible asset. If this is the case, this expenditure (included in the cost of the business combination) shall form part of the amount attributed to goodwill at the acquisition date (see IFRS 3 Business Combinations).***

(\*) In this Standard, monetary amounts are denominated in 'currency units' (CU).

69. In some cases, expenditure is incurred to provide future economic benefits to an 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, except when it forms part of the cost of a business combination, expenditure on research is recognised as an expense when it is incurred (see paragraph 54). Other examples of expenditure that is recognised as an expense when it is incurred include:
- (a) expenditure on start-up activities (ie start-up costs), unless this expenditure is included in the cost of an item of property, plant and equipment in accordance with 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 (ie pre-opening costs) or expenditures for starting new operations or launching new products or processes (ie preoperating costs).
  - (b) expenditure on training activities.
  - (c) expenditure on advertising and promotional activities.
  - (d) expenditure on relocating or reorganising part or all of an entity.
70. Paragraph 68 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*

71. ***Expenditure on an intangible item that was initially recognised as an expense shall not be recognised as part of the cost of an intangible asset at a later date.***

MEASUREMENT AFTER RECOGNITION

72. ***An entity shall choose either the cost model in paragraph 74 or the revaluation model in paragraph 75 as its accounting policy. If an intangible asset is accounted for using the revaluation model, all the other assets in its class shall also be accounted for using the same model, unless there is no active market for those assets.***
73. A class of intangible assets is a grouping of assets of a similar nature and use in an entity's operations. The items within a class of intangible assets are revalued simultaneously 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.

*Cost Model*

74. ***After initial recognition, an intangible asset shall be carried at its cost less any accumulated amortisation and any accumulated impairment losses.***

*Revaluation Model*

75. ***After initial recognition, an intangible asset 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 Standard, fair value shall be determined by reference to an active market. Revaluations shall 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.***

## IAS 38

76. The revaluation model 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 cost.
77. The revaluation model 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 65), the revaluation model may be applied to the whole of that asset. Also, the revaluation model may be applied to an intangible asset that was received by way of a government grant and recognised at a nominal amount (see paragraph 44).
78. It is uncommon for an active market with the characteristics described in paragraph 8 to exist for an intangible asset, although this may happen. For example, in some 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. Moreover, prices are often not available to the public.
79. 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.
80. 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.
81. ***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 shall be carried at its cost less any accumulated amortisation and impairment losses.***
82. ***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 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.***
83. 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 in accordance with IAS 36 *Impairment of Assets*.
84. If the fair value of the asset can be determined by reference to an active market at a subsequent measurement date, the revaluation model is applied from that date.

85. *If an intangible asset's carrying amount is increased as a result of a revaluation, the increase shall be credited directly to equity under the heading of revaluation surplus. However, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.*
86. *If an intangible asset's carrying amount is decreased as a result of a revaluation, the decrease shall be recognised in profit or loss. However, the decrease shall be debited directly to equity under the heading of revaluation surplus to the extent of any credit balance in the revaluation surplus in respect of that asset.*
87. 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 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.

#### USEFUL LIFE

88. *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 constituting, 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 to the period over which the asset is expected to generate net cash inflows for the entity.*
89. The accounting for an intangible asset is based on its useful life. An intangible asset with a finite useful life is amortised (see paragraphs 97-106), and an intangible asset with an indefinite useful life is not (see paragraphs 107-110). The Illustrative Examples accompanying this Standard illustrate the determination of useful life for different intangible assets, and the subsequent accounting for those assets based on the useful life determinations.
90. Many factors are considered in determining the useful life of an intangible asset, including:
- (a) the expected usage of the asset by the entity and whether the asset could be managed efficiently by another management team;
  - (b) typical product life cycles for the asset and public information on estimates of useful lives of similar 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 entity's ability and intention 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 entity.

## IAS 38

91. 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 intention 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.
92. 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 is short.
93. The useful life of an intangible asset may be very long or even 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.
94. ***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.***
95. 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 entity controls access to these benefits. The useful life is the shorter of the periods determined by these factors.
96. Existence of the following factors, among others, indicates that an entity would be able to renew the contractual or other legal rights without significant cost:
- (a) there is evidence, possibly based on experience, that the contractual or other legal rights will be renewed. If renewal is contingent upon the consent of a third party, this includes evidence that the third party will give its consent;
  - (b) there is evidence that any conditions necessary to obtain renewal will be satisfied;
- and
- (c) the cost to the entity of renewal is not significant when compared with the future economic benefits expected to flow to the entity from renewal.

