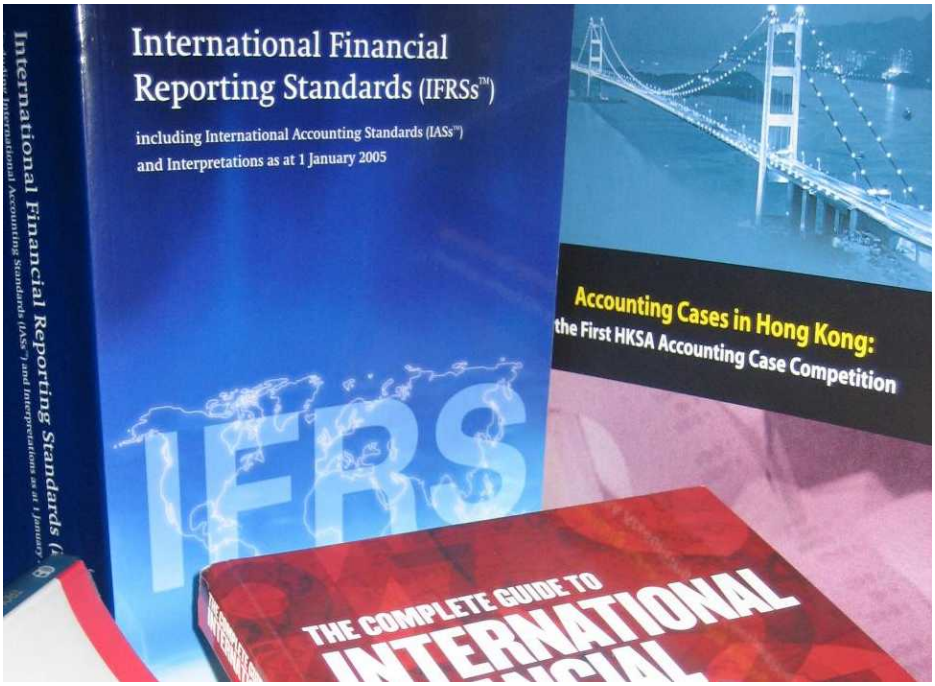
Training on International Financial Reporting Standards

26 July 2006



Training on
International Financial Reporting Standards

26 July 2006

26 July 2006 – Training Contents

CICPA Training – IAS 36, 38 and 41 and IFRS 6

26 July 2006

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Agenda of 26 July 2006

- Intangible Assets (IAS 38)
- Agriculture (IAS 41)
- Exploration for and Evaluation of Mineral Resources (IFRS 6)
- Impairment of Assets (IAS 36)

Simple but Comprehensive

Contentious and key issues

Real Life Cases and Examples

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Agenda of 26 July 2006 – Part 1

Intangible Assets (IAS 38)

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Intangible Assets (IAS 38)

26 July 2006

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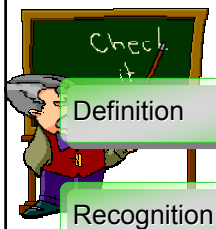
Topic To Be Covered



Definition

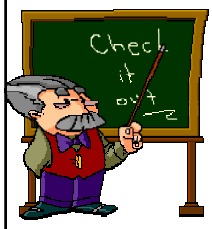
Recognition

Measurement

Presentation and Disclosure

1. Objective and Scope
2. Definition of intangible asset
3. Recognition and measurement
4. Recognition of expense
5. Measurement after recognition
6. Useful life
7. Intangible assets with finite useful lives
8. Intangible assets with indefinite useful lives
9. Impairment
10. Retirements and disposals
11. Disclosure
12. Transitional provisions and effective date

Topic To Be Covered



1. Objective and Scope

1. Objective and Scope

- IAS 38 *Intangible Assets*
  - is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another Standard
  - requires an entity to recognise an intangible asset if, and only if, specified criteria are met
  - specifies how to measure the carrying amount of intangible assets and requires specified disclosures about intangible assets.

1. Objective and Scope

- IAS 38 shall be applied in accounting for intangible assets, except:
  a) intangible assets that are within the scope of another IFRSs;
  b) financial assets, as defined in IAS 39 *Financial Instruments: Recognition and Measurement*;
  c) the recognition and measurement of exploration and evaluation assets (see IFRS 6 *Exploration for and Evaluation of Mineral Resources*); and
  d) expenditure on the development and extraction of minerals, oil, natural gas and similar non-regenerative resources.

Another IFRSs

1. Objective and Scope

- 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 as property, plant and equipment or
  - under IAS 38 as an intangible asset,

  an entity uses judgement to assess which element is more significant.

1. Objective and Scope

Example

Is computer software an intangible asset?

- Computer software for a computer-controlled machine tool that cannot operate without that specific software

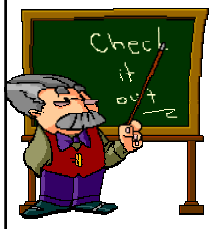
When the software is an integral part of the related hardware and it is treated as PPE

- Operating system of a computer, say Windows XP or Linux

The same applies

When the software is not an integral part of the related hardware, computer software is treated as an intangible asset.

Topic To Be Covered



1. Objective and Scope
2. Definition of intangible asset

2. Definition of Intangible Assets

An intangible asset is

- an identifiable non-monetary asset without physical substance.

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.

Monetary assets are

- money held and assets to be received in fixed or determined amounts of money

Identifiability

Control

Future economic benefit

2. Definition of Intangible Assets

Example

Some common examples of intangible resources:

- 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
- marketing rights

Identifiability

Control

Future economic benefit

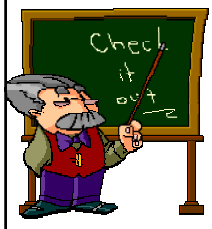
Can they meet the definition of an intangible asset?

2. Definition of Intangible Assets

More clarification on its meaning → **Identifiability**

- An asset meets the Identifiability Criterion in the definition of an intangible asset when it:
  - a) is separable
    - i.e. 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.

Topic To Be Covered



1. Objective and Scope
2. Definition of intangible asset
3. Recognition and measurement

3. Recognition and Initial Measurement

General principle

- 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 (as discussed); and
  b) the recognition criteria

- This requirement applies to
  – costs incurred initially to acquire or internally generate an intangible asset (i.e. initial cost) and
  – those incurred subsequently to add to, replace part of, or service it (i.e. subsequent expenditure).

Implies both initial and subsequent costs with same recognition criteria

3. Recognition and Initial Measurement

Similar as IAS 16 PPE

Recognition criteria

- 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.

- An entity shall assess the probability
  – 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

Initial measurement

- An intangible asset shall be measured initially at cost.

3. Recognition and Initial Measurement

Intangible assets may arise from

1. Separate acquisition
2. Acquisition as part of a business combination
3. Acquisition by way of a government grant
4. Exchange of assets
5. Internally generated goodwill
6. Internally generated intangible assets

Our Focus Today

3. Recognition and Initial Measurement

6. Internally generated intangible assets → **Research and Development**

- 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 IAS 38.

If an entity cannot distinguish the research phase from the development phase of an internal project to create an intangible asset

- treats the expenditure on that project as if it were incurred in the research phase only.

3. Recognition and Initial Measurement

Research and Development

- **Research** is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

- **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.

3. Recognition and Initial Measurement

Research and Development

- **Research** is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

- **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.

3. Recognition and Initial Measurement

Example

Research and Development

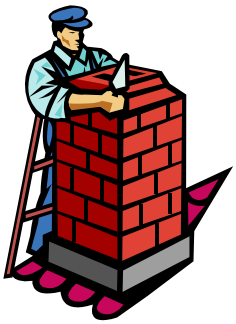
Examples of research activities are:

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.

3. Recognition and Initial Measurement

Research and Development

- **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.



3. Recognition and Initial Measurement

Research and Development

- 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.

3. Recognition and Initial Measurement

Example

Research and Development

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.

How can probable future economic benefits be demonstrated?

3. Recognition and Initial Measurement

Research and Development

- Even the recognition criteria are met,
  - internally generated brands, mastheads, publishing titles, customer lists and items similar in substance
    - shall not be recognised as intangible assets.
- Specifically disallowed in IAS 38

3. Recognition and Initial Measurement

Research and Development

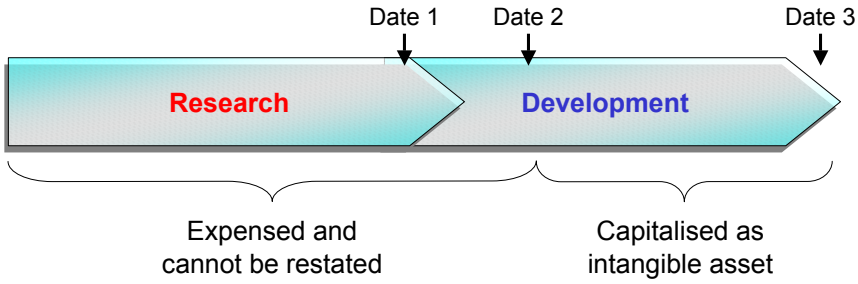
- The cost of an internally generated intangible asset
  - is the sum of expenditure incurred from the date when the intangible asset first meets the recognition criteria.
  - prohibits reinstatement of expenditure previously recognised as an expense.

