ICAEW KNOW-HOW

FINANCIAL REPORTING FACULTY

APPLYING IAS 36 IMPAIRMENT OF ASSETS

IFRS FACTSHEET

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Applying IAS 36 Impairment of Assets
This factsheet is a summary of the basic principles of accounting for impairment under IAS 36, with some practical help that reflects on-going challenging economic circumstances.

Key regulations for this factsheet
This factsheet includes links and references to key regulations. There's a summary of the links, and guidance on how to use them, on page 2.

Section 1

Introduction

The principle of IAS 36 *Impairment of Assets* is that assets should be carried at no more than their recoverable amount. Recoverable amount is the amount that an entity could recover through use or sale of an asset. If an asset's recoverable amount is less than its carrying value, then the asset is impaired and IAS 36 requires that an impairment loss is recognised.

IAS 36 details the procedures that an entity should follow to ensure this principle is applied and is applicable for the majority of non-financial assets. The standard also specifies when an impairment loss should be reversed and prescribes disclosures related to impairment.

Applying IAS 36 involves significant judgement and gives rise to a number of practical considerations. Economic and political uncertainty continues to affect businesses in a number of territories and industry sectors. Declines in growth forecasts and the rapid pace of technological change are also likely to affect assumptions behind asset valuations. This means impairment testing and the related disclosures continue to be relevant and challenging topics for entities.

Section 2

Links to regulations

Using the links and margin notes in this document

The margin notes in this factsheet identify relevant sections of standards and other regulations – these sections cannot be considered in isolation when applying them in practice.

You might find it useful to download relevant section(s) of the standard(s) so that you can refer to them when using this document.

Make sure that you use the right version of the regulations or standards

Standards and regulations are often updated and amended, and may have transitional provisions. It is important to use the right version, and to make sure that it applies to the relevant time period. The standards below are linked to the faculty's standards tracker which shows when standards were amended, and when amendments come into effect. Links are then provided to the version of the standard relevant to specific time periods. To use the links in the standards tracker it is strongly recommended that you are first logged into the Financial Reporting Faculty, and also logged into eIFRS.

Regulations and guidance
IAS 10 *Events after the Reporting Period*
IAS 36 *Impairment of Assets*
IFRS 13 *Fair Value Measurement*
IFRIC 10 *Interim Financial Reporting and Impairment*
IAS 16 *Property, Plant and Equipment*
IAS 38 *Intangible Assets*
IAS 41 *Agriculture*
IFRS 3 *Business Combinations*
IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*
IFRS 8 *Operating Segments*
IFRS 9 *Financial Instruments*
IFRS 15 *Revenue from Contracts with Customers*
IFRS 16 *Leases*
IFRS 17 *Insurance Contracts*
FRC's Annual Activity Reports of Corporate Reporting Reviews
FRC's Thematic Review: Impairment of non-financial assets
ESMA's report of *Enforcement and Regulatory Activities of European Accounting Enforcers in 2018*

Section 3

Overview

Underlying principle

IAS 36.1, 6

The principle of IAS 36 is that assets should be carried in the balance sheet at no more than their recoverable amount. Recoverable amount is the higher of the asset's fair value less costs of disposal and its value in use.