If the cost of renewal is significant when compared with the future economic benefits expected to flow to the entity from renewal, the 'renewal' cost represents, in substance, the cost to acquire a new intangible asset at the renewal date.

**INTANGIBLE ASSETS WITH FINITE USEFUL LIVES***Amortisation Period and Amortisation Method*

97. ***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, ie when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Amortisation shall cease at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations and the date that the asset is derecognised. The amortisation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. If that pattern cannot be determined reliably, the straight-line method shall be used. The amortisation charge for each period shall be recognised in profit or loss unless this or another Standard permits or requires it to be included in the carrying amount of another asset.***

98. 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 is selected on the basis of the expected pattern of consumption of the expected future economic benefits embodied in the asset and is applied consistently from period to period, unless there is a change in the expected pattern of consumption of those future economic benefits. There is rarely, if ever, 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.
99. Amortisation is usually recognised in profit or loss. However, sometimes the future economic benefits embodied in an asset are absorbed in producing other assets. In this case, the amortisation charge constitutes 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 IAS 2 *Inventories*).

#### *Residual Value*

100. ***The residual value of an intangible asset with a finite useful life 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.***

101. 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 entity expects to dispose of the intangible asset before the end of its economic life.
102. An estimate of an asset's residual value is based on the amount recoverable from disposal using prices prevailing at the date of the estimate for the sale of a similar asset that has reached the end of its useful life and has operated under conditions similar to those in which the asset will be used. The residual value is reviewed at least at each financial year-end. A change in the asset's residual value is accounted for as a change in an accounting estimate in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.
103. The residual value of an intangible asset may increase to an amount equal to or greater than the asset's carrying amount. If it does, the asset's amortisation charge is zero unless and until its residual value subsequently decreases to an amount below the asset's carrying amount.

#### *Review of Amortisation Period and Amortisation Method*

104. ***The amortisation period and the amortisation method for an intangible asset with a finite useful life shall be reviewed at least at each financial year-end. If the expected useful life of the asset is different from previous estimates, the amortisation period shall be changed accordingly. If there has been a change in the expected pattern of consumption of the future economic benefits embodied in the asset, the amortisation method shall be changed to reflect the changed pattern. Such changes shall be accounted for as changes in accounting estimates in accordance with IAS 8.***

## IAS 38

105. During the life of an intangible asset, it may become apparent that the estimate of its useful life is inappropriate. For example, the recognition of an impairment loss may indicate that the amortisation period needs to be changed.
106. Over time, the pattern of future economic benefits expected to flow to an 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

107. *An intangible asset with an indefinite useful life shall not be amortised.*
108. In accordance with 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) annually,
- and
- (b) whenever there is an indication that the intangible asset may be impaired.

*Review of Useful Life Assessment*

109. *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 in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.*
110. In accordance with 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 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

111. To determine whether an intangible asset is impaired, an entity applies IAS 36 *Impairment of Assets*. That Standard explains when and how an 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.

## RETIREMENTS AND DISPOSALS

112. *An intangible asset shall be derecognised:*
- (a) *on disposal;*
- or*
- (b) *when no future economic benefits are expected from its use or disposal.*

113. ***The gain or loss arising from the derecognition of an intangible asset shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the asset. It shall be recognised in profit or loss when the asset is derecognised (unless IAS 17 Leases requires otherwise on a sale and leaseback). Gains shall not be classified as revenue.***
114. The disposal of an intangible asset may occur in a variety of ways (eg by sale, by entering into a finance lease, or by donation). In determining the date of disposal of such an asset, an entity applies the criteria in IAS 18 *Revenue* for recognising revenue from the sale of goods. IAS 17 applies to disposal by a sale and leaseback.
115. If in accordance with the recognition principle in paragraph 21 an entity recognises in the carrying amount of an asset the cost of a replacement for part of an intangible asset, then it derecognises the carrying amount of the replaced part. If it is not practicable for an entity to determine the carrying amount of the replaced part, it may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or internally generated.
116. The consideration receivable on disposal of an intangible asset is recognised initially at its fair value. If payment for the 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 in accordance with IAS 18 reflecting the effective yield on the receivable.
117. Amortisation of an intangible asset with a finite useful life does not cease when the intangible asset is no longer used, unless the asset has been fully depreciated or is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5.

