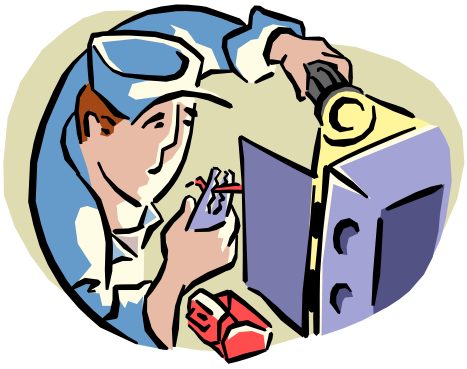
Impairment of Assets (IAS 36)

19 April 2007



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Impairment of Assets

Case

HSBC

- Goodwill is tested for impairment annually by comparing
  - the present value of the expected future cash flows from a business with
  - the carrying value of its net assets, including attributable goodwill.
- Goodwill is stated at cost less accumulated impairment losses.

Goodwill

Impairment of Assets

Case

- Assets that have an indefinite useful life
  - are tested for impairment annually.
- Assets that are subject to depreciation and amortisation
  - are reviewed to determine whether there is any indication that the carrying value of these assets may not be recoverable and have suffered an impairment loss.
- If any such indication exists
  - the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any.
  - The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

Goodwill

Intangible Assets

Impairment of Assets – Summary

Triggering events	At each reporting date, an entity shall assess whether there is any indication that an asset may be impaired.
Recoverable Amount	If any such indication exists, the entity shall estimate the recoverable amount of the asset.
	It is the higher of an asset's: Fair Value Less Costs to Sell and Value in Use
Impairment Loss	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.

Impairment of Assets – Summary

Case

HKEX *(2004 Annual Report)*

Accounting Policy on Impairment of Assets

- Assets that have an indefinite useful life
  - are not subject to amortisation and are tested annually for impairment.
- Assets that are subject to amortisation
  - are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.
- An impairment loss is recognised
  - for the amount by which the asset's carrying amount exceeds its recoverable amount (i.e., the higher of an asset's fair value less costs to sell and value in use).
- Such impairment losses are recognised in the profit and loss account
  - except where the asset is carried at valuation and the impairment loss does not exceed the revaluation surplus for that same asset, in which case it is treated as a decline in revaluation.

Impairment of Assets – Summary

Case

HKEX *(2004 Annual Report)*

Accounting Policy on Impairment of Assets

- In respects of assets other than goodwill,
  - an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount and the circumstances and events leading to the impairment cease to exist.
- A reversal of impairment loss is limited to
  - the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years.
- Reversal of impairment losses are credited to the profit and loss account
  - except when the asset is carried at valuation, in which case the reversal of impairment loss is treated as a revaluation movement.

Topics To Be Covered

- Definition
- Recognition
- Measurement
- Presentation and Disclosure

1. Objective
2. Scope
3. Identifying an Asset That May Be Impaired
4. Measuring Recoverable Amount
5. Recognising and Measuring an Impairment Loss
6. Cash-generating Unit and Goodwill
7. Impairment Loss
8. Reversing an Impairment Loss
9. Disclosures

1. Objective

- IAS 36 Impairment of Assets
  - is to prescribe the procedures that an entity applies to ensure that its assets are carried at no more than their 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

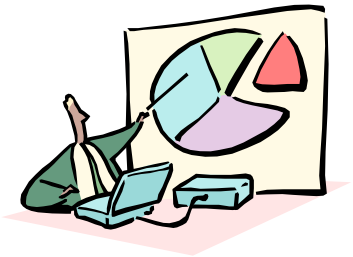
1. Objective

- IAS 36 Impairment of Assets
  - 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
    - IAS 36 requires the entity to recognise an impairment loss.

- Carrying amount is the amount at which an asset is recognised after deducting any accumulated depreciation (amortisation) and accumulated impairment losses thereon.
- An impairment loss is the amount by which the carrying amount of an asset (or a cash-generating unit) exceeds its recoverable amount.

Topics To Be Covered

1. Objective
2. **Scope**



2. Scope

IAS 36 shall be applied in accounting for the impairment of all assets, other than:

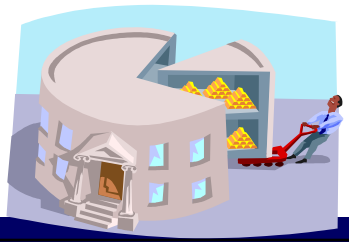
a) inventories (see IAS 2)
b) assets arising from construction contracts (see IAS 11)
c) deferred tax assets (see IAS 12)
d) assets arising from employee benefits (see IAS 19)
e) financial assets that are within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* (see IAS 39)
f) investment property that is measured at fair value (see IAS 40)
g) biological assets related to agricultural activity that are measured at fair value less estimated point-of-sale costs (see IAS 41)
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* (see IFRS 4)
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* (see IFRS 5)

2. Scope

IAS 36 applies to financial assets classified as:

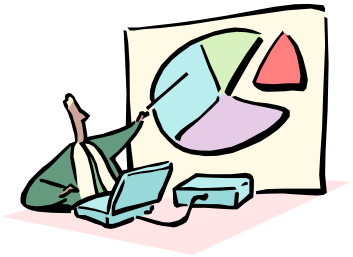
a) subsidiaries, as defined in IAS 27 *Consolidated and Separate Financial Statements*;
b) associates, as defined in IAS 28 *Investments in Associates*; and
c) joint ventures, as defined in IAS 31 *Interests in Joint Ventures*.

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



Topics To Be Covered

1. Objective
2. Scope
3. **Identifying an Asset That May Be Impaired**



3. Identify An Asset That May Be Impaired

Triggering events

- 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.

For all assets within the scope of IAS 36, except for ……

3. Identify An Asset That May Be Impaired

Triggering events

- Irrespective of whether there is any indication of impairment, an entity shall also:

Intangible Assets

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.