3. Recognition and Initial Measurement

Example

When can the cost be capitalised?

Research and Development



Date 1 – Date of development commenced

Date 2 – Date of recognition criteria meet

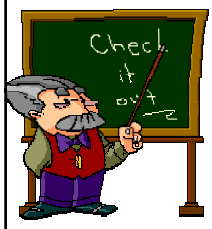
Date 3 – Date of new developed product ready for intended use

3. Recognition and Initial Measurement

Example

- An entity is developing a new production process.
- During 2005, expenditure incurred was $1,000, of which
  - a) $900 was incurred before 1 Dec. 2005 and — **Expensed**
  - b) $100 was incurred between 1 Dec. 2005 and 31 Dec. 2005 — **Capitalised**
- The entity is able to demonstrate that, at 1 Dec. 2005, the production process met the criteria for recognition as an intangible asset.
- The recoverable amount of the know-how embodied in the process is estimated to be $500. — **No impairment**
- During 2006, expenditure incurred is $2,000. — **Capitalised**
- At the end of 2006, the recoverable amount of the know-how embodied in the process is estimated to be $1,900. — **Impairment = $200**

Topic To Be Covered



1. Objective and Scope
2. Definition of intangible asset
3. Recognition and measurement
4. Recognition of expense

4. Recognition of Expense

- 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; 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.
- 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.

4. Recognition of Expense

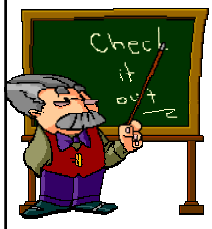
Answers

- The intangible assets of Issue are the data purchase and data capture costs of internally developed databases and are capitalised as development expenditure and written off over 4 years.

(ACCA 2003.06)

- IAS 38 sets out the criteria that should be met in order to recognise an internally generated intangible asset.
- As regards development costs, the company is required to demonstrate that the intangible asset will generate net cash inflows in excess of the cash outflows (future economic benefit!).
- Also development costs of an asset, which have been recognised, are subject to an impairment test under IAS 36 Impairment of Assets.
- The criteria to recognise these costs used by Issue will need to be scrutinised but it appears at first sight that these costs should have been written off.

Topic To Be Covered



1. Objective and Scope
2. Definition of intangible asset
3. Recognition and measurement
4. Recognition of expense
5. Measurement after recognition

5. Measurement after Recognition

- An entity shall choose either:

Cost Model

Revaluation Model

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.

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.

5. Measurement after Recognition

Cost Model

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

Revaluation Model

- 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 IAS 38, 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.

5. Measurement after Recognition

Revaluation Model

Application of revaluation model

- 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.

5. Measurement after Recognition

Revaluation Model

Frequency of revaluations

- 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.

5. Measurement after Recognition

Revaluation Model

Be careful ……

When there is no active market

- 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.
- 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.

This may be an indication of impairment and impairment testing under IAS 36 is then required

5. Measurement after Recognition

Revaluation Model

Same as IAS 16 PPE

Recognition of revaluation surplus or deficit

- 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.
- 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.

5. Measurement after Recognition

Revaluation Model

Same as IAS 16 PPE

Realisation of revaluation surplus

- 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 intangible asset.

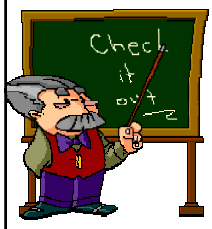
5. Measurement after Recognition

Example

- Transystems designs websites and writes bespoke software.
- Further, during the current financial period, the group has capitalised its domain names acquisition costs of $1 million within tangible non-current assets, and revalued the asset to $3 million.

- In order to meet the definition of an Intangible Asset, IAS 38 requires identifiability, control and the existence of future economic benefits. It would appear that the domain names should be shown as an intangible asset. Further on actual recognition, the intangible asset should be measured at cost.
- Any subsequent revaluation using the Revaluation Model is only possible if there is an active market for the intangible asset.
- The definition of an 'active market' is quite stringent to the extent that very few intangibles have such a market.
- Thus, the domain name costs should be shown at cost under intangible assets and amortised/reviewed for impairment.
- The revaluation model cannot be used in this case.

Topic To Be Covered



1. Objective and Scope
2. Definition of intangible asset
3. Recognition and measurement
4. Recognition of expense
5. Measurement after recognition
6. Useful life

6. Useful Life

- No matter, which of the following model is used by an entity:

Cost Model or **Revaluation Model**

- IAS 38 sets out that an entity shall assess whether the useful life of an intangible asset is

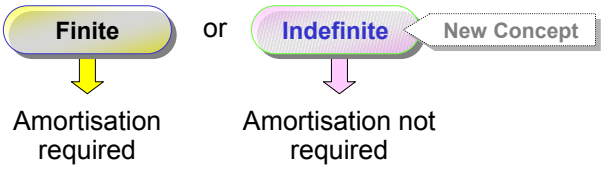
Finite or **Indefinite** **New Concept**

If finite
- the length of, or number of production or similar units constituting, that useful life.

An intangible asset has 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.

6. Useful Life

- The accounting for an intangible asset is based on its useful life.
  - Many factors are considered in determining the useful life of an intangible asset.



6. Useful Life

- The term 'indefinite' does not mean 'infinite'.
- The useful life of an intangible asset reflects only that <u>level of future maintenance expenditure</u> required to maintain the asset at its standard of performance assessed <u>at the time of estimating the asset's useful life</u>, 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 <u>not depend on planned future expenditure</u> in excess of that required to maintain the asset at that standard of performance.

6. Useful Life

Intangible asset arising from contractual or other legal rights

- The useful life of such intangible asset
  - 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.

Finite

Indefinite — New Concept

- If the contractual or other legal rights can be renewed, the useful life of the intangible asset shall include the renewal period only if
  - there is evidence to support renewal by the entity without significant cost.

6. Useful Life

Example

- An analysis of consumer habits and market trends provides evidence that the copyrighted material will generate net cash inflows for only 30 more years.

- The copyright would be amortised over its 30-year estimated useful life.
- The copyright also would be reviewed for impairment in accordance with IAS 36
  - by assessing at each reporting date whether there is any indication that it may be impaired.

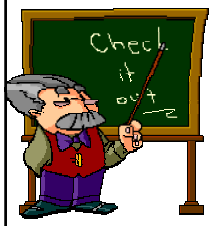
6. Useful Life

Case

Beijing Enterprises Holdings Ltd.

- Further stated its accounting policy on intangible assets as follows:
  - Useful lives of acquired intangible assets are assessed to be either
    - finite or
    - indefinite.
  - Intangible assets with finite useful lives
    - are stated at cost less accumulated amortisation and any accumulated impairment losses.
  - Intangible assets with indefinite useful lives
    - are stated at cost and not amortised.

Topic To Be Covered



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6. Useful life
7. Intangible assets with finite useful lives

7. Finite Useful Life

Amortisation

- The depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life.
  - Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value.
- Amortisation
  - shall begin when the asset is available for use,
    - i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.
  - shall cease at the earlier of
    - the date that the asset is classified as held for sale (or included in a disposal group held for sale) in accordance with IFRS 5 and
    - the date that the asset is derecognised.

7. Finite Useful Life

Amortisation

Amortisation Method

- 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.

Say PPE or Inventories

7. Finite Useful Life

- 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.

Amortisation

Amortisation Method

Residual Value

- 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

7. Finite Useful Life

- 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.

Amortisation

Amortisation Method

Residual Value

- In addition, 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.
  - Any changes shall be accounted for as changes in accounting estimates in accordance with IAS 8.

7. Finite Useful Life

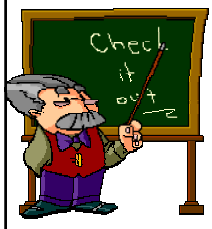
Example

Assessing the useful lives of intangible assets

- The product protected by the patented technology is expected to be a source of net cash inflows for at least 15 years.
- The entity has a commitment from a third party to purchase that patent in 5 years for 60% of the fair value of the patent at the date it was acquired, and the entity intends to sell the patent in 5 years.

The patent would be
- amortised over its 5-year useful life to the entity with a residual value equal to the present value of 60% of the patent's fair value at the date it was acquired.
- reviewed for impairment in accordance with IAS 36 by assessing at each reporting date whether there is any indication that it may be impaired.

Topic To Be Covered



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8. Intangible assets with indefinite useful lives

8. Indefinite Useful Life

- An intangible asset with an indefinite useful life shall not be amortised.
- In accordance with IAS 36 *Impairment of Assets*
  - an entity is required to test an intangible asset with an indefinite 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.

Indefinite New Concept

8. Indefinite Useful Life

- The useful life of such intangible asset 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 (support an indefinite useful life assessment for that asset)
    - such change in the useful life assessment shall be accounted for as a change in an accounting estimate in accordance with IAS 8

Indefinite New Concept

Be careful ……

- 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 impairment loss.

8. Indefinite Useful Life

Example

Assessing the useful lives of intangible assets

- The broadcasting licence is renewable every 10 years if the entity
  - provides at least an average level of service to its customers and
  - complies with the relevant legislative requirements.
- The licence may be renewed indefinitely at little cost and has been renewed twice before the most recent acquisition.
- The acquiring entity intends to renew the licence indefinitely and evidence supports its ability to do so.
- Historically, there has been no compelling challenge to the licence renewal.
- The technology used in broadcasting is not expected to be replaced by another technology at any time in the foreseeable future.
- Therefore, the licence is expected to contribute to the entity's net cash inflows indefinitely.