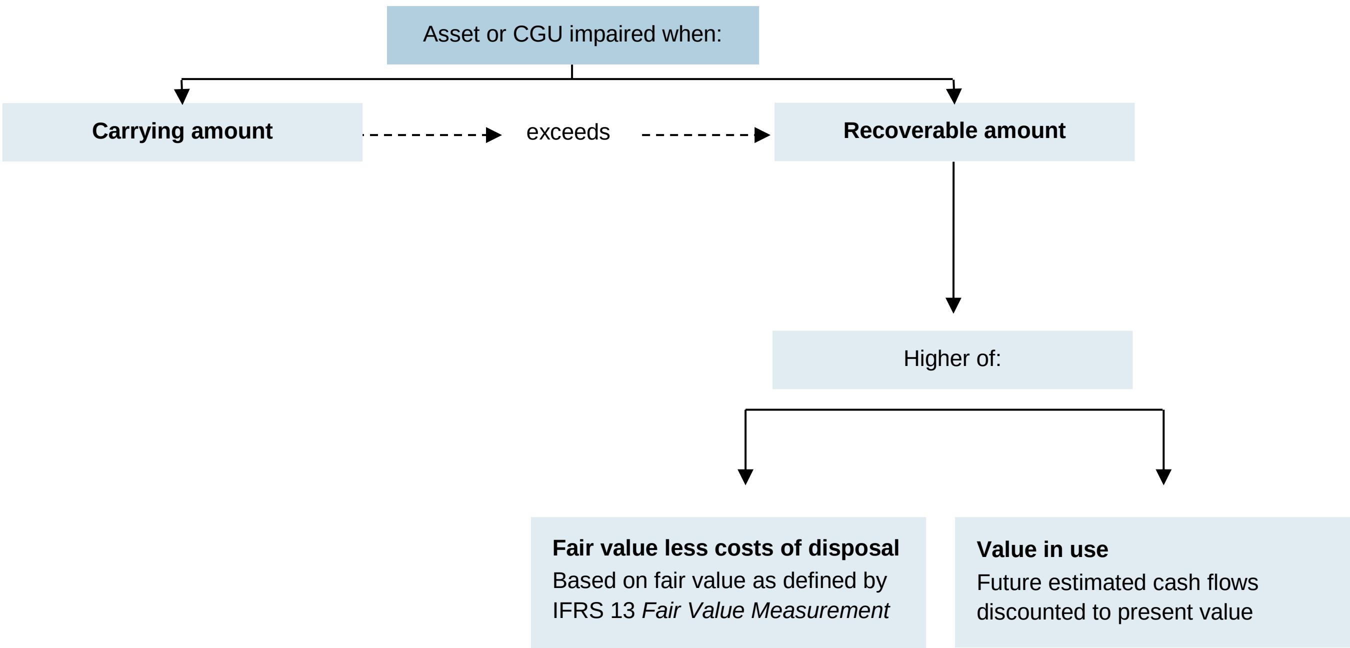
IAS 36.9-10

IAS 36 requires an assessment at each reporting date of whether there is any indication that an asset within its scope may be impaired. With the exception of goodwill and certain intangible assets, it is only when there is such an indication that the entity is required to estimate the asset's recoverable amount. Goodwill, intangible assets with an indefinite useful life and intangible assets which are not yet available for use must be tested annually for impairment irrespective of whether there is any indication of impairment.

Impairment losses

IAS 36.59

When an asset's carrying amount exceeds its recoverable amount, the asset is impaired and must be written down to its recoverable amount.



IAS 36.60

Impairment losses are recognised in profit or loss unless recognised in other comprehensive income against any revaluation surplus related to the asset.

IAS 36.110

Impairment losses, with the exception of those recognised in relation to goodwill, are generally capable of being reversed in subsequent accounting periods if indications arise that suggest the impairment may have decreased or no longer exists.

Explanations of each stage of the impairment accounting process, including impairment reversal and required disclosures, are set out in sections 4-11 below.

Cash-generating units

IAS 36.66, 104

If it is not possible to estimate the recoverable amount of an individual asset, an entity applies the requirements in respect of impairment at the level of the cash-generating unit (CGU) to which the asset belongs.

There are particular considerations when applying the requirements of IAS 36 to CGUs, which are covered in sections 5 and 8. Section 5 considers how to identify CGUs and section 8 explains that any impairment loss must be allocated to the assets in the CGU in a specific order:

i) first against any goodwill allocated to the CGU;

ii) then against the other assets of the CGU on a pro rata basis.

Impairment loss reduces carrying amount to recoverable amount

→

Allocate loss to assets of CGU:
1. Against goodwill, then
2. Against other assets pro rata

↓

Recognise loss:
1. Directly against any revaluation surplus related to the asset, then
2. In profit or loss

Goodwill and corporate assets are examples of assets that cannot be tested for impairment individually and must be assessed as part of a CGU, or group of CGUs. Section 9 outlines additional requirements to consider when testing goodwill for impairment.

Section 4

Scope

The requirements of IAS 36 are applied in accounting for the impairment of all assets other than: IAS 36.2

- inventories;
- contract assets and assets arising from costs to obtain or fulfil a contract that are recognised in accordance with IFRS 15 *Revenue from Contracts with Customers*;
- deferred tax assets;
- assets arising from employee benefits;
- financial assets within the scope of IFRS 9 *Financial Instruments*;
- investment property measured at fair value;
- biological assets related to agricultural activity within the scope of IAS 41 *Agriculture* that are measured at fair value less costs to sell;
- 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
- 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*.

IAS 36 therefore applies to property, plant and equipment, right of use assets, intangible assets, goodwill, and investment property carried at cost. The standard also applies to financial assets classified as subsidiaries, associates and joint ventures being accounted for at cost or using the equity method. IAS 36.4

Practical tip: interaction with IFRS 5

Non-current assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 are outside the scope of IAS 36. However, IFRS 5 requires assets to be measured immediately before their initial classification as held for sale 'in accordance with applicable IFRSs'.

A decision to sell an asset is an indicator of impairment (see section 6) and will trigger an impairment review. This will result in IAS 36 being applied immediately before the asset is classified as held for sale (assuming the relevant criteria are met) and treated in accordance with IFRS 5.