Goodwill

b) test
- goodwill acquired in a business combination

for impairment annually

3. Identify An Asset That May Be Impaired

Case

JOHNSON ELECTRIC

2006 Annual Report states:

Intangible Assets

- Assets that have an indefinite useful life
  - are not subject to amortisation,
  - but are tested at least annually for impairment and also reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Goodwill

- Goodwill
  - is tested annually for impairment and carried at cost less accumulated impairment losses.

3. Identify An Asset That May Be Impaired

Case

Galaxy Entertainment Group Limited (2005 Annual Report)

Accounting policy on impairment of assets

- Assets that have an indefinite useful life
  - are not subject to amortisation, which are at least tested annually for impairment and
  - are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.
- Assets that are subject to amortisation
  - are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

3. Identify An Asset That May Be Impaired

Intangible Assets

Timing of impairment test on intangible assets

- 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.

Goodwill

Timing of impairment test on goodwill

- To be discussed later ……

3. Identify An Asset – Case

Case

Intangible Assets

HSBC

- Intangible assets that have an indefinite useful life, or are not yet ready for use
  - are tested for impairment annually.
- This impairment test
  - may be performed at any time during an annual period,
  - provided it is performed at the same time every year.
- An intangible asset recognised during the current period
  - is tested before the end of the current annual period.

3. Identify An Asset That May Be Impaired

- 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) an asset's market value declined significantly more than would be expected
b) significant changes with an adverse effect on the entity in the technological, market, economic or legal environment
c) market interest rates or other rates increased that likely affects the discount rate used in calculating an asset's value in use
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 in which, an asset is used or is expected to be used.
g) evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected.

3. Identify An Asset That May Be Impaired

Example

- Perfect Industry Company Limited (PI)
  - is an experienced original equipment manufacturer (OEM) in cameras
  - focuses in film camera production while its production in compact digital cameras (CDC) is only accounted for 10% of its production.
  - realises that the market for traditional film cameras is declining in terms of demand and profit margin because customers are shifting to digital cameras.
- In view of the market sentiment, PI is considering to the following 3 options:

  Option 1 - Upgrading as an OEM manufacturer for consumer

  Option 2 - Becoming an original brand manufacturer (OBM) for budget CDCs for the PRC using the "Perfection"

  Option 3 - Shifting to an OEM for non-CDC products
- Discuss the key financial reporting issues in relation to the 3 options regarding the impairment of production facilities.

Source from HKICPA

3. Identify An Asset That May Be Impaired

Answers

- Under Option 1, a part or the whole of the company's existing production facilities will be replaced by newly acquired equipment to produce consumer CDCs.
- This raises the issue of whether the company's existing production facilities have been impaired and, if there is impairment, when the impairment should be recognised.
- In accordance with IAS 36, the company should assess at each balance sheet date whether there is any indication that an asset may be impaired. If any such indication exists, the company should estimate the recoverable amount of the asset.
- In assessing whether there is any indication that the company's production facilities may be impaired, both external and internal indications should be considered.
- If the company determines to replace a part or the whole of the existing production facilities, there will be significant changes in the extent or manner that the production facilities are used or are expected to be used, and these changes will have a significant adverse effect on the company. This would constitute strong indication that the production facilities have been impaired.

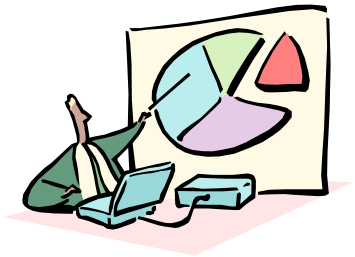
3. Identify An Asset That May Be Impaired

Answers

- The company should therefore estimate the recoverable amount, which is the higher of the value in use and the net selling price of the production facilities to be replaced. The amount of the recoverable amount below the carrying amount of the production facilities to be replaced would be the impairment loss, which should be recognised immediately in the income statement when the company implements the replacement.
- Even if the company has no plans to replace a part or the whole of the existing production under Options 2 and 3, the fact that the traditional film market is declining rapidly indicates that the economic performance of the company's production facilities are, or will be, worse than expected.
- We should therefore also estimate the recoverable amount of the production facilities. The amount of the recoverable amount below the carrying amount of the production facilities would be the impairment loss, which should be recognised immediately in the income statement.

Topics To Be Covered

1. Objective
2. Scope
3. Identifying an Asset That May Be Impaired
4. **Measuring Recoverable Amount**



4. Measuring Recoverable Amount

Triggering events

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Recoverable Amount → It is the higher of an asset's

Fair value less costs to sell **&** Value in Use

4. Measuring Recoverable Amount

- IAS 36 defines recoverable amount as the higher of an asset's or cash-generating unit's

Fair Value Less Costs to Sell and **Value in Use**

- 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

4. Measuring Recoverable Amount

Fair Value Less Costs to Sell

- It 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.
  - **The best evidence**
    - ⇒ is a price in a binding sale agreement in an arm's length transaction, adjusted for incremental costs to the disposal
  - **If no binding sale agreement but an asset is traded in an active market**
    - ⇒ the asset's market price less the costs of disposal
  - **If there is no binding sale agreement or active market for an asset**
    - ⇒ 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

4. Measuring Recoverable Amount

Value in Use

- Value in use is the present value of the future cash flows expected to be derived from an asset or cash-generating unit.
  - 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) time value of money, represented by the current market risk-free rate of interest;
    - d) 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.

⇨ (b), (d) and (e) can be reflected as adjustments to either
- future cash flows or
- discount rate

4. Measuring Recoverable Amount

- 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.