8. Indefinite Useful Life

Example

Assessing the useful lives of intangible assets

- The broadcasting licence would be treated as having an indefinite useful life because it is expected to contribute to the entity's net cash inflows indefinitely.
- Therefore, the licence would not be amortised until its useful life is determined to be finite.
- The licence would be tested for impairment in accordance with IAS 36
  - annually and
  - whenever there is an indication that it may be impaired.

8. Indefinite Useful Life

Example

Assessing the useful lives of intangible assets

- Same as previous example
- The licensing authority subsequently decides that it will no longer renew broadcasting licences, but rather will auction the licences.
- At the time the licensing authority's decision is made, the entity's broadcasting licence has three years until it expires.
- The entity expects that the licence will continue to contribute to net cash inflows until the licence expires.

- Because the broadcasting licence can no longer be renewed, its useful life is no longer indefinite.
- Thus, the acquired licence would be amortised over its remaining three-year useful life and immediately tested for impairment in accordance with IAS 36.

8. Indefinite Useful Life

Example

Assessing the useful lives of intangible assets

- The route authority may be renewed every 5 years, and the acquiring entity intends to comply with the applicable rules and regulations surrounding renewal.
- Route authority renewals are routinely granted at a minimal cost and historically have been renewed when the airline has complied with the applicable rules and regulations.
- The acquiring entity
  - expects to provide service indefinitely between the 2 cities from its hub airports and
  - expects that the related supporting infrastructure (airport gates, slots, and terminal facility leases) will remain in place at those airports for as long as it has the route authority.
- An analysis of demand and cash flows supports those assumptions.

8. Indefinite Useful Life

Example

Assessing the useful lives of intangible assets

- Because the facts and circumstances support the acquiring entity's ability to continue providing air service indefinitely between the two cities, the intangible asset related to the route authority is treated as having an indefinite useful life.
- Therefore, the route authority would not be amortised until its useful life is determined to be finite.
- It would be tested for impairment in accordance with IAS 36
  - annually and
  - whenever there is an indication that it may be impaired.

8. Indefinite Useful Life

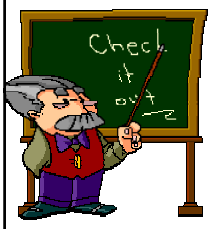
Case

ESPRIT

Esprit Holdings Limited

- Adopted HK GAAP to 30 June 2003
- Begin to adopt all the new/revised IFRS in 2004 Annual Report
  - On the first time adoption of IFRS, the Group reassessed the useful life of previously recognised intangible assets.
  - As a result of this assessment, the acquired Esprit trademarks were classified as an indefinite-lived intangible asset in accordance with IAS 38 *Intangible Assets*.
  - This conclusion is supported by the fact that Esprit trademark legal rights are capable of being renewed indefinitely at insignificant cost and therefore are perpetual in duration, relate to a well known and long established fashion brand since 1968, and based on future financial performance of the Group, they are expected to generate positive cash flows indefinitely.

Topic To Be Covered



1. Objective and Scope
2. Definition of intangible asset
3. Recognition and measurement
4. Recognition of expense
5. Measurement after recognition
6. Useful life
7. Intangible assets with finite useful lives
8. Intangible assets with indefinite useful lives
9. Impairment

9. Impairment Losses

- To determine whether an intangible asset is impaired, an entity applies IAS 36 *Impairment of Assets*, that 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.
- In IAS 36, under normal situation

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.

9. Impairment Losses

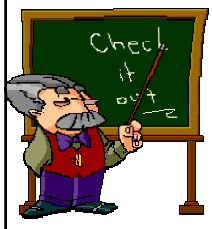
Triggering events

- However, 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.

More discussion on IAS 36 today ……

Topic To Be Covered



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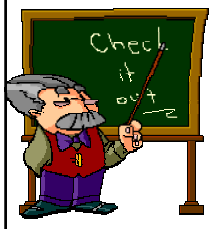
8. Intangible assets with indefinite useful lives
9. Impairment
10. Retirements and disposals

10. Retirements and Disposals

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

Topic To Be Covered



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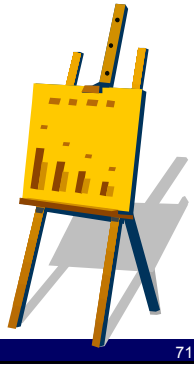
9. Impairment
10. Retirements and disposals
11. Disclosure

11. Disclosures

- IAS 38 introduces some additional disclosure requirements
- Changes are mainly amendments for the changes on finite and indefinite useful life
- Disclosures can be divided into disclosures for:
  - General aspects for all intangible assets
  - Intangible assets measured at revalued amount
  - Research and development expenditure
  - Other information



11. Disclosures

Case

ESPRIT

Esprit Holdings Limited

- Adopted HK GAAP to 30 June 2003
- Begin to adopt all the new/revised IFRS in 2004 Annual Report
  - On the first time adoption of IFRS, the Group reassessed the useful life of previously recognised intangible assets.
  - As a result of this assessment, the acquired Esprit trademarks were classified as an indefinite-lived intangible asset in accordance with IAS 38 *Intangible Assets*.
  - This conclusion is supported by the fact that Esprit trademark legal rights are capable of being renewed indefinitely at insignificant cost and therefore are perpetual in duration, relate to a well known and long established fashion brand since 1968, and based on future financial performance of the Group, they are expected to generate positive cash flows indefinitely.

11. Disclosures

Case

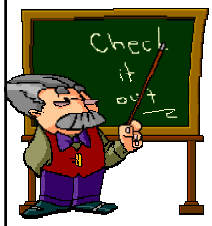
ESPRIT

Esprit Holdings Limited

- This view is supported by an independent professional appraiser, who has been appointed by the Group to perform an assessment of the useful life of Esprit trademarks in accordance with the requirements set out in IAS 38.
- Having considered the factors specific to the Group, the appraiser opined that Esprit trademarks should be regarded as an intangible asset with an indefinite useful life.
- Under IAS 38, the Group reevaluates the useful life of Esprit trademarks each year to determine whether events or circumstances continue to support the view of indefinite useful life for this asset.

Only these …… those required by IAS 36 for impairment testing should be disclosed, too

Topic To Be Covered



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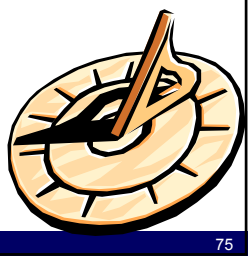
9. Impairment
10. Retirements and disposals
11. Disclosure
12. Transitional provisions and effective date

12. Transitions and Effective Date

Early adoption together with IFRS 3

- 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 of IFRS 3, it also shall apply IAS 38 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 IAS 38 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.



12. Transitions and Effective Date

Other cases

- Otherwise, an entity shall apply IAS 38:
  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 1 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 IAS 38 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.

12. Transitions and Effective Date

Exchange of Assets

- New requirement on exchange of assets to be applied prospectively
- It means that if an exchange of assets was measured before the effective date of IAS 38 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

- Entities are encouraged to apply the requirements of IAS 38 before the effective dates.
- However, if an entity IAS 38 before those effective dates, it also shall apply IFRS 3 and IAS 36 at the same time.

Intangible Assets (IAS 38)

26 July 2006

Nelson Lam
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Agenda of 26 July 2006

Simple but Comprehensive

Contentious and key issues

Real Life Cases and Examples

- Intangible Assets (IAS 38)
- Agriculture (IAS 41)
- Exploration for and Evaluation of Mineral Resources (IFRS 6)
- Impairment of Assets (IAS 36)

Nelson Lam
CFA FCCA FCPA(Practising)
MBA MSc BBA CPA(US) ACA

Agenda of 26 July 2006 – Part 2

- Agriculture (IAS 41)

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Agriculture (IAS 41)

26 July 2006

Nelson Lam
CFA FCCA FCPA(Practising)
MBA MSc BBA CPA(US) ACA

Agriculture – Summary

Case

2004 Annual Report states:

- The principal effect of the implementation of SSAP 36 (IAS 41) is in relation to
  - the accounting treatment,
  - financial statement presentation and
  - disclosure of agricultural activity.
- In previous years, biological assets and agricultural produce are stated at the lower of cost and net realisable value under the historical cost model.
- SSAP 36 requires the adoption of a fair value model ……

SIIC 上海實業控股有限公司
SHANGHAI INDUSTRIAL HOLDINGS LIMITED
上海實業集團成員 A Member of SIIC

Topics To Be Covered

- Definition
- Recognition
- Measurement
- Presentation and Disclosure

1. Objective, Scope and Definitions
2. Recognition
3. Measurement (All Stages)
4. Government Grant
5. Disclosure
6. Effective Date and Transition

Topics To Be Covered

- Definition

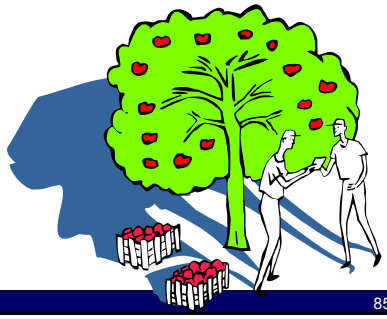
1. Objective, Scope and Definitions

1. Objective, Scope and Definitions

- IAS 41 prescribes
  - the accounting treatment,
  - financial statement presentation, and
  - disclosures

  related to agricultural activity.