Section 5

Cash-generating units

Relevance of cash-generating units

It may not always be possible to estimate the recoverable amount of an individual asset. While fair value less costs of disposal is generally determinable, measuring value in use requires future cash flows to be forecast and individual assets do not always generate cash inflows independently from other assets. IAS 36.66-67

In such cases, value in use and therefore recoverable amount can only be determined for the asset's cash-generating unit (CGU).

Identifying CGUs

An asset's CGU is the smallest identifiable group of assets that includes the asset and generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. IAS 36.6

An asset or group of assets must be identified as a cash-generating unit where an active market exists for the output produced by that asset or group of assets, even if some or all of the output is used internally. This is because the asset or group of assets could generate cash inflows that would be largely independent of the cash inflows from other assets or group of assets. IAS 36.70

CGUs must be identified consistently from one period to the next for the same asset or types of assets, unless a change is justified. IAS 36.72

Practical tip: identification of CGUs

As noted above, identifying CGUs is dependent on establishing groups of assets that generate independent cash inflows. Cash outflows are not relevant for the purposes of identifying CGUs. Establishing CGUs will be a matter of fact and not necessarily consistent with the way management monitors the business. For example, each branch of a retail chain will generally be considered a separate CGU even if Head Office chooses to monitor performance on, say, a regional basis. Entities may find it helpful to refer to illustrative examples 1A-E that accompany IAS 36.

Practical tip: disposals

When an asset is to be disposed of, its cash inflows will be independent of the cash inflows of other assets. Therefore, the asset should be assessed for impairment in its own right, rather than as part of a CGU. In such circumstances an entity should also refer to IFRS 5.

Practical tip: difference between CGUs and operating segments

While CGUs are often a matter of fact, operating segments are more a matter of choice. In some instances a single CGU may also be an operating segment. However, it is more likely that an operating segment will comprise several CGUs.

IFRS 8 *Operating Segments* defines an operating segment as being a component of an entity:

- that engages in business activities from which it earns revenues and incurs expenses;
- whose operating results are reviewed regularly for the chief operating decision maker (CODM) to make decisions about resource allocation and to assess performance; and
- for which discrete information is available.

Corporate assets

IAS 36 defines corporate assets as being assets, other than goodwill, that contribute to the future cash flows of more than one CGU. Examples include assets such as a headquarters building, electronic data processing (EDP) equipment or a research centre. IAS 36.6, 100

Allocating corporate assets to CGUs and performing related impairment tests is discussed further in section 7.

Goodwill

IAS 36 requires goodwill acquired in a business combination to be tested for impairment annually. As goodwill does not generate cash flows independently, it must be tested at the level of a CGU, or group of CGUs. Section 9 provides guidance on the particular considerations relevant to testing goodwill for impairment. IAS 36.10 (b)

Section 6

When to perform an impairment test

An impairment test is required for all assets within the scope of IAS 36 when there is an indication of impairment at the reporting date. IAS 36.9-10

In addition IAS 36 requires certain assets to be tested for impairment annually, irrespective of whether there is any indication of impairment.
These are:

- Goodwill acquired in a business combination;
- Intangible assets with an indefinite useful life; and
- Intangible assets which are not yet available for use.

Practical tip: testing goodwill for impairment

Goodwill is tested for impairment at the level of a CGU, or group of CGUs, as it does not generate cash flows independently. The requirement to test goodwill annually for impairment therefore means the CGU, or group of CGUs to which goodwill has been allocated, will need to be tested annually. This is a wider requirement than might first appear to be the case. Further discussion on testing goodwill for impairment is included in section 9.

Practical tip: timing of tests

Intangible assets requiring an annual impairment test may be tested at any time during the annual period[1], providing that the test is performed at the same time each year. Different intangible assets may be tested at different times, so the impairment testing workload can be spread. However, if such an intangible is initially recognised during the current period, it must be tested for impairment before the end of the current annual period. This is also the case for goodwill and cash generating units (see section 9 below). IAS 36.10(a), IAS 36.96

Indications of impairment

Indications of impairment may be internal or external. IAS 36 requires the indications below to be considered as a minimum. These lists are not exhaustive and if other indications of impairment are identified, an impairment test should be performed. IAS 36.12-14

External sources of information

- A significant decline in an asset's value during the period.
- A significant adverse change in the technological, market, economic or legal environment in which the entity operates or in the market to which an asset is dedicated.
- An increase in market interest rates in the period, leading to a material decline in the asset's recoverable amount.
- The carrying amount of the net assets of an entity exceeding its market capitalisation.

Practical tip: market capitalisation as an indicator of impairment

Market capitalisation being below the carrying amount of a group's net assets is a trigger for an impairment test. Although it is possible that the assets are not impaired, a significant difference between these two measures is often a strong indicator that an impairment exists.
When considering a parent company's investments in subsidiaries, if the carrying amount of the parent's net assets in its separate financial statements exceeds the group's market capitalisation, this is also an indicator of a potential impairment.