Value in Use

- **Basis for Estimates of Future Cash Flows**
- **Composition of Estimates of Future Cash Flows**
- **Foreign Currency Future Cash Flows**
- **Discount Rates**

4. Measuring Recoverable Amount

Value in Use

- **Basis for Estimates of Future Cash Flows**

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.

4. Measuring Recoverable Amount

Value in Use

Composition of Estimates of Future Cash Flows

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.

4. Measuring Recoverable Amount

Value in Use

- 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.
- The discount rate(s) shall be a pre-tax rate(s) that reflect 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.

Foreign Currency Future Cash Flows

Discount Rates

4. Measuring Recoverable Amount

Example

- Desolve committed to close one of its subsidiary by the year-end, 31 July 2006.
- An equipment of the subsidiary was carried at a value of $10 million at 31 July 2006.
- It was anticipated that the equipment would generate cash flows of $7 million up to 30 November 2006 and that its fair value less costs to sell at 31 July 2006 was $8 million.
- The equipment was sold on 30 November 2006 for $6 million.

Source from ACCA

4. Measuring Recoverable Amount

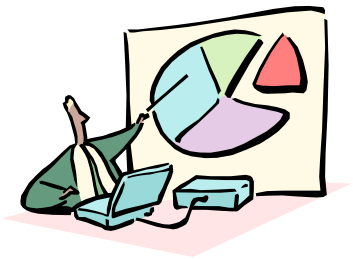
Answers

- The commitment by Desolve to close the operations would be an indicator of possible impairment.
- As at 31 July 2006, the equipment has
  - a carrying value of $10 million,
  - a value in use of $7 million and
  - a fair value less costs to sell of $8 million.

  Thus the carrying value is compared with the higher of the fair value less costs to sell and value in use and as a result the equipment is deemed to be impaired in value to the total of $2 million ($10 million - $8 million).
- The question arises as to whether the sale proceeds of $6 million on 30 Nov. 2006 should be taken as a fairer measure of the equipment's value.
  - This post balance sheet event could be taken into account in the impairment review.
  - The income being generated after the year-end could be taken as the disposal proceeds of $6 million plus cash flows of $7 million, i.e. $13 million.
  - This figure would then be the equipment's recoverable amount, which would mean that the asset is not impaired.

Topics To Be Covered

1. Objective
2. Scope
3. Identifying an Asset That May Be Impaired
4. Measuring Recoverable Amount
5. **Recognising and Measuring an Impairment Loss**



5. Recognising and Measuring an Impairment Loss

Triggering events

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Recoverable Amount

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Impairment Loss

- 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.
- 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.

5. Recognising and Measuring an Impairment Loss

- 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 (for example, IAS 37)
- 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.

Impairment Loss

5. Recognising and Measuring an Impairment Loss

Case

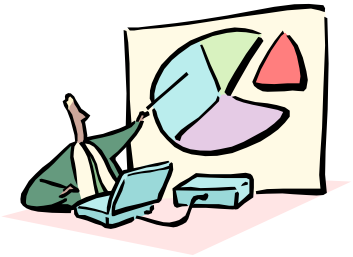
Galaxy Entertainment Group Limited (2005 Annual Report)

Accounting policy on impairment of assets

- An impairment loss is recognised for the amount
  - by which the carrying amount of the asset exceeds its recoverable amount.
- The recoverable amount is the higher of
  - the fair value of an asset less costs to sell and
  - value in use.
- For the purposes of assessing impairment,
  - assets are grouped at the lowest levels for which there are separately identifiable cash flows.

Cash-generating Unit

Topics To Be Covered



1. Objective
2. Scope
3. Identifying an Asset That May Be Impaired
4. Measuring Recoverable Amount
5. Recognising and Measuring an Impairment Loss
6. **Cash-generating Unit and Goodwill**

6. Cash-Generating Unit & Goodwill

- 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).

Intangible Assets

- Intangible assets may be such individual asset.
- Goodwill is definitely such individual asset.

Goodwill

Amendments of IAS 36 are mainly for the requirements on cash-generating unit and goodwill

6. Cash-Generating Unit & Goodwill

- A cash-generating unit (CGU)
  - 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.
- Discussion points on CGU and goodwill include:

Allocating Goodwill to CGU

Testing CGU with Goodwill for Impairment

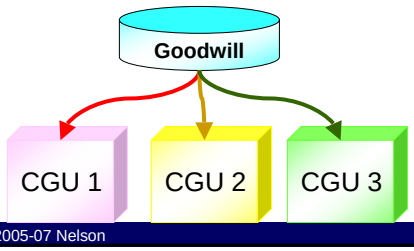
Minority Interest

Timing of Impairment Tests

6. Cash-Generating Unit & Goodwill

Allocating Goodwill to CGU → Initial allocation

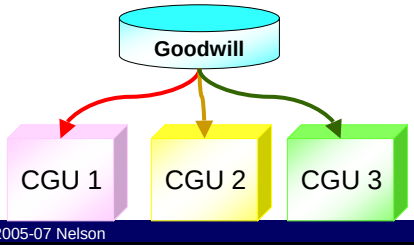
- For the purpose of impairment testing, goodwill acquired in a business combination shall
  - from the acquisition date, be allocated to each of the acquirer's CGUs (or groups of CGUs) that are expected to benefit from the synergies of the combination
  - irrespective of whether other assets or liabilities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



6. Cash-Generating Unit & Goodwill

Allocating Goodwill to CGU → Initial allocation

- 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*.

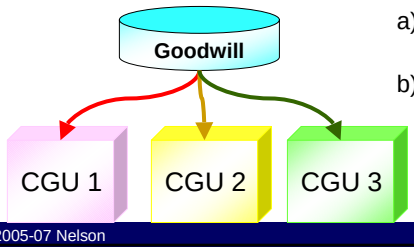


6. Cash-Generating Unit & Goodwill

Allocating Goodwill to CGU → Initial allocation

- If the initial allocation of goodwill cannot be completed as required
  – that initial allocation shall be completed before the end of the first annual period beginning after the acquisition date (i.e. within 12 months).