What is agricultural activity?



1. Objective, Scope and Definitions

Agricultural activity is the *management* by an entity of

- the *biological transformation* of *biological assets*
  - for sale,
  - into *agricultural produce*, or
  - into additional *biological assets*.

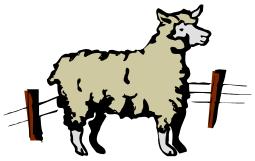
Biological transformation comprises the processes of growth, degeneration, production, and procreation that cause qualitative or quantitative changes in a biological asset.

- ***Biological asset*** is
  - a living animal or plant.
- ***Agricultural produce*** is
  - the harvested product of the entity's biological assets.
- ***Harvest*** is
  - the detachment of produce from a biological asset, or
  - the cessation of a biological asset's life processes.

1. Objective, Scope and Definitions

Example

Not within IAS 41



Biological asset → Agricultural produce → Product after harvest

1. Objective, Scope and Definitions

IAS 41

- shall be applied to account for the following when they relate to agricultural activity:
  a) biological assets;
  b) agricultural produce *at the point of harvest*; and
  c) government grants.
- does not apply to:
  a) land related to agricultural activity (see IAS 16 or IAS 40); and
  b) intangible assets related to agricultural activity (see IAS 38).

- IAS 41 is applied to agricultural produce, which is the harvested product of the entity's biological assets, only at the point of harvest.
- Thereafter, IAS 2 Inventories, or another applicable IFRS is applied.

Topics To Be Covered

Definition

1. Objective, Scope and Definitions

Recognition

2. Recognition

2. Recognition

- An entity shall recognise a biological asset or agricultural produce when, and only when:
  a) the entity controls the asset as a result of past events;
  b) it is probable that future economic benefits associated with the asset will flow to the entity; and
  c) the fair value or cost of the asset can be measured reliably.

Control

Future economic benefit

Measured reliably

2. Recognition

- In agricultural activity, control may be evidenced by, for example
  - legal ownership of cattle and the branding or
  - marking of the cattle on acquisition, birth, or weaning.

Control

Future economic benefit

- The future benefits are normally assessed by measuring the significant physical attributes.

Topics To Be Covered

Definition

Recognition

Measurement

1. Objective, Scope and Definitions
2. Recognition
3. **Measurement (All Stages)**

3. Measurement

- Biological asset shall be measured
  - on initial recognition and
  - at each balance sheet date

  at its

Fair value
less estimated point-of-sale costs

  - except for the case where the fair value cannot be measured reliably.

- Agricultural produce harvested from an entity's biological assets shall be measured at its

Fair value
less estimated point-of-sale costs
at the point of harvest

  - Such measurement is the cost at that date when applying IAS 2 Inventories, or another applicable IFRS.

The first IFRS requires fair value measurement in all stages without a choice.

3. Measurement – Fair Value

Fair value
less estimated point-of-sale costs

Fair value
less estimated point-of-sale costs
at the point of harvest

- Fair value, same as other IFRS, is
  - the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
- Point-of-sale costs
  - include commissions to brokers and dealers, levies by regulatory agencies and commodity exchanges, and transfer taxes and duties, but
  - exclude transport and other costs necessary to get assets to a market.

3. Measurement – Fair Value

Case

中国粮油食品（集团）有限公司
CHINA NATIONAL CEREALS, OILS & FOODSTUFFS CORP.

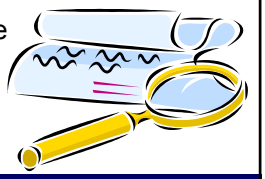
2004 Annual Report stated the following points:

- In general, biological assets on initial recognition and at each balance sheet date are measured
  - at fair value less estimated point-of-sale costs.
- Agricultural produce harvested from an entity's biological assets is measured
  - at its fair value less estimated point-of-sale costs at the point of harvest.
- The adoption of SSAP 36 (IAS 41) has resulted in the Group stating grape vines and grape
  - at fair value less estimated point-of-sale costs.
- In prior years,
  - grape vines were stated at cost less accumulated depreciation and
  - grapes were stated at the lower of cost and net realisable value.

3. Measurement – Fair Value

Determination of fair value

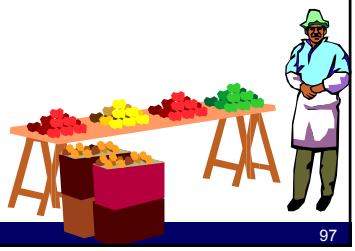
- Facilitated by grouping biological assets or agricultural produce according to significant attributes, e.g., by age or quality
  - select the attributes same as the attributes used in the market as a basis for pricing
- Contract price may not a good indicator
  - Since fair value reflects the current market conditions but contract prices do not
  - Fair value is not adjusted because of the existence of a contract



3. Measurement – Fair Value

Determination of fair value

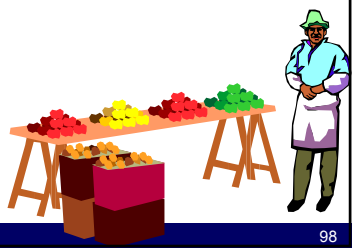
- If an active market exists
  ⇒ quoted price is appropriate basis for determining the fair value
- If an entity has access to different active markets
  ⇒ the entity uses the most relevant one, say the market expected to used



3. Measurement – Fair Value

Determination of fair value

- If no active market exists ⇒ consider the following:
  a) the most recent market transaction price
  b) market prices for similar assets with adjustment to reflect differences
  c) sector benchmarks, such as the value of cattle in term of meat per kg
  d) present value of expected net cash flows



3. Measurement – Fair Value

Case

CHAODA MODERN AGRICULTURE (HOLDINGS) LIMITED

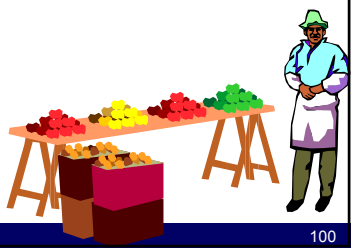
2004/05 Interim Report explained the determination of the fair value as follows:

- In accordance with the valuation report issued by Sallmanns, an independent professional valuer, the fair values less estimated point-of-sale costs of the biological assets are determined under the following basis:
  a) Fruit trees and tea trees: present value of expected net cash flows from the biological assets discounted at a current market-determined pre-tax rate; and
  b) Livestock: market-determined prices of biological assets with similar size, species and age.
- The fair values of vegetables are determined by the directors with reference to market-determined prices, cultivation area, species, growing conditions, cost incurred ad expected yield of crops.

3. Measurement – Fair Value

Determination of fair value

- Cost may sometimes approximate fair value, particularly when
  a) little biological transformation has taken place since initial cost incurred *(e.g, for fruit tree seedlings planted immediately prior to a balance sheet date)*; or
  b) the impact of the biological transformation on price is not expected to be material
  (e.g., for the initial growth in a 30-year pine plantation production cycle)



3. Measurement – Fair Value

Case

中國綠色食品(控股)有限公司
CHINA GREEN (HOLDINGS) LIMITED
(Incorporated in Bermuda with limited liability)

2005 Annual Report states:

- As at 30 April 2005, the biological assets carried at cost represented the growing of asparagus.
- The asparagus was cultivated at initial stage and the directors considered that
  - the fair value of asparagus was largely the same as the cost incurred after taking into consideration the growing conditions and the period of plantation.

3. Measurement – Gain and Loss

- Included in profit or loss for the period in which it arises for
  - a gain or loss arising on initial recognition of a biological asset at fair value less estimated point-of-sale costs
  - a gain or loss arising from a change in fair value less estimated point-of-sale costs of a biological asset
  - a gain or loss arising on initial recognition of agricultural produce at fair value less estimated point-of-sale costs (say as a result of harvesting

3. Measurement – Gain and Loss

- The fair value less estimated point-of-sale costs of a biological asset can change due to both:
  - i) Physical changes - the physical change or growth of a biological asset, and
  - ii) Price changes - the effects of change in market price of a biological asset, in the market.

Encouraged to disclose

3. Measurement – Gain and Loss

- The aggregate gain and loss can thus be analysed as follows:
  - i) Physical change represents, at current prices:
    - the value of the biological asset in its state as at current B/S date
    - less the value of the biological asset in its state as at previous B/S date
  - ii) Price change represents, at the biological asset's state as at the previous B/S date:
    - the value of the biological asset at prices prevailing as at current B/S date
    - less the value of the biological asset at prices prevailing as at previous B/S date

Current price held constant

Previous state held constant

Encouraged to disclose

3. Measurement – No Fair Value

- IAS 41 makes 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:
  1. which market-determined prices or values are not available, and
  2. which alternative estimates of fair value are determined to be clearly unreliable.

Presumption Rebutted

Restrictive conditions imposed

- In such a case, that biological asset shall be measured at
  - its cost less any accumulated depreciation and any accumulated impairment losses (by considering IAS 2, 16 and 36)

3. Measurement – No Fair Value

Presumption Rebutted

- 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
  - it is presumed that fair value can be measured reliably.