[1] Annual period is referring to the period for which the entity is preparing financial statements in accordance with IAS 1 *Presentation of Financial Statements* although in certain circumstances this can be longer or shorter than one year. It is not referring to the period for which interim financial statements may be prepared in accordance with IAS 34 *Interim Financial Reporting*.

Internal sources of information

- Evidence of physical damage to or obsolescence of an asset.
- A significant adverse change in the extent or manner of use of an asset (eg, plans to restructure or discontinue operations, dispose of an asset or reassess its useful life).
- Evidence that the economic performance of an asset (the related operating results and cash flows) is or will be worse than expected.

Dividends

Dividends received from an investment in a subsidiary, joint venture or associate are an indication of impairment when: IAS 36.12(h)

- evidence is available that the carrying amount of the investment in the separate financial statements exceeds the carrying amounts of the investee's net assets, including associated goodwill, in the consolidated financial statements; or
- the dividend exceeds the total comprehensive income of the investee in the period in which the dividend is declared.

Practical tip: relevance of indications of impairment

The above indications trigger an impairment review only when they are relevant to the measurement of the particular assets. For example, changes in short-term interest rates might not affect the recoverable amount of long-term assets.

Practical tip: impact of economic uncertainty

Indications of impairment could potentially arise from:

- increases in interest rates;
- changes in selling prices or costs arising from movements in exchange rates;
- continued political instability; or
- economic uncertainties related to the effects of the decision to exit the EU.

Practical tip: cohesiveness of annual report and accounts

Although financial statements are a historical document, reflecting circumstances that exist up to and including the reporting date, the annual report is likely to contain more current information in the 'front-half'. The inclusion of references to circumstances such as challenging economic conditions in narrative reports may raise expectations that impairment reviews have taken place at the reporting date and that related disclosures will be found in the financial statements. Entities must take care to consider the cohesiveness of the annual report and accounts as a whole.

When an indication of impairment is identified, even when there is no resulting impairment loss, it may be appropriate to review the useful lives and residual values of the assets affected, as these may have changed. IAS 36.17

Events after the reporting period

When evidence relating to impairment arises after the end of the reporting period, but before the financial statements are authorised for issue, it will be necessary to consider the requirements of IAS 10 *Events after the Reporting Period.*

IAS 10 identifies events that provide evidence of conditions that existed at the end of the reporting period as adjusting events. Events that are indicative of conditions that arose after the reporting period are identified as non-adjusting events. IAS 10.3

The standard specifically identifies the receipt of information after the reporting period indicating that an asset was impaired at the end of the reporting period as being an example of an adjusting event. Evidence regarding the measurement of recoverable amount at the reporting date will also be an adjusting event. IAS 10 requires amounts recognised in financial statements to be adjusted to reflect such adjusting events. IAS 10.9

Indications of impairment arising after the reporting period that do not provide evidence of conditions existing at the reporting date are non-adjusting events. Although an entity must not adjust amounts recognised in its financial statements to reflect non-adjusting events, additional disclosures are required where the non-adjusting event is material and non-disclosure might be reasonably expected to influence users' decisions. The entity must disclose the nature of the event and an estimate of its financial effect, or a statement that such an estimate cannot be made. IAS 10.10, 21

Section 7

Performing an impairment test – assets other than goodwill

The basic principle

An impairment test involves comparing an asset's carrying amount in the balance sheet with its recoverable amount. IAS 36.8

In this section, references to 'an asset' should be read as references also to a CGU.

Recoverable amount

Recoverable amount is the higher of fair value less costs of disposal and value in use. IAS 36.18

When assessing recoverable amount, it is not always necessary to determine both fair value less costs of disposal and value in use. This is because if one of these amounts is higher than the carrying amount in the balance sheet, then there is no impairment and there is no need to estimate the other amount. IAS 36.19

Practical tip: value in use is often higher than fair value less costs of disposal

For many assets used within a business the value in use is likely to be higher than the fair value less costs of disposal. For example, the fair value less costs of disposal of a motor vehicle might be lower than its carrying amount, but if it can be used profitably in the business over its useful economic life then it is unlikely to be impaired.

Sometimes it will not be possible to measure fair value less costs of disposal, in which case IAS 36 permits the asset's value in use to be used as its recoverable amount. This might be because there is no basis for making a reliable estimate of the price at which an orderly transaction to sell the asset would take place between market participants at the measurement date under current market conditions. IAS 36.20

When there is no reason to believe that value in use materially exceeds its fair value less costs of disposal, IAS 36 permits an entity to use fair value less costs of disposal as the recoverable amount. IAS 36.21

Recoverable amount of intangible assets with an indefinite useful life

Intangible assets with an indefinite useful life are required to be tested annually for impairment irrespective of whether there is an indication that they may be impaired (see section 6).