- In accordance with IFRS 3
  – if the initial accounting for a business combination can be determined only provisionally, 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 12 months of the acquisition date.



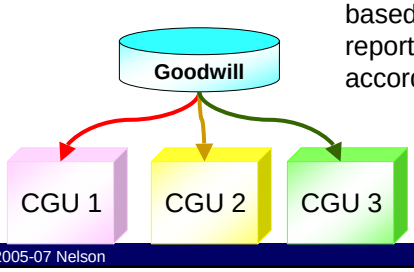
6. Cash-Generating Unit & Goodwill

Case

Allocating Goodwill to CGU → Initial allocation

HSBC

- Goodwill is allocated to cash-generating units for the purposes of impairment testing.
- Goodwill is tested for impairment at the lowest level at which goodwill is monitored for internal management purposes.
- This is not at a higher level than a segment based on either the primary or secondary reporting format (as determined in accordance with IAS 14 'Segment reporting').



6. Cash-Generating Unit & Goodwill

Case

Melco Development Limited (2005 Annual Report)

Melco

Accounting policy on goodwill

– For the purposes of impairment testing, goodwill arising from an acquisition is allocated to
  - each of the relevant cash-generating units, or
  - groups of cash-generating units,

  that are expected to benefit from the synergies of the acquisition.

6. Cash-Generating Unit & Goodwill

Allocating Goodwill to CGU → Disposal

- If goodwill has been allocated to a CGU and the entity disposes of an operation within that CGU
  - 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 CGU retained,

       unless the entity can demonstrate that some other method better reflects the goodwill associated with the operation disposed of.

What kind of value?

6. Cash-Generating Unit & Goodwill

Example

Allocating Goodwill to CGU → Disposal

- An entity sells for $100 an operation that was part of a CGU 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 CGU retained is $300.

$100

$300

- Because the goodwill allocated to the CGU 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% of the goodwill ($100 / $400) allocated to the CGU is included in the carrying amount of the operation that is sold.

6. Cash-Generating Unit & Goodwill

Case

Allocating Goodwill to CGU → Disposal

HSBC

- At the date of disposal of a business
  - attributable goodwill is included in the Group's share of net assets in the calculation of the gain or loss on disposal.

Luenthai
Your Apparel Supply Chain Services Partner

- In its 2005 Interim Report, full set of HKFRS was adopted:
  - Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses.
  - Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.
  - Goodwill is allocated to cash-generating units for the purpose of impairment testing.

Any improvement?

6. Cash-Generating Unit & Goodwill

Case

Allocating Goodwill to CGU → Disposal

Luenthai
Your Apparel Supply Chain Services Partner

- In its 2005 Interim Report, full set of HKFRS was adopted:
  - Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses.
  - Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.
  - Goodwill is allocated to cash-generating units for the purpose of impairment testing.

Business, instead of Entity

6. Cash-Generating Unit & Goodwill

Example

On 1.1.2005	Parent P	Sub S
Property	$ 0	$ 6,000
Investment	0	0
Cash at bank	30,000	2,000
	30,000	8,000
Issued equity	$ (30,000)	$ (5,000)
Retained earnings	0	(3,000)
	(30,000)	(8,000)

On 1.1.2005

- Parent P acquired 20% interest in Subsidiary S at $3,500 by cash.
- Fair value of the property of S was $8,000.

During 2005

- Parent P reported nil profit and profit of S was HK$6,000 (became cash).
- Fair value of S is HK$30,000 at year-end.
- P accounted for S as held for trading.

On 1.1.2006

- P acquired additional 60% interest in S at $22,000 by cash.
- Fair value of the property of S was $11,000.

6. Cash-Generating Unit & Goodwill

Example

On 1.1.2006	Parent P	Sub S	J#1	J#2	Consolidated
Property	$ 0	$ 6,000		5,000	$ 11,000
Goodwill	0	0		12,100	12,100
Investment	28,000	0	(2,500)	(25,500)	0
Cash at bank	4,500	8,000			12,500
	32,500	14,000			35,600
Issued equity	$ (30,000)	$ (5,000)		5,000	$ (30,000)
Retained earnings	(2,500)	(9,000)	2,500	7,800	(1,200)
Revaluation reserves	0	0		(600)	(600)
Minority interest	0	0		(3,800)	(3,800)
	(32,500)	(14,000)			(35,600)

6. Cash-Generating Unit & Goodwill

Example

- Assume S mainly involved in holding investment property to derive rental and had 2 properties managed independently.
- On 2.1.2006, S disposed of one property at $8,000 (cost $3,000) and the remaining property's recoverable amount was $14,000 (cost $3,000).

On company level of S:	
Sales proceed of property	$ 8,000
Cost of property	(3,000)
Gain on disposal	$ 5,000
On consolidated level:	
Sales proceed of property	$ 8,000
Cost of property to the group ($11,000 ÷ 22,000 x 8,000)	4,000
Gain on disposal at group level	$ 4,000
Goodwill written off in accordance with IAS 36 ($12,100 ÷ 22,000 x 8,000)	**$ 4,400**

6. Cash-Generating Unit & Goodwill

Example

Original consolidation journals:

		Dr($)	Cr($)
Dr	Retained earnings	2,500	
Cr	Investment		2,500

To restate the initial 20% investment in Subsidiary S to cost

Dr	Property – fair value adjustment ($11,000 - $6,000)	5,000	
	Issued equity – subsidiary (given)	5,000	
	Retained earnings – subsidiary (given)	9,000	
	Goodwill (as calculated in last slide)	12,100	
Cr	Investment – cost of combinations (twice)		25,500
	Minority interest (19,000 x 20%)		3,800
	Retaining earnings recognised *(to the extent that they relate to the previously held ownership interests)*		1,200
	Revaluation reserves		600