3. Measurement – No Fair Value

Case

路勁基建有限公司
ROAD KING INFRASTRUCTURE LIMITED

2004 Annual Report states:

- Given the uncertainty in the process of prodcuing ginseng crops and the lack of a market for immature ginseng, the ginseng crops are stated at cost less impairment until the time of harvest ……
- At the point of harvest, ginseng crops are stated at their fair value less estimated point-of-sale costs.

Topics To Be Covered

Definition

Recognition

Measurement

1. Objective, Scope and Definitions
2. Recognition
3. Measurement (All Stages)
4. **Government Grant**

4. Government Grants

Government grants related to biological assets

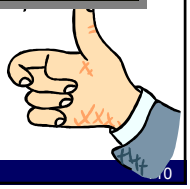
- Measured at fair value less estimated point-of-sale costs
  - If such government grant is unconditional
    - ➢ it shall be recognised as income when, and only when, it becomes receivable
  - If such government grant is conditional
    - ➢ an entity shall recognise the government grant as income when, and only when, the conditions attaching to such grant are met
- Measured at cost
  - An entity applies IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*
    - ➢ for example, para. 12 of IAS 20 requires government grants be recognised as income over the periods necessary to match them with the related costs which they are intended to compensate, on a systematic basis

4. Government Grants

Example

- Entity A receives a government grant of HK$ 5 million.
- It is required to farm in a particular location for 5 years.
- It will be required to return all of the government grant if it farms for less than 5 years.

- In this case, the government grant is not recognised as income until the five years have passed.
- However, if the government grant allows part of the government grant to be retained based on the passage of time
  - ➢ the entity recognises the government grant as income on a time proportion basis.



Topics To Be Covered

Definition

Recognition

Measurement

Presentation and Disclosure

1. Objective, Scope and Definitions
2. Recognition
3. Measurement (All Stages)
4. Government Grant
5. **Disclosure**

5. Disclosure

IAS 1 requires that

- As a minimum, the face of the balance sheet shall include line items that present the following amounts:
  a) property, plant and equipment;
  b) investment property;
  c) intangible assets;
  d) financial assets
  e) investments accounted for using the equity method;
  f) biological assets;

5. Disclosure

- Lengthy and detailed disclosures are required in IAS 41
- General disclosure includes
  - the aggregate gain or loss arising during the current period
    - on initial recognition of biological assets and agricultural produce, and
    - from the change in fair value less estimated point-of-sale costs of biological assets.
  - a description of each group of biological assets
  - the methods and significant assumptions applied in determining the fair value
  - a reconciliation of changes in the carrying amount of biological assets
- Additional disclosure
  - biological assets where fair value cannot be measured reliably
  - government grant related to agricultural activity

Topics To Be Covered

Definition	1. Objective, Scope and Definitions
Recognition	2. Recognition
Measurement	3. Measurement (All Stages)
	4. Government Grant
Presentation and Disclosure	5. Disclosure
	6. Effective Date and Transition

6. Effective Date and Transition

- IAS 41 becomes operative for annual financial statements covering periods beginning on or after 1 January 2005.
- Earlier application is encouraged.
- If an entity applies IAS 41 for periods beginning before 1 January 2005, it shall disclose that fact.
- IAS 41 does not establish any specific transitional provisions.
- The adoption of IAS 41 is accounted for in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
  - i.e. **Retrospective Application** → "as if" basis
    - reclassify to biological assets
    - adjust opening retained earnings
    - restate comparative information

Agriculture (IAS 41)

26 July 2006

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Agenda of 26 July 2006

Simple but Comprehensive

Contentious and key issues

Real Life Cases and Examples

- Intangible Assets (IAS 38)
- Agriculture (IAS 41)
- Exploration for and Evaluation of Mineral Resources (IFRS 6)
- Impairment of Assets (IAS 36)

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Agenda of 26 July 2006 – Part 3

- Exploration for and Evaluation of Mineral Resources (IFRS 6)

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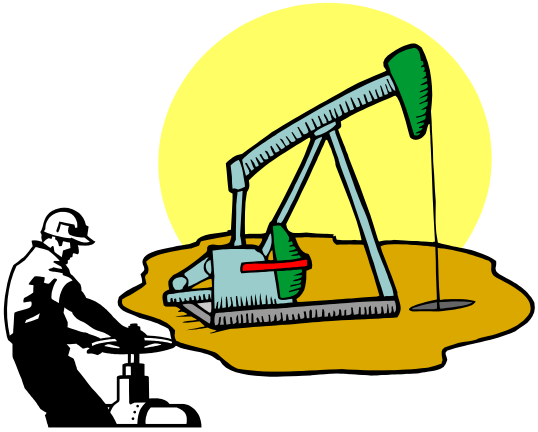
Exploration for and Evaluation of Mineral Resources (IFRS 6)

26 July 2006



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Topics To Be Covered

- Definition
- Recognition
- Measurement
- Presentation and Disclosure

1. Objective of IFRS 6
2. Scope of IFRS 6
3. Limited Improvements
   a. Recognition of exploration and evaluation assets
   b. Measurement of exploration and evaluation assets
   c. Presentation – classification and reclassification
4. Impairment
5. Disclosure
6. Effective date and transition

1. Objective of IFRS 6

The objective of IFRS 6 is

– to specify the financial reporting for the exploration for and evaluation of mineral resources

What are mineral resources?

What are the exploration for and evaluation of mineral resources?

1. Objective of IFRS 6

The objective of IFRS 6 is

– to specify the financial reporting for the exploration for and evaluation of mineral resources

- Intended not to define in IFRS 6
- but include minerals, oil, natural gas and similar non-regenerative resources

What are mineral resources?

affected companies include: oil, gas, mining …..

What are the exploration for and evaluation of mineral resources?

- the search for mineral resources after the entity has obtained legal rights to explore in a specific area
- the determination of the technical feasibility and commercial viability of extracting the mineral resource

1. Objective of IFRS 6 (Summary)

In particular, IFRS 6 requires:

a. limited improvements to existing accounting practices for exploration and evaluation expenditures.

b. entities that recognise exploration and evaluation assets to
   - assess such assets for impairment in accordance with IFRS 6, and
   - measure any impairment in accordance with IAS 36 *Impairment of Assets*.

c. disclosures

Limited Improvements

Impairment

Disclosure

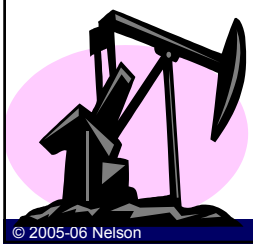
2. Scope of IFRS 6

Pre-Production Stage of Mineral Resources

From ***SEED***

Study & acquire → ***E***xploration → ***E***valuation → ***D***evelopment

To Harvest



Mineral resources value chain

Upstream

Exploration and Production

Transportation

Distribution and Selling

Downstream

2. Scope of IFRS 6

Pre-Production Stage of Mineral Resources

From ***SEED***

Study & acquire → ***E***xploration → ***E***valuation → ***D***evelopment

To Harvest

- Study a site or prospect
- Acquire the legal right to explore

- Explore the site
- Search in greater detail

- Determine technical feasibility and commercial viability

- Build the necessary infrastructure to extract

Which stage(s) does IFRS 6 cover?

2. Scope of IFRS 6

- An entity <u>shall apply</u> IFRS 6 to
  - ***E***xploration and ***E***valuation (***E&E***) Expenditures that it incurs.

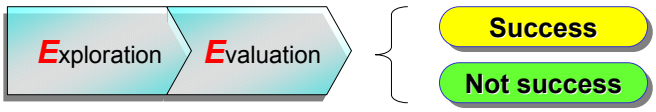
Pre-E&E → ***E***xploration → ***E***valuation → *Post E&E*

- IFRS 6 does not address other aspects of accounting by entities engaged in the exploration for and evaluation of mineral resources.
- An entity <u>shall not apply</u> IFRS 6 to expenditures incurred:
  a) ***Pre-E&E*, and**
  b) ***Post E&E***

2. Scope of IFRS 6

Case

- An entity shall apply IFRS 6 to
  - ***E***xploration and ***E***valuation (***E&E***) Expenditures that it incurs.



Why do we concern ***E&E***?

BASF, the largest chemical co., explained its exploration risk:
- In the oil and gas segment, future growth in exploration and production is largely based on the success of exploration activities.
- When searching for new reserves of crude oil and natural gas there are geological risks with regard to the presence, quantity and quality of hydrocarbons.

Can the expenditure on such activities be recognised?

2. Scope of IFRS 6

- An entity shall apply IFRS 6 to
  - ***E***xploration and ***E***valuation (***E&E***) Expenditures that it incurs.

Success

Not success

- Exploration and evaluation expenditures
  ➔ E&E expenditures
  - ➢ Expenditures incurred by an entity
    - in connection with the exploration for and evaluation of mineral resources
    - before the technical feasibility and commercial viability of extracting a mineral resource are demonstrable.
- Exploration and evaluation assets
  ➔E&E assets
  - ➢ E&E expenditures recognised as assets in accordance with the entity's accounting policy.