When certain criteria are met, IAS 36 permits the most recent calculation of the asset's recoverable amount from a preceding period to be used in the current period. IAS 36.24

The criteria that must be met are:

- when the intangible asset is being tested as part of a CGU, the assets and liabilities making up that unit have not changed significantly since the recent calculation of recoverable amount being used;
- the recent calculation exceeded the asset's carrying amount by a substantial margin; and
- based on an analysis of events and circumstances since the calculation that is being used, there is only a remote likelihood that the asset's current recoverable amount would be less than its carrying amount.

Further faculty factsheets
More information on IFRS 13 is included in the faculty factsheet *IFRS 13 Fair Value Measurement.*

Calculating fair value less costs of disposal

IAS 36 replicates the definition of fair value from IFRS 13 *Fair Value Measurement*, being 'the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date'. IAS 36.6

IAS 36 defines costs of disposal as incremental costs directly attributable to the disposal of an asset, excluding finance costs and income tax expense. This would include legal costs, stamp duty and other transaction taxes, costs of removing an asset and direct incremental IAS 36.6, 28-29 costs of bringing an asset into condition for its sale. Costs of disposal do not include termination benefits or other costs associated with the reorganisation of a business.

Calculating value in use

IAS 36 defines value in use as being the present value of the future cash flows expected to be derived from an asset. IAS 36.6

It is established by: IAS 36.31

- estimating future cash inflows and outflows from the use and ultimate disposal of the asset; and
- applying an appropriate discount rate to those cash flows.

Future cash flows

Cash flow projections should: IAS 36.33

- be based on reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions that will exist over the remaining life of the asset, with greater weight being given to external evidence;
- be based on the most recent approved budgets/forecasts, which should cover a maximum period of five years unless a longer period can be justified;
- exclude the effects of any future restructuring to which the entity is not yet committed and the effects of improving or enhancing the asset's performance. IAS 36.44

Cash flows beyond the period covered by the most recent budgets/forecasts should be estimated by extrapolating the projections based on the budgets/forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified. This growth rate should not exceed the long-term average growth rate for the products, industries or country or countries in which the entity operates or for the market in which the asset is used, unless a higher rate can be justified.

Estimates of future cash flows should not include income tax receipts or payments or cash flows from financing activities. IAS 36.50

Appendix A to IAS 36 provides guidance on using present value techniques to measure value in use.

Practical tip: cash flows relating to future restructurings and improvements

As noted above, cash inflows or outflows that are expected to arise from future restructurings or from improving the asset's performance may not be included when calculating value in use. The same consideration does not apply when determining an asset's fair value less costs of disposal when the assumptions supporting the valuation should be similar to those a market participant would make. For example, in determining fair value it might be reasonable to expect that a hypothetical purchaser would implement appropriate restructuring or capital expenditure plans and factor this into their offer price.

Practical tip: cash flow forecasts specifically for value in use calculation

It may be necessary to prepare adjusted cash flow forecasts specifically for the purposes of the value in use calculation. For example, when planned enhancements to an asset have been taken into consideration in determining recent budgets and forecasts, a separate cash flow forecast may be required to exclude any income or costs arising from the planned enhancement.

Practical tip: factoring in climate change to a value in use calculation

The physical effects of climate change, as well as its related effects on regulation, technological developments and consumer preferences, could impact on business models across all industries. These factors may result in changes to management's estimates of the entity's projected cash flows or the level of risk associated with achieving those projections, and so should form part of the entity's value in use assessment. Particular aspects that might need incorporating include:

- expected changes in consumer behaviour;
- expected government action; and/or
- modifying expected rates of growth when extrapolating cash flow projections beyond the period covered by budgets/forecasts.

Foreign currency future cash flows

When calculating value in use, cash flows are to be estimated in the currency in which they will be generated and then discounted using a rate appropriate for that currency. The present value is to be translated using the spot exchange rate at the date of the value in use calculation. Future exchange rates should not be estimated when determining value in use. IAS 36.54

Discount rate

The discount rate should be a pre-tax rate reflecting current market assessments of the time value of money and risks specific to the asset for which the future cash flow estimates have not been adjusted. IAS 36.55

Such a rate might be estimated: IAS 36.56

- from the rate implicit in current market transactions for similar assets; or
- from the weighted average cost of capital of a listed entity that has a single asset (or a portfolio of assets) similar in terms of service potential and risks to the asset under review.

However, the discount rate(s) used to measure an asset's value in use should not reflect risks for which the future cash flow estimates have been adjusted. Otherwise, the effect of some assumptions will be double counted.