To recognise the goodwill and eliminate the investments with the equity shares

6. Cash-Generating Unit & Goodwill

Example

Additional consolidation journals:

		Dr($)	Cr($)
Dr	Income statement (Retained earnings)	1,000	
Cr	Property		1,000

To adjust the gain recognised in S as fair value had been taken up at group level before

Dr	Retained earnings	800	
Cr	Minority interest (4,000 x 20%)		800

To allocate the gain on disposal of property to minority interest

Dr	Income statement (Retained earnings)	4,400	
Cr	Goodwill		4,400

To write off the goodwill allocated to the "business" in accordance with IAS 36

6. Cash-Generating Unit & Goodwill

Example

On 1.1.2006	Parent P	Sub S	J#1	J#2	J#3	Consolidated
Property	$ 0	$ 3,000		5,000	(1,000)	$ 7,000
Goodwill	0	0		12,100	(4,400)	7,700
Investment	28,000	0	(2,500)	(25,500)		0
Cash at bank	4,500	16,000				20,500
	32,500	19,000				35,200
Issued equity	$ (30,000)	$ (5,000)		5,000		$ (30,000)
Retained earnings	(2,500)	(14,000)	2,500	7,800	6,200	0
Revaluation reserves	0	0		(600)		(600)
Minority interest	0	0		(3,800)	(800)	(4,600)
	(32,500)	(19,000)				(35,200)

A portion of the fair value changes from 1st to 2nd acquisition relating to the 2 properties should also be realised when one of them was disposed of, $600 ÷ 22,000 x 8,000 = $218. *Please suggest journal!*

6. Cash-Generating Unit & Goodwill

Allocating Goodwill to CGU → Reorganise

- If an entity reorganises its reporting structure *in a way that changes the composition of one or more CGUs to which goodwill has been allocated*
  - the goodwill shall be reallocated to the CGUs affected.

6. Cash-Generating Unit & Goodwill

Example

Allocating Goodwill to CGU → Reorganise

- Goodwill had previously been allocated to CGU A.
- The goodwill allocated to CGU A cannot be identified or associated with an asset group at a level lower than CGU A, except arbitrarily.
- A is to be divided and integrated into 3 other CGUs, namely B, C and D.

- Because the goodwill allocated to CGU A cannot be non-arbitrarily identified or associated with an asset group at a level lower than CGU A
- Goodwill is reallocated to CGU B, C and D on the basis of the relative values of the 3 portions of CGU A before those portions are integrated with CGU B, C and D.

6. Cash-Generating Unit & Goodwill

Testing CGU with Goodwill for Impairment

Goodwill Unallocated

- When goodwill relates to a CGU but has not been allocated to that unit
  - the unit shall be tested for impairment, whenever there is an indication that the CGU may be impaired
  - any impairment loss shall be recognised

Goodwill Allocated

- A CGU to which goodwill has been allocated
  - shall be tested for impairment
    - annually, and
    - whenever there is an indication that the unit may be impaired
  - If the carrying amount of the CGU exceeds its recoverable amount, the entity shall recognise any impairment loss

6. Cash-Generating Unit & Goodwill

Minority Interest

- 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.
  - Thus, goodwill attributable to a minority interest is not recognised in the parent's consolidated financial statements.

New requirement ……

6. Cash-Generating Unit & Goodwill

Minority Interest

- For the purpose of impairment testing a non-wholly-owned CGU with goodwill
  - the carrying amount of that CGU is notionally adjusted, before being compared with its recoverable amount
- Notional adjustment
  - accomplished by grossing up the carrying amount of goodwill allocated to the CGU 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 CGU is impaired.
  - If it is impaired, the entity allocates the impairment loss first to reduce the carrying amount of goodwill allocated to the CGU.

6. Cash-Generating Unit & Goodwill

Example

Minority Interest

- Entity A acquires 80% interest in GV at $1,600 on 1 Jan. 2005
- It implies that 100% interest of GV to Entity A would be $2,000.
- Subsidiary GV has identifiable net assets at a fair value of $1,500

	80%	100%
Cost of combination	$1,600	$2,000
Fair value of GV	1,200	1,500
Goodwill	400	500

- Goodwill recognised in the consolidation is $400.
- Assume at 30 Jun. 2005, the carrying amount of all the balances are the same but the recoverable amount of GV (a single CGU) is $1,900.
- Compare the calculation with or without notional adjustment on goodwill attributable to minority interest

6. Cash-Generating Unit & Goodwill

Example

Minority Interest

Without Notional Adjustment

Carrying amount of GV in A's consolidation	$ 1,500
Goodwill recognised (attributable to A)	400
Total carrying amount	$ 1,900
Recoverable amount of GV	$ 1,900

No impairment observed

With Notional Adjustment

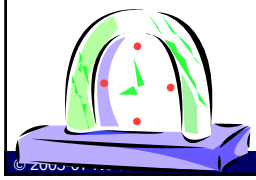
Total carrying amount (as above)	$ 1,900
Notional adjustment	
• Goodwill attributable to minority interest	100
Notionally adjusted carrying amount	$ 2,000
Recoverable amount of GV	$ 1,900

Impairment loss of $100

6. Cash-Generating Unit & Goodwill

Timing of Impairment Tests

- Annual impairment test for a CGU 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 CGUs may be tested for impairment at different times.
- However, if some or all of the goodwill allocated to a CGU 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.

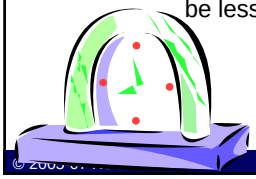


Similar to that for Intangible Assets!