2. Scope of IFRS 6

Case

In oil exploration and production industry

- While a few companies adopted ***Full Cost Method***
  - most companies follow ***Successful Efforts Method*** in accounting for exploration and development expenditure
- Including the "Big 3" ……

2004 Annual Report of BP plc, the largest integrated oil co., stated:

- Oil and natural gas exploration and development expenditure is accounted for using the *successful efforts method of accounting*.
- Its accounting policy sets out 3 kinds of exploration and development expenditure as follows:
  1. Licence and property acquisition costs
  2. Exploration expenditure
  3. Development expenditure

Which is/are within the scope of IFRS 6?

2. Scope of IFRS 6

Case

What's the situation in HK?

Sinopec Corp.
CHINA PETROLEUM & CHEMICAL CORPORATION

中国石油

CNOOC LIMITED
中国海洋石油有限公司

2004 Annual Report of PetroChina stated:

- The *successful efforts method of accounting* is used for oil and gas exploration and production activities.
- Under this method, all costs for development wells, support equipment and facilities, and proved mineral interests in oil and gas properties are capitalised ……

What are the details of successful efforts method …… *discussed later!*

3. Limited Improvements

a. Recognition of *E&E assets*
b. Measurement of *E&E assets*
c. Presentation – classification and reclassification

Limited Improvements

3a. E&E Assets – Recognition

Case

Sinopec Corp.
CHINA PETROLEUM & CHEMICAL CORPORATION

Sinopec also elaborated *successful efforts method* as follows:

- Under this method, costs of development wells and the related support equipment are capitalised.
- The cost of exploratory well is initially capitalised as construction in progress pending determination of whether the well has found proved reserves.

But can such cost be capitalised under IFRS?

Successful efforts method implies:

- Recognise all costs as assets in the balance sheet first (initially)
- Write off the expenditure if it cannot result in proved reserves

3a. E&E Assets – Recognition

Under the Framework of IFRS:

– When there is no standard on a specific transaction or event, an entity is required to observe, inter alia, the Framework, and the definition and recognition criteria there.

Definition

Recognition

Let's revisit them ……

3a. E&E Assets – Recognition

- Asset is defined as a resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise

Definition

- Recognition is the process of incorporating in the balance sheet or income statement an item that
  1. meets the definition of an element and
  2. satisfies the criteria for recognition

Recognition

If based on this, is future economic benefit of *E&E expenditure* probable initially?

- **Criteria for recognition** – an item that meets the definition of an element should be recognised if:
  1. it is probable that any future economic benefit associated with the item will flow to or from the enterprise; and
  2. the item has a cost or value that can be measured with reliability.

3a. E&E Assets – Recognition

Case

Royal Dutch/Shell elaborated *successful efforts method* for its exploration costs in 2004 Annual Report as follows:

- Exploration costs are charged to income when incurred, except that
  - exploratory drilling costs are included in tangible fixed assets, pending determination of proved reserves.

Can such cost be capitalised? Is inflow of future economic benefit really probable?

3a. E&E Assets – Recognition

IFRS 6 introduce a temporary exemption from the Framework

- Thus, an entity adopting IFRS 6 may continue to use the accounting policies applied immediately before adopting the IFRS.
- This includes continuing to use recognition and measurement practices that are part of those accounting policies.

3b. E&E Assets – Measurement

Measurement at Recognition

- ***E&E assets*** shall be measured at cost.

➢ Elements of cost of ***E&E assets***
- An entity shall
  - determine a policy specifying which expenditures are recognised as E&E assets and
  - apply the policy consistently.
- In making this determination, an entity
  - considers the degree to which the expenditure can be associated with finding specific mineral resources.

3b. E&E Assets – Measurement

Example

Measurement at Recognition

- ***E&E assets*** shall be measured at cost.

Examples of expenditures that might be included in the initial measurement of E&E assets (the list is not exhaustive):

a) acquisition of rights to explore;
b) topographical, geological, geochemical and geophysical studies;
c) exploratory drilling;
d) trenching;
e) sampling; and
f) activities in relation to evaluating the technical feasibility and commercial viability of extracting a mineral resource.

3b. E&E Assets – Measurement

Measurement at Recognition

- ***E&E assets*** do not include
  - Expenditures related to the development of mineral resources, which shall not be recognised as *E&E assets*.
    - The Framework and IAS 38 *Intangible Assets* provide guidance on the recognition of assets arising from development.
- In accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
  - an entity recognises
    - any obligations for removal and restoration that are incurred during a particular period as a consequence of having undertaken the exploration for and evaluation of mineral resources.

3b. E&E Assets – Measurement

Case

BP plc, early adopted IFRS 6 in 2005, stated its accounting policies that:

- Exploration expenditure
  - Costs directly associated with an exploration well are capitalized as an intangible asset until the drilling of the well is complete and the results have been evaluated.
- Development expenditure
  - Expenditure on the construction, installation or completion of infrastructure facilities …… is capitalized within oil and gas properties.
- Decommissioning
  - Liabilities for decommissioning costs are recognized
    - when the Group has an obligation to dismantle and remove a facility or an item of plant and to restore the site on which it is located, and
    - when a reasonable estimate of that liability can be made.
  - Where an obligation exists for a new facility ……. this will be on construction or installation.

3b. E&E Assets – Measurement

Measurement at Recognition → **Measurement after Recognition**

- After recognition, an entity shall apply either

  Cost Model or **Revaluation Model**

  to the ***E&E assets***.

- If the revaluation model is applied, either the model in IAS 16 or the model in IAS 38
  - it shall be consistent with the classification of the assets.

Changes in Accounting Policy?

3b. E&E Assets – Measurement

All costs recognised in the balance sheet ← **Full Cost Method**

All costs recognised first, written off later if proved unsuccessful ← **Successful Efforts Method**

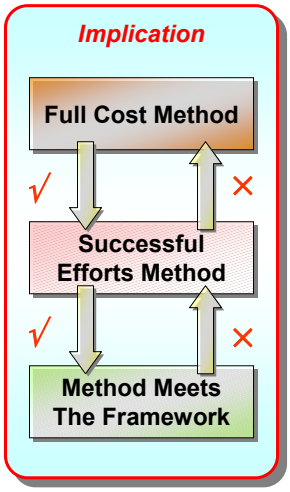
All costs not recognised first, but recognised later if proved successful ← **Method Meets The Framework**

Changes in Accounting Policy?

3b. E&E Assets – Measurement

IFRS 6 requires

- An entity may change its accounting policies for E&E expenditures 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.



Changes in Accounting Policy?

3c. Presentation

Classification of E&E assets

- An entity shall
  - classify *E&E assets* as tangible or intangible according to the nature of the assets acquired and
  - apply the classification consistently.
- Some *E&E assets* are treated as intangible (e.g. drilling rights), whereas others are tangible (e.g. vehicles and drilling rigs).
- IFRS 6 further clarifies:
  - To the extent that a tangible asset is consumed in developing an intangible asset, the amount reflecting that consumption is part of the cost of the intangible asset.
  - However, using a tangible asset to develop an intangible asset does not change a tangible asset into an intangible asset.

3c. Presentation

Reclassification of E&E assets

- An *E&E asset* shall no longer be classified as such when
  - the technical feasibility and commercial viability of extracting a mineral resource are demonstrable.
- *E&E assets* shall be assessed for impairment, and any impairment loss recognised, before reclassification.

3c. Presentation

Case

BP plc, early adopted IFRS 6 in 2005, stated its accounting policies that:

- Exploration expenditure
  - Costs directly associated with an exploration well are capitalised as an intangible asset until the drilling of the well is complete and the results have been evaluated.
  - When proved reserves of oil and natural gas are determined and development is sanctioned, the relevant expenditure is transferred to oil and gas properties.
- Oil and gas properties
  - Oil and gas properties are depreciated using a unit-of-production method.
  - The cost of producing wells is amortized over proved developed reserves ……

bp

4. Impairment

Limited Improvements

Impairment

4. Impairment

- *E&E assets* shall be assessed for impairment when
  - facts and circumstances suggest that the carrying amount of an exploration and evaluation asset may exceed its recoverable amount.

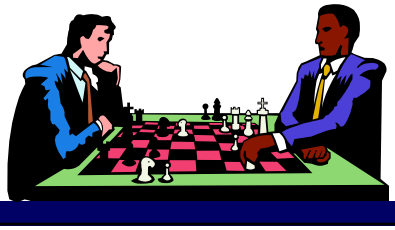
4. Impairment

Example

- Facts and circumstances indicate that an entity should test *E&E assets* for impairment (the list is not exhaustive):
  a) the period for which the entity has the right to explore in the specific area has expired during the period or will expire in the near future, and is not expected to be renewed.
  b) substantive expenditure on further exploration for and evaluation of mineral resources in the specific area is neither budgeted nor planned.
  c) exploration for and evaluation of mineral resources in the specific area have not led to the discovery of commercially viable quantities of mineral resources and the entity has decided to discontinue such activities in the specific area.
  d) sufficient data exist to indicate that, although a development in the specific area is likely to proceed, the carrying amount of the *E&E asset* is unlikely to be recovered in full from successful development or by sale.