When an asset-specific rate is not available, surrogates are used to estimate the discount rate. Paragraphs A15-A21 in Appendix A to IAS 36 provide further guidance on estimating the discount rate in this situation. IAS 36.57, Appendix A

Practical tip: determining the discount rate – avoiding double counting

Determining an appropriate asset-specific discount rate is generally not easy. As a starting point an entity might use its incremental borrowing rate or weighted average cost of capital (WACC), adjusted for tax and any atypical feature of the entity's capital structure. Specialist advice may well be required.

Practical tip: calculating pre-tax discount rate

The use of post-tax instead of pre-tax discount rates in value in use calculations is an area often identified by accounting enforcers.

Although theoretically the use of post-tax discount rates and cash flows will provide the same outcome as using pre-tax figures, the need to consider deferred tax makes this more complicated to achieve in practice. If an impairment test using a post-tax value in use calculation only narrowly indicates that there is no impairment, then fair value less costs of disposal should be calculated as the next step.

Alternatively, a pre-tax discount rate may be arrived at by utilising a goal-seek function in spreadsheet software. Firstly, post-tax cash flows would be discounted using a post-tax discount rate. Then the goal-seek function can be used to ascertain what discount rate would give rise to the same value in use based on pre-tax cash flows.

Specific considerations when performing an impairment test on a CGU

When performing an impairment test on a CGU, the carrying amount of the CGU must be determined on a consistent basis to the recoverable amount. IAS 36.75

The carrying amount of the CGU includes the carrying amount of only those assets that are either directly attributable to the CGU, or that are allocated on a reasonable and consistent basis, and that will generate the future cash flows used in calculating the CGU's value in use.

The carrying amount of the CGU must not include the carrying amount of any recognised liability, unless the CGU's recoverable amount cannot be calculated without considering this liability.

Practical tip: comparing like with like

For practical reasons, it may be difficult to calculate the recoverable amount of a CGU without including assets or liabilities which are not part of the CGU (eg, receivables/payables). This does not create a problem, provided the carrying amounts of these assets or liabilities are also taken into account when calculating the CGU's carrying amount to ensure an entity is comparing like with like when performing an impairment test.

Corporate assets

As mentioned in section 5, corporate assets are assets that contribute to the future cash flows of more than one CGU. When testing a CGU for impairment, an entity must identify all corporate assets that relate to the CGU under review. IAS 36.102

When a portion of the carrying amount of a corporate asset can be allocated to the CGU on a reasonable and consistent basis, the carrying amount of the CGU including the portion of the corporate asset's carrying amount is compared to its recoverable amount. IAS 36.102 (a)

Practical tip: allocating corporate assets

When practicable, it is often most appropriate to allocate shared assets by reference to the extent to which the shared resources are used. This is illustrated in example 8 in IAS 36.IE 69-75.

However, in practice, some entities allocate corporate assets based on the respective carrying values of the net assets allocated directly to the individual CGUs, even though this may not always be representative of the amount of central resources consumed by the individual CGUs. Other common methods of allocating corporate assets include pro-rating based on relative turnover, contribution or sales volumes. Another approach could be used if it appropriately reflects the way in which the corporate asset contributes to the individual CGUs.

Example: head office assets

An entity has three divisions (A, B and C), each of which has been identified as a CGU. The net assets directly involved in each of the CGUs have carrying amounts of £300m, £450m and £500m respectively. In addition there are head office assets with a carrying value of £250m. An allocation of the head office assets to the CGUs is in this case based on the relative usage proportions. The relative proportion of the head office resources used by the CGUs is 2:3:5:

	A	B	C	Total
	£m	£m	£m	£m
Net assets directly attributable to the CGU	300	450	500	1,250
Allocation of head office	$\left[\frac{2}{10} \times 250\right]$ 50	$\left[\frac{3}{10} \times 250\right]$ 75	$\left[\frac{5}{10} \times 250\right]$ 125	250
Total	350	525	625	1,5000

If there were an indication of impairment relating to A, the recoverable amount would be compared to £350m rather than £300m. Similarly, the cash flows upon which the value in use of A is based would include the relevant portion of any cash outflows arising from central overheads.

When a portion of the corporate asset's carrying amount cannot be allocated on a reasonable and consistent basis, the impairment test is carried out in two stages:

IAS 36.102 (b)

- firstly, the carrying amount of the CGU excluding the corporate asset is compared to its recoverable amount. Any impairment loss is recognised in accordance with section 8 below.
- secondly, the smallest group of CGUs to which a portion of the carrying amount of the corporate asset can be allocated on a reasonable and consistent basis is identified. The carrying amount of that group of CGUs, including the portion of the carrying amount of the corporate asset, is compared to the recoverable amount of the group of units. Any further impairment loss is recognised in accordance with section 8.