6. Cash-Generating Unit & Goodwill

Timing of Impairment Tests

- The most recent detailed calculation made in a preceding period of the recoverable amount of a CGU to which goodwill has been allocated
  - may be used in the impairment test of that CGU in the current period provided all of the following criteria are met:
    - a) the assets and liabilities making up the CGU have not changed significantly
    - b) the most recent recoverable amount calculation resulted in an amount that exceeded the carrying amount of the CGU by a substantial margin; and
    - c) the likelihood that a current recoverable amount determination would be less than the current carrying amount of the CGU is remote.



6. Cash-Generating Unit & Goodwill

Case

Melco Development Limited (2005 Annual Report)

Accounting policy on goodwill

- A cash-generating unit to which goodwill has been allocated is tested for impairment
  - annually, and
  - whenever there is an indication that the unit may be impaired.
- For goodwill arising on an acquisition in a financial year, the cash-generating unit to which goodwill has been allocated is tested for impairment
  - before the end of that financial year.

6. Cash-Generating Unit & Goodwill

Corporate Assets

- are assets other than goodwill that contribute to the future cash flows of both
  - the CGU under review and
  - other CGUs.

Examples include:
- Building of a headquarter
- EDP Equipment
- Research centre

- In testing a CGU for impairment
  - an entity shall identify all the corporate assets that relate to the CGU under review.
  - The allocation approach of the corporate assets is also amended ……

6. Cash-Generating Unit & Goodwill

Corporate Assets

Can be allocated on a reasonable and consistent basis

- such portion shall be included as part of the carrying amount of the CGU for impairment test

Cannot be allocated on a reasonable and consistent basis

- The entity shall:

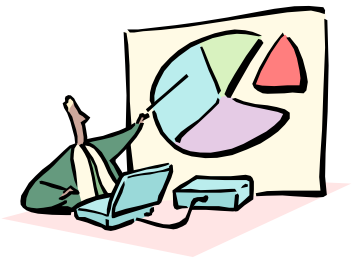
Firstly, test smaller CGU

1) compare the carrying amount of the CGU (excluding the corporate asset) with its recoverable amount
   - recognise any impairment loss first

Then, test larger CGU containing the goodwill

2) identify the smallest group of CGUs that includes the CGU 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
3) compare the carrying amount of that group of CGUs, including the portion of the carrying amount of the corporate asset allocated to that group of CGUs, with the recoverable amount of the group of CGUs.
   - Any impairment loss shall be recognised.

Topics To Be Covered



1. Objective
2. Scope
3. Identifying an Asset That May Be Impaired
4. Measuring Recoverable Amount
5. Recognising and Measuring an Impairment Loss
6. Cash-generating Unit and Goodwill
7. **Impairment Loss**

7. Impairment loss for CGU

- An impairment loss
  - shall be recognised for a CGU
    - if, and only if, the recoverable amount of the CGU (group of CGUs) is less than the carrying amount of the CGU (group of CGUs).
  - shall be allocated to reduce the carrying amount of the assets of the CGU (group of CGUs) in the following order:
    a) first, to reduce the carrying amount of any goodwill allocated to the CGU (group of CGUs); and
    b) then, to the other assets of the CGU (group of CGUs) pro rata on the basis of the carrying amount of each asset in the CGU (group of CGUs).

    These reductions in carrying amounts shall be treated as impairment losses on individual assets

Goodwill first → **Other on pro rata**

7. Impairment loss for CGU

- In allocating an impairment loss for a CGU, 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 CGU (group of CGUs).
- A liability shall be recognised for any remaining amount of an impairment loss for a CGU
  – if, and only if, that is required by another IAS/IFRS.

7. Impairment loss for CGU

Example

Entity A performed an impairment review on the CGU X, which has the following assets on hand:

	Carrying amount
Goodwill	$ 1,500
Property, plant and equipment (carried at revalued amounts)	4,000
Property, plant and equipment (carried at cost)	5,700
Inventory, at net realisable value	2,400
AFS financial assets, at recoverable amount	1,300
Total	14,900

- After an impairment review, Entity A found that the recoverable amount of CGU X is $12,000.
- Calculate the impairment loss and allocate to the individual asset.

7. Impairment loss for CGU

Example

	Carrying amount after impairment loss	Allocated impairment loss	Carrying amount after impairment loss
Goodwill	$ 1,500	$ (1,500)	$ 0
Property, plant and equipment (carried at revalued amounts)	4,000	(577)	3,423
Property, plant and equipment (carried at cost)	5,700	(823)	4,877
Inventory	2,400	-	2,400
AFS financial assets	1,300	-	1,300
Total	14,900	**(2,900)**	12,000

- Firstly, the impairment loss reduces any amount of goodwill
- Then, the residual loss is allocated to other non-current assets pro rata based on the carrying amounts of those non-current asset.

7. Impairment loss for CGU

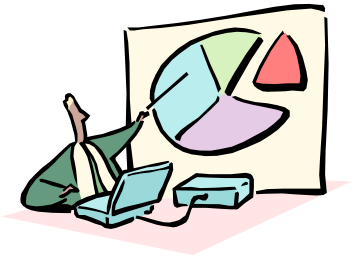
Case

Melco Development Limited (2005 Annual Report)

Accounting policy on goodwill

- When the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated
  - to reduce the carrying amount of any goodwill allocated to the unit first, and
  - then to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit.
- Any impairment loss for goodwill
  - is recognised directly in the income statement.

Topics To Be Covered



8. Reversing an Impairment Loss

- Annual Assessment on Any Indication
  - 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.
  - 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:
    - External sources of information
    - Internal sources of information

8. Reversing an Impairment Loss

- Recognition of reversal on recognised impairment loss
  - 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 be increased to its recoverable amount.
  - That increase is a reversal of an impairment loss.

8. Reversing an Impairment Loss

- Reversing an impairment loss for an individual asset
  - 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.
  - 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.
  - 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.