## DISCLOSURE

### General

118. ***An entity 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 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 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) ***assets classified as held for sale or included in a disposal group classified as held for sale in accordance with IFRS 5 and other disposals;***
    - (iii) ***increases or decreases during the period resulting from revaluations under paragraphs 75, 85 and 86 and from impairment losses recognised or reversed directly in equity in accordance with IAS 36 Impairment of Assets (if any);***

## IAS 38

- (iv) *impairment losses recognised in profit or loss during the period in accordance with IAS 36 (if any);*
  - (v) *impairment losses reversed in profit or loss during the period in accordance with IAS 36 (if any);*
  - (vi) *any amortisation recognised during the period;*
  - (vii) *net exchange differences arising on the translation of the financial statements into the presentation currency, and on the translation of a foreign operation into the presentation currency of the entity;*
- and*
- (viii) *other changes in the carrying amount during the period.*

119. A class of intangible assets is a grouping of assets of a similar nature and use in an 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.

120. An entity discloses information on impaired intangible assets in accordance with IAS 36 in addition to the information required by paragraph 118(e)(iii)-(v).

121. IAS 8 requires an entity to disclose the nature and amount of a change in an accounting estimate that has a material effect in the current period or is expected to have a material effect in subsequent periods. Such disclosure may arise from changes in:

- (a) the assessment of an intangible asset's useful life;
  - (b) the amortisation method;
- or
- (c) residual values.

122. An entity shall also disclose:

- (a) *for an intangible asset 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 entity shall describe the factor(s) that played a significant role in determining that the asset has an indefinite useful life.*
- (b) *a description, the carrying amount and remaining amortisation period of any individual intangible asset that is material to the entity's financial statements.*
- (c) *for intangible assets acquired by way of a government grant and initially recognised at fair value (see paragraph 44):*
  - (i) *the fair value initially recognised for these assets;*
  - (ii) *their carrying amount;*

*and*

  - (iii) *whether they are measured after recognition under the cost model or the revaluation model.*
- (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.*
- (e) *the amount of contractual commitments for the acquisition of intangible assets.*

123. When an entity describes the factor(s) that played a significant role in determining that the useful life of an intangible asset is indefinite, the entity considers the list of factors in paragraph 90.

*Intangible Assets Measured after Recognition using the Revaluation Model*

124. *If intangible assets are accounted for at revalued amounts, an entity shall disclose the following:*

- (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 recognised had the revalued class of intangible assets been measured after recognition using the cost model in paragraph 74;*
- (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 assets' fair values.*

125. 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 the cost and revaluation models.

## IAS 38

*Research and Development Expenditure*

126. **An entity shall disclose the aggregate amount of research and development expenditure recognised as an expense during the period.**
127. Research and development expenditure comprises all expenditure that is directly attributable to research or development activities (see paragraphs 66 and 67 for guidance on the type of expenditure to be included for the purpose of the disclosure requirement in paragraph 126).

*Other Information*

128. An entity is encouraged, but not required, to 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 entity but not recognised as assets because they did not meet the recognition criteria in this Standard or because they were acquired or generated before the version of IAS 38 *Intangible Assets* issued in 1998 was effective.

**TRANSITIONAL PROVISIONS AND EFFECTIVE DATE**

129. **If an entity elects in accordance with paragraph 85 of IFRS 3 Business Combinations to apply IFRS 3 from any date before the effective dates set out in paragraphs 78-84 of IFRS 3, it also shall apply this Standard prospectively from that same date. Thus, the entity shall not adjust the carrying amount of intangible assets recognised at that date. However, the entity shall, at that date, apply this Standard to reassess the useful lives of its recognised intangible assets. 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 in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.**
130. **Otherwise, an entity shall apply this Standard:**
- (a) **to the accounting for intangible assets acquired in business combinations for which the agreement date is on or after 31 March 2004;**
- and**
- (b) **to the accounting for all other intangible assets prospectively from the beginning of the first annual period beginning on or after 31 March 2004. Thus, the entity shall not adjust the carrying amount of intangible assets recognised at that date. However, the entity shall, at that date, apply this Standard to reassess the useful lives of such intangible assets. 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 in accordance with IAS 8.**

*Exchanges of Similar Assets*

131. The requirement in paragraphs 129 and 130(b) to apply this Standard prospectively means that if an exchange of assets was measured before the effective date of this Standard 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 its fair value at the acquisition date.

Early Application

IAS 38

132. **Entities to which paragraph 130 applies are encouraged to apply the requirements of this Standard before the effective dates specified in paragraph 130. However, if an entity applies this Standard before those effective dates, it also shall apply IFRS 3 and IAS 36 Impairment of Assets (as revised in 2004) at the same time.**

**WITHDRAWAL OF IAS 38 (ISSUED 1998)**

133. This Standard supersedes IAS 38 *Intangible Assets* (issued in 1998).
-