Section 8

Recognising an impairment loss and subsequent accounting – assets other than goodwill

Recognising an impairment loss for an individual asset other than goodwill

An impairment loss is recognised if, and only if, the recoverable amount of an asset is less than its carrying amount. The asset must be written down to its recoverable amount. IAS 36.59-61

The appropriate recognition of the corresponding debit entry will depend on whether the asset is carried at a revalued amount in accordance with another IFRS (eg, under the revaluation model in IAS 16 *Property, Plant and Equipment*) or at historical cost.

- Impairment losses on non-revalued assets are recognised in profit or loss.
- Impairment losses on revalued assets are recognised:
  - in other comprehensive income against any revaluation surplus to the extent that it relates to the asset which is impaired, and then
  - in profit or loss.

Example: recognising an impairment loss on non-revalued assets

A factory which is carried at depreciated historical cost has a carrying amount of £10m. It becomes impaired due to an adverse change in the market for the goods that it produces. Its recoverable amount is calculated to be £7m.

The factory would therefore be written down to £7m with the full impairment loss of £3m being recognised in profit or loss.

Example: recognising an impairment loss on revalued assets

A factory which is subject to a policy of revaluation has a carrying amount of £10m. Its depreciated historical cost is £8m. There is an amount of £2m accumulated in revaluation surplus in respect of the factory. The factory becomes impaired due to an adverse change in the market for goods that it produces. Its recoverable amount is calculated to be £7m.

The factory would therefore be written down to £7m. The first £2m of the impairment loss – which reduces the amount accumulated in equity under the heading of revaluation surplus in respect of the asset – is recognised in other comprehensive income. The remaining £1m impairment loss is then recognised in profit or loss.

Subsequent measurement

After recognising an impairment loss, the revised carrying amount of the asset, less any residual value, should be depreciated over the asset's remaining useful life, which may need to be reassessed. IAS 36.63

Allocating an impairment loss to the assets of a CGU

When the carrying amount of a CGU exceeds its recoverable amount, an impairment loss must be recognised. IAS 36.104

The credit entry is allocated to reduce the carrying amount of the assets of the CGU (or group of CGUs) in the following order:

- firstly, goodwill allocated to the CGU (or group of CGUs); and
- then to the other assets of the CGU (or group of CGUs) on a pro rata basis, based on the carrying amount of each asset, but subject to the restriction discussed below.

The debit entry of the impairment loss is recognised in the same way as impairment losses on individual assets, dependent on whether the assets in the CGU have been revalued upwards in the past.

Impairment losses allocated to assets in a CGU may not reduce the carrying amount of an asset below the highest of: IAS36.105

- its fair value less costs of disposal;
- its value in use; and
- zero.

The amount of the impairment loss that would otherwise have been allocated to the asset should be allocated pro rata to the other assets of the CGU (group of CGUs).

Example: allocating an impairment loss across a CGU

An entity carries out an impairment assessment for a CGU with a total carrying value of £2,600,000 and estimates that its total recoverable amount is £1,350,000. The total impairment loss is therefore £1,250,000.

Information on the individual assets in the CGU is as follows:

	Carrying amount pre-impairment £'000	**Fair value less costs to sell £'000**	**Value in use £'000**
Goodwill	800	-	-
Other intangibles	300	100	Not known
Property	600	500	Not known
Plant and equipment	500	Not known	Not known
Debtors, cash	400	400	400
Total	2,600		

Allocation of £1,250,000 impairment:

i) first to goodwill: £800,000

ii) pro rata allocation of remaining impairment [£1,250,000 less £800,000 = £450,000] to other assets (carrying value before impairment £1,800,000), restricted to ensure that assets are not written down below the highest of fair value less costs to sell, value in use or nil:

	Other intangibles £'000	**Property £'000**	**Plant and equipment £'000**	**Debtors, cash £'000**
Initial allocation	75	150	125	100
	[450x300/1,800]	[450x600/1,800]	[450x500/1,800]	[450x400/1,800]
Restricted to	200	100	500	nil
Excess impairment	nil	50	nil	100
Reallocation of impairment	56	(50)	94	(100)
	[150x300/800]		[150x500/800]	
Final impairment	131	100	219	-

The revised carrying values after impairment are therefore:

	Carrying amount pre-impairment £'000	**Impairment £'000**	**Carrying amount post-impairment £'000**
Goodwill	800	800	0
Other intangibles	300	131	169
Property	600	100	500
Plant and equipment	500	219	281
Debtors, cash	400	0	400
Total	2,600	1,250	1,350

Section 9

Additional requirements for goodwill

As mentioned in section 5, goodwill must be tested for impairment by being allocated to a CGU, or group of CGUs. References in this section to a CGU to which goodwill is allocated should be read as references also to a group of CGUs to which goodwill is allocated. IAS 36.81

Allocating goodwill to CGUs

Goodwill acquired in a business combination is allocated to the acquirer's CGUs – or groups of CGUs – that are expected to benefit from the synergies of the combination. This allocation is made irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units. IAS 36.80

Each CGU or group of CGUs to which goodwill is so allocated must:

- represent the lowest level within the entity at which the goodwill is monitored for internal management purposes; and
- not be larger than an operating segment as defined by IFRS 8 *Operating Segments* before aggregation. IFRS 8.5

Practical tip: goodwill and pre-existing CGUs

IAS 36 requires goodwill to be allocated to the CGUs expected to benefit from the synergies of the combination. These CGUs may be those of the acquired entity and/or pre-existing CGUs of the acquiring entity.