8. Reversing an Impairment Loss

- Reversing an impairment loss for a CGU
  - A reversal of an impairment loss for a CGU 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 allocating a reversal of an impairment loss for a CGU in accordance with the above paragraph, 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.

8. Reversing an Impairment Loss

- Reversing an impairment loss for goodwill
  - An impairment loss recognised for goodwill shall not be reversed in a subsequent period.
  - IAS 38 *Intangible Assets* prohibits the recognition of internally generated goodwill.
  - Any increase in the recoverable amount of goodwill subsequent to 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.

8. Reversing an Impairment Loss

Case

Melco Development Limited (2005 Annual Report)

Accounting policy on goodwill

- An impairment loss for goodwill
  - is not reversed in subsequent periods.

Accounting policy on impairment

- When an impairment loss subsequently reverses,
  - the carrying amount of the asset is increased to the revised estimate of its recoverable amount,
  - but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years.

8. Reversing an Impairment Loss

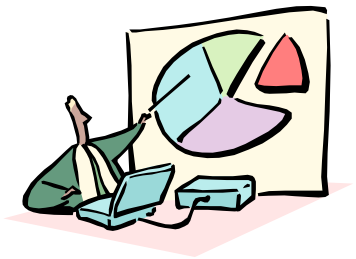
Case

HKEX *(2004 Annual Report)*

Accounting Policy on Impairment of Assets

- In respects of **assets other than goodwill**, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount and the circumstances and events leading to the impairment cease to exist.
- A reversal of impairment loss is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years.
- Reversal of impairment losses are credited to the profit and loss account except when the asset is carried at valuation, in which case the reversal of impairment loss is treated as a revaluation movement.

Topics To Be Covered



1. Objective
2. Scope
3. Identifying an Asset That May Be Impaired
4. Measuring Recoverable Amount
5. Recognising and Measuring an Impairment Loss
6. Cash-generating Unit and Goodwill
7. Impairment Loss
8. Reversing an Impairment Loss
9. **Disclosures**

9. Disclosure

- More extensive disclosure required now
- Main additional disclosure requirements include:
  - Extensive information for each CGU (or group of CGUs) for which the carrying amount of goodwill or intangible assets with indefinite useful lives allocated, including
    - Key assumptions used and the management approach to measure the recoverable amounts (aligned with revised IAS 1)
    - Period for cash flow projection, growth rate, discount rate ……
    - Certain other information when a reasonably possible change in a keey assumption would cause the carrying amount of CGUs to exceed its recoverable amount
  - any portion of the goodwill acquired in a business combination during the period has not been allocated to a CGU (group of CGUs) at the reporting date
    - the amount of the unallocated goodwill shall be disclosed together with the reasons why that amount remains unallocated.

9. Disclosure

Case

ESPRIT

Esprit Holdings Limited

- In accordance with IAS 36, the Group completed its annual impairment test for Esprit trademarks by comparing their recoverable amount to their carrying amount as at June 30, 2004.
- The Group appointed independent professional valuers to conduct a valuation of the Esprit trademarks as one corporate asset based on value-in-use calculation.
- The resulting value of the Esprit trademarks as at June 30, 2004 was significantly higher than their carrying amount.

Only these ……

9. Disclosure

Case

ESPRIT

Esprit Holdings Limited

- This valuation uses cash flow projections based on financial estimates covering a three-year period, expected royalty rates deriving from the Esprit trademarks in the range of 3% to 8% and a discount rate of 14%.
- The cash flows beyond the three-year period are extrapolated using a steady 3% growth rate.
- This growth rate does not exceed the long-term average growth rate for apparel markets in which the Group operates.
- Management has considered the above assumptions and valuation and also taken into account the business expansion plan going forward, the current wholesale order books and the strategic retail expansion worldwide and believes that there is no impairment in the Esprit trademarks.
- Management believes that any reasonably foreseeable change in any of the above key assumptions would not cause the aggregate carrying amount of trademarks to exceed the aggregate recoverable amount.

9. Disclosure

Case

- For the purposes of impairment reviews, the recoverable amount of goodwill is determined based on value-in-use calculations.
- The value-in-use calculations use cash flow projections based on financial budgets approved by management.
- There are a number of assumptions and estimates involved for the preparation of cash flow projections for the period covered by the approved budget.
- Key assumptions include the expected growth in revenues and gross margin, timing of future capital expenditures, long term growth rates and selection of discount rates, to reflect the risks involved, ranging from 8% to 15%.
- Management prepared the financial budgets reflecting actual and prior year performance and market development expectations.
- Judgement is required to determine key assumptions adopted in the cash flow projections and changes to key assumptions can significantly affect these cash flow projections.

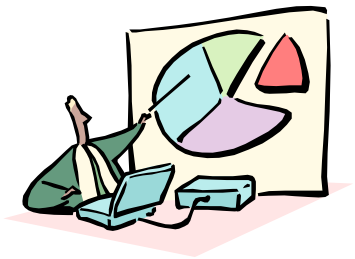
9. Disclosure

Case

Beijing Enterprises Holdings Ltd.

- Has early adopted all new HKFRS in 2004 Annual Report and stated key assumption on which management has based its cash flow projections to undertake impairment testing of goodwill -
  - Budgeted turnover are based on the following assumptions:
    - in respect of the relevant business unit in expressway and toll road segment, based on the traffic and till revenue forecast issued by independent valuers; and
    - in respect of the business units in other business segments, with reference to
      i) the expected growth rate of the market in which the assessed entity operates, &
      ii) the expected market share of the assessed entity.
  - Budgeted gross margins: the basis used to determine the value assigned to the budgeted ross margins is the average gross margins achieved in the year immediately before the budgeted year, increased for expected efficiency improvements.
  - Business environment: no major changes in the existing political, legal and economic conditions in the PRC and other locations in which the assessed entity carried on its business.