4. Impairment

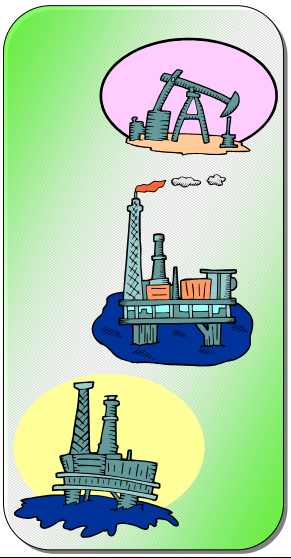
- When facts and circumstances suggest that the carrying amount exceeds the recoverable amount
  - An entity shall measure, present and disclose any resulting impairment loss in accordance with IAS 36
    - Except for the level at which *E&E assets* are assessed for impairment
    - The level for assessment
      - does not follows IAS 36
      - but follows IFRS 6



4. Impairment

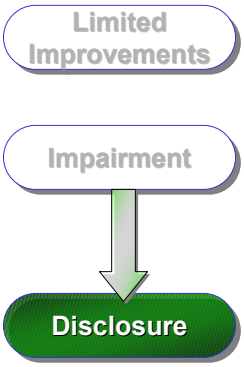
Specifying the level at which *E&E assets* are assessed for impairment

- An entity shall determine an accounting policy for allocating *E&E assets* to cash-generating units (CGUs) or groups of CGUs for the purpose of assessing such assets for impairment.
- Each CGU or group of CGUs to which an *E&E asset* is allocated shall not be larger than a segment
  - based on either the entity's primary or secondary reporting format determined in accordance with IAS 14 *Segment Reporting*.
- The level identified by the entity for the purposes of testing *E&E assets* for impairment may comprise one or more CGUs.



5. Disclosure

- An entity shall disclose information that identifies and explains the amounts recognised in its financial statements arising from the exploration for and evaluation of mineral resources.
- To comply with it, an entity shall disclose:
  a) its accounting policies for *E&E expenditures* including the recognition of *E&E assets*.
  b) the amounts of assets, liabilities, income and expense and operating and investing cash flows arising from the exploration for and evaluation of mineral resources.
- An entity shall
  – treat *E&E assets* as a separate class of assets and
  – make the disclosures required by either IAS 16 or IAS 38 consistent with how the assets are classified.



6. Effective Date and Transition

- An entity shall apply this IFRS for
  - annual periods beginning on or after 1 January 2006.
- Earlier application is encouraged.
  - If an entity applies the IFRS for a period beginning before 1 January 2006, it shall disclose that fact.
- If it is impracticable to apply a particular requirement of paragraph 18 (i.e. impairment review) to comparative information that relates to annual periods beginning before 1 January 2006, an entity shall disclose that fact.
  - IAS 8 explains the term 'impracticable'.

6. Effective Date and Transition

Case

Sinopec Corp.
CHINA PETROLEUM & CHEMICAL CORPORATION

Sinopec stated in its 2005 Interim Financial Statements as follows:

- Under IFRS 6, for each type of exploration and evaluation (E&E) expenditure, an entity is permitted to adopt a policy either of immediate expense or of capitalisation as an E&E asset.
- An entity is also allowed to continue its existing policy, subject to certain limitations.
- Those limitations include requiring that an entity should segregate E&E assets into tangible and intangible items based on the nature of assets, and an entity should apply IAS 36 "Impairment of assets in measuring the impairment of E&E assets when there are indications that they carrying amount of an E&E asset may exceed its recoverable amount.
- IFRS 6 is effective for fiscal year beginning on or after 1 January 2006.
- Currently, the Group does not expect the application of this statement will have a material impact on its consolidated financial statements.

Further Development

Further Development

Possible amendment in future

IFRS 6 Exploration for & Evaluation of Mineral Resources

IAS 41 Agriculture

- IFRS 6
  - has not been developed as a long term standard
  - but, rather, has to be seen as a stepping stone towards a more comprehensive and conceptually sound standard dealing with the accounting for exploration for and evaluation of mineral resources that meets the needs of all stakeholders.

(European Financial Reporting Advisory Group, 2005)

Further Development

IFRS 6 covers only these

From ***SEED***

Study & acquire → ***E***xploration → ***E***valuation → ***D***evelopment

To Harvest

All the other areas?

The IABS clarified that:

- A comprehensive project would seek to develop an internationally acceptable approach to resolving accounting issues in the extractive industries.

Mineral resources value chain

Upstream

Exploration and Production

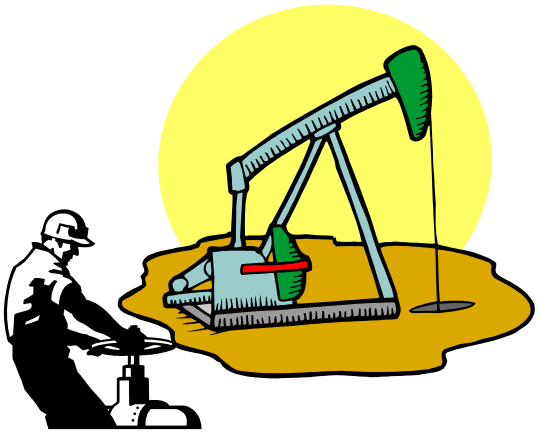
Transportation

Distribution and Selling

Downstream

Exploration for and Evaluation of Mineral Resources (IFRS 6)

26 July 2006



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Agenda of 26 July 2006

Simple but Comprehensive

Contentious and key issues

Real Life Cases and Examples

Intangible Assets (IAS 38)

Agriculture (IAS 41)

Exploration for and Evaluation of Mineral Resources (IFRS 6)

Impairment of Assets (IAS 36)

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Impairment of Assets (IAS 36)

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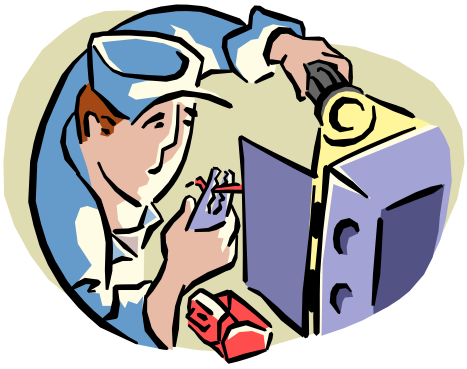
Impairment of Assets (IAS 36)

26 July 2006



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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.

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.
	If any such indication exists, the entity shall estimate the recoverable amount of the asset.
Recoverable Amount	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.

Topics To Be Covered

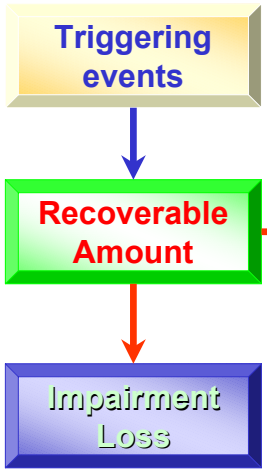
- Definition
- Recognition
- Measurement
- Presentation and Disclosure

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
- 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.

1. Objective – Summary



Each reporting date, assess whether there is any indication that an asset may be impaired

If any such indication exists, the recoverable amount of the asset should be estimated

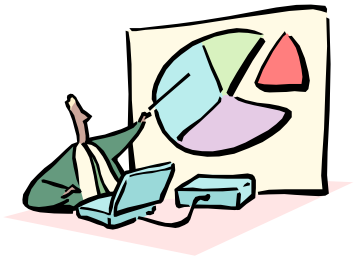
It is the higher of an asset's

Fair value less costs to sell & Value in Use

When recoverable amount is lower than the carrying amount, impairment loss, being the excess of the asset's carrying amount over its recoverable amount, should be recognized as an expense

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:

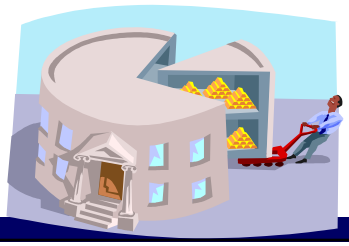
a) inventories (see IAS 2 *Inventories*);
b) assets arising from construction contracts (see IAS 11 *Construction Contracts*);
c) deferred tax assets (see IAS 12 *Income Taxes*);
d) assets arising from employee benefits (see IAS 19 *Employee Benefits*);
e) financial assets that are within the scope of 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.*

2. Scope

IAS 36 applies to financial assets classified as:

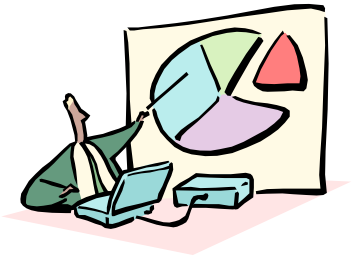
a) subsidiaries, as defined in IAS 27 Consolidated and Separate Financial Statements;
b) associates, as defined in IAS 28 Investments in Associates; and
c) joint ventures, as defined in IAS 31 Interests in Joint Ventures.

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.