Topics To Be Covered



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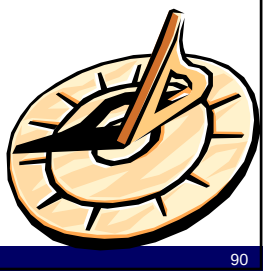
8. Reversing an Impairment Loss
9. Disclosures
10. **Transition and Effective Date**

10. Transition and Effective Date

- If an entity elects to apply IFRS 3 from any date before the effective dates set out in IFRS 3, it shall also apply IAS 36 prospectively from that same date.
- Otherwise, an entity shall apply IAS 36:
  - To goodwill and intangible assets acquired in business combinations for which the agreement date is on or after **31 March 2004**; and
  - To all other assets prospectively from the beginning of the first annual period beginning on or after **31 March 2004**.
- Entity to which the above paragraph applies are encouraged to apply the requirements of IAS 36 before the effective dates specified above.
- However, if an entity applies IAS 36 before those effective dates, it shall also apply IFRS 3 and IAS 38 *Intangible Assets* at the same time.



Comprehensive Cases & Examples

Case

HSBC

- HSBC adopted UK GAAP previously and proposed to change to IFRS in 2005
- It assessed that the impact of those changes from IFRS 3 would be ***high***
- Its US SEC filing (Dec. 2004) further stated that:
  - Goodwill recorded at 31 December 2003 …… will be the subject of impairment testing thereafter
  - In the event of impairment, the absence of previous amortisation is likely to lead to ***larger impairment charges*** than would have been required under UK GAAP
  - The cessation of goodwill amortisation will impact the income statement

Comprehensive Cases & Examples

Case

HSBC

- HSBC announced its 2004 IFRS Comparative Financial Information on 5 July 2005 and stated the impact on cessation of goodwill amortisation:

	YE 2004 US$M
Profit before tax under UK GAAP	17,608
Goodwill amortisation	1,818
Other changes	(483)
Profit before tax under IFRS	18,943

Comprehensive Cases & Examples

Case

Esprit Holdings Limited

- In 2004, as a result of the adoption of IFRS 3, IAS 36 and IAS 38
  - Depreciation reduced (profit increased) by **HK$ 106 million**
  - Trademarks increased by **HK$ 86 million**
  - Goodwill arising on the acquisition of Red Earth fully impaired with a loss of **HK$ 15 million**

Comprehensive Cases & Examples

Case

PCCW

- The acquisition of HK Telecom in 2000

Consideration	HK$ 225 billion
Goodwill	172 billion
Impairment loss in 2000	122 billion

(more than half of the consideration was impaired immediately)

- At that time, the impairment loss was not reflected in the income statement of that year
- In future, the impairment should be reviewed annually (or more frequently) and reflected in the income statement in that year

Ending ……

Comprehensive Cases & Examples

Case

Annual Report 2005 and Announcement

- The Group tests goodwill for impairment annually, or more frequently if there are indications that goodwill might be impaired. The recoverable amounts are determined based on a value-in-use calculation.
- These calculations use cash flow projections based on financial budgets and forecasts approved by senior management covering a 5-year period, taking into account projected regulatory capital requirements.
- Cash flows beyond the 5-year period are extrapolated using the estimated growth rates stated below.
- The growth rates do not exceed the long-term average growth rate for the market in which the businesses operate.

← Acquired in 2001, see how's the effect on that?

Based on Singapore FRS 103 which is largely the same as IFRS 3

Comprehensive Cases & Examples

Case

Annual Report 2005 and Announcement

- Key assumptions used for value-in-use calculations in assessing DBS Bank (Hong Kong) Limited
  - Growth rate 4.5%
  - Discount rate 9.5%
- For the year ended 31 December 2005, an impairment charge of $1,128 million has been recorded in 'Goodwill charges' in the income statement.
- This is attributed to goodwill arising from acquisition of **DBS Bank (Hong Kong) Limited**.
- The reduced value-in-use resulted from revised cash flow projections on a lower profit base in 2005.

Based on Singapore FRS 103 which is largely the same as IFRS 3

Comprehensive Cases & Examples

Case

Annual Report 2005 and Announcement

In DBS Group's consolidated balance sheet as at 31 Dec. 2005:

	HK$ billion
Carrying value of DBS Hong Kong	10.8
Estimated recoverable value	9.6
Impairment charge	1.2

Why?

The reduced value-in-use resulted
- from revised cash flow projections
- on a lower profit base in 2005.

Based on Singapore FRS 103 which is largely the same as IFRS 3

Comprehensive Cases & Examples

Case

Annual Report 2005 and Announcement

Impact to Whole Group?

	2005 (S$ million)	2004 (S$ million)
Net profit attributable to shareholders before goodwill charges	1,952	2,435
Goodwill charge - impairment 58% of net profit →	(1,128)	0
Goodwill charge - amortisation	0	(440)
Net profit attributable to shareholders	824	1,995

The reduced value-in-use resulted
- from revised cash flow projections
- on a lower profit base in 2005.

Based on Singapore FRS 103 which is largely the same as IFRS 3

Impairment of Assets (IAS 36)

19 April 2007

Full set of slides in PDF can be found in
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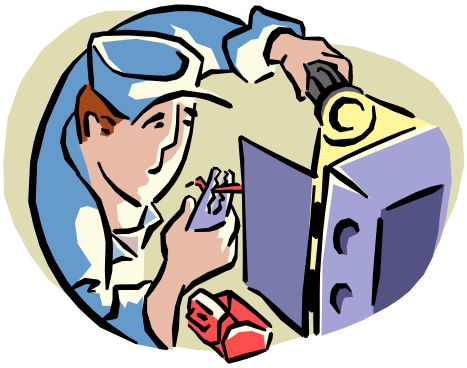

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