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

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

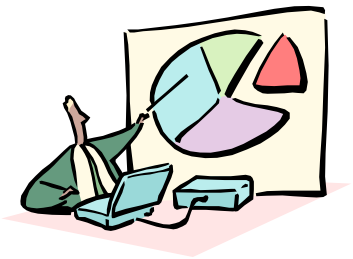
- Intangible assets that have an indefinite useful life, or are not yet ready for use
  - are tested for impairment annually.
- This impairment test
  - may be performed at any time during an annual period,
  - provided it is performed at the same time every year.
- An intangible asset recognised during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

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

↓

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

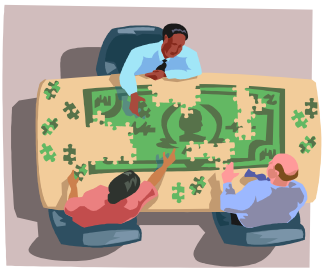
Fair value less costs to sell **&** Value in Use

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

Example

- Desolve committed to close one of its subsidiary by the year-end, 31 July 2001.
- An equipment of the subsidiary was carried at a value of $10 million at 31 July 2001.
- It was anticipated that the equipment would generate cash flows of $7 million up to 30 November 2001 and that its fair value less costs to sell at 31 July 2001 was $8 million.
- The equipment was sold on 30 November 2001 for $6 million.

Sourced from ACCA 2001 Dec.

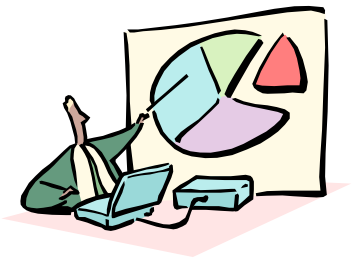
4. Measuring Recoverable Amount

Answers

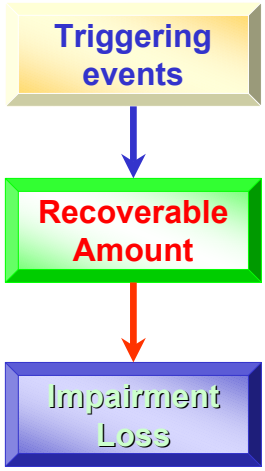
- The commitment by Desolve to close the operations would be an indicator of possible impairment.
- The equipment has a carrying value of $10 million, a value in use of $7 million and a fair value less costs to sell of $8 million as at 31 July 2001.
- Thus the carrying value is compared with the higher 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 November 2001 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.
- For example, the income being generated after the year-end could be taken as the disposal proceeds of $6 million plus the 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



- 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.

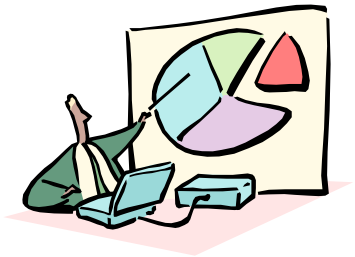
5. Recognising and Measuring an Impairment Loss

- 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

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

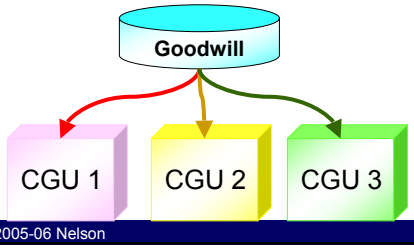
Testing CGU with Goodwill for Impairment

Timing of Impairment Tests

6. Cash-Generating Unit & Goodwill

Allocating Goodwill to CGU → Initial allocation

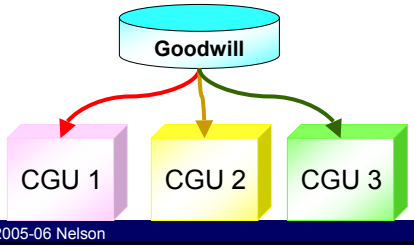
- For the purpose of impairment testing, goodwill acquired in a business combination shall
  - from the acquisition date, be allocated to each of the acquirer's CGUs (or groups of CGUs) that are expected to benefit from the synergies of the combination
  - irrespective of whether other assets or liabilities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

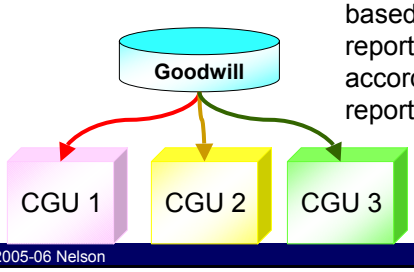


6. Cash-Generating Unit & Goodwill

Case

Allocating Goodwill to CGU → Initial allocation

- 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 HKAS 14 'Segment reporting').



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.

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. — $100
- The goodwill allocated to the unit cannot be identified or associated with an asset group at a level lower than that unit, except arbitrarily. — $300
- The recoverable amount of the portion of the CGU retained is $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.

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

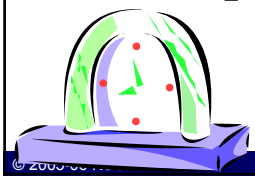
- A CGU to which goodwill has been allocated
  - shall be tested for impairment
    - annually, and
    - whenever there is an indication that the unit may be impaired
  - If the carrying amount of the CGU exceeds its recoverable amount, the entity shall recognise any impairment loss

6. Cash-Generating Unit & Goodwill

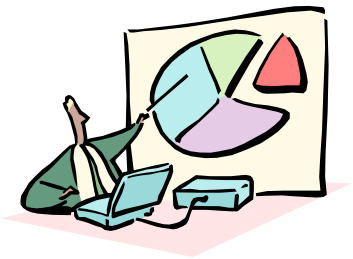
Timing of Impairment Tests

- 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!



Topics To Be Covered

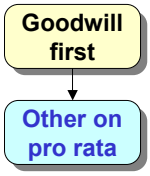


1. Objective
2. Scope
3. Identifying an Asset That May Be Impaired
4. Measuring Recoverable Amount
5. Recognising and Measuring an Impairment Loss
6. Cash-generating Unit and Goodwill
7. **Impairment Loss**

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).

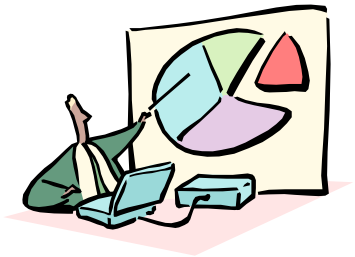
    These reductions in carrying amounts shall be treated as impairment losses on individual assets



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.

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 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

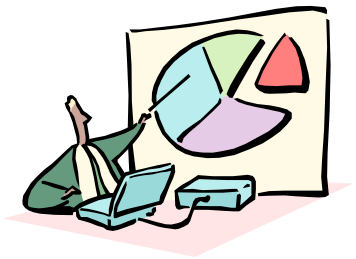
Case

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



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

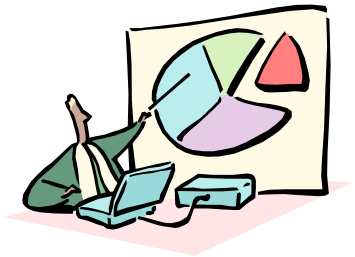
- This valuation uses cash flow projections based on financial estimates covering a three-year period, expected royalty rates deriving from the Esprit trademarks in the range of 3% to 8% and a discount rate of 14%.
- The cash flows beyond the three-year period are extrapolated using a steady 3% growth 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

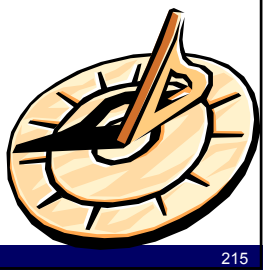
- For the purposes of impairment reviews, the recoverable amount of goodwill is determined based on value-in-use calculations.
- The value-in-use calculations use cash flow projections based on financial budgets approved by management.
- There are a number of assumptions and estimates involved for the 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.

Topics To Be Covered



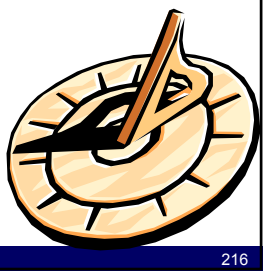
10. Transition and Effective Date

- 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.



10. Transition and Effective Date

- If an entity elects to apply HKFRS 3 from any date before the effective dates set out in HKFRS 3, it also shall apply HKAS 36 prospectively from that same date.
- Otherwise, an entity shall apply HKAS 36:
  a) to goodwill and intangible assets acquired in business combinations for which the agreement date is on or after **1 January 2005**; and
  b) to all other assets prospectively from the beginning of the first annual period beginning on or after **1 January 2005**.
- Entities to which the above paragraph applies are encouraged to apply the requirements of HKAS 36 before the effective dates specified above.
- However, if an entity applies HKAS 36 before those effective dates, it also shall apply HKFRS 3 and HKAS 38 *Intangible Assets* at the same time.



Comprehensive Cases & Examples

Case

- 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 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

- 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)

26 July 2006

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CICPA Training – IAS 36, 38 and 41 and IFRS 6

26 July 2006

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Nelson

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Financial Reporting • Audit • Consulting • Tax Advice

Mr. Nelson Lam

MBA MSc BBA(Hons) ACA ACS ACIS CFA CPA(US) FCCA FCPA(Practising) MHKSI

- FCCA, CPA, CFA Charterholder
- Qualified in Big 4 and worked for professional firms before established Nelson and Company
- With proven experience and expertise in providing financial reporting, assurance, tax planning, and financial advisory services
- Regularly spoke for different professional bodies, universities, and media

Brief Background of Nelson and Company

- A professional accountancy firm established in Hong Kong
- Only a young and small professional firm but with experience and sound technical competence.
- With a solid client base, current clients include individual and listed companies from Africa, Mainland China, HK, Netherlands, Russia, UK and US

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