Practical tip: goodwill is not always allocated to individual CGUs

Goodwill will often contribute to the cash inflows of several cash-generating units and cannot be allocated to individual CGUs on a non-arbitrary basis. As a result, the lowest level within the entity at which the goodwill is monitored for internal management purposes may comprise a number of CGUs to which the goodwill relates.

Goodwill is therefore tested for impairment at a level that reflects the way an entity manages its operations and with which the goodwill would naturally be associated. But it is important to keep in mind that, although goodwill may be tested for impairment at a higher level than that of individual CGUs, this does not alter the position for other assets. In particular, any impairment testing of assets that have been allocated to an individual CGU will need to be carried out at the level of that individual CGU and before the group of CGUs containing the goodwill (explained in more detail below).

If it has not been possible to allocate goodwill to a CGU (or group of CGUs) before the end of the annual period in which the business combination takes place, the allocation must be determined before the end of the annual period which begins after the acquisition date. IAS 36.84

Illustration: timeline to allocate goodwill to CGUs and interaction with fair value measurement period

Suppose an entity has a reporting date of 31 December and a business combination takes effect on 1 April 20X8. Ideally, the initial allocation of goodwill recognised on the business combination to a CGU, or group of CGUs, will be determined by the end of the annual reporting period in which the combination takes place ie, by the reporting date of 31 December 20X8.

If this has not been possible, the allocation must be determined by the end of the first annual period that begins after the acquisition date. The first annual period beginning after the acquisition date is the year beginning 1 January 20X9. The entity has until 31 December 20X9 to finalise the allocation of goodwill to a CGU, or group of CGUs.

This provides a longer period to finalise the allocation of goodwill than IFRS 3 *Business Combinations* gives to finalise the measurement of goodwill. IFRS 3 allows 12 months from the date of acquisition for the fair value measurement of net assets acquired to be finalised ie, up to 31 March 20X9 in this illustration.

If the initial accounting for a business combination can only be determined on a provisional basis at the reporting date of 31 December 20X8, the impairment test is similarly carried out on a provisional basis. The carrying amounts of assets within the CGU, or group of CGUs, will need to be recalculated when the measurement of goodwill is finalised and impairment tests revisited as a result of any adjustments made.

Order of testing for impairment

Impairment testing an individual CGU to which goodwill is allocated

IAS 36.90

A CGU to which goodwill has been allocated is tested for impairment annually and whenever there is an indication that the CGU may be impaired. This is done by comparing the carrying amount of the CGU, including the goodwill, with its recoverable amount. When the carrying amount is greater than the recoverable amount, an impairment loss must be recognised.

IAS 36.97

When an asset within the CGU is being tested for impairment at the same time, that asset is tested before testing the CGU including the goodwill.

Impairment testing a CGU within a group of CGUs to which goodwill is allocated

IAS 36.88, 97

As explained above, goodwill cannot always be allocated to individual CGUs and must therefore be allocated to a group of CGUs. In this case, an individual CGU in that group is tested for impairment:

- when there is an indication that it may be impaired; and
- annually if that CGU contains an intangible asset with an indefinite useful life or which is not yet available for use and that intangible can only be tested for impairment as part of the CGU.

The recoverable amount of the CGU is then compared to its carrying amount, excluding any goodwill. Any impairment loss is recognised in accordance with section 8. This must be done before the group of CGUs including the goodwill is tested.

Timing of testing CGUs for impairment

IAS 36.96

A CGU to which goodwill has been allocated may be tested for impairment at any time during the annual period, providing that the test is performed at the same time each year. Different CGUs may be tested at different times.

IAS 36.99

As for intangible assets with an indefinite life (see section 7), IAS 36 permits the most recent calculation of the recoverable amount of a CGU to which goodwill has been allocated, made in a preceding period, to be used in the current period provided certain criteria are met.

The criteria that must be met are:

- the assets and liabilities making up the CGU have not changed significantly since the recent calculation of recoverable amount being used;
- the recent calculation exceeded the CGU’s carrying amount by a substantial margin; and
- based on an analysis of events and circumstances since the calculation that is being used, there is only a remote likelihood that the CGU’s current recoverable amount would be less than its carrying amount.

Impairment testing CGUs with goodwill and non-controlling interests

IFRS 3.32

IFRS 3 requires goodwill arising on a business combination to be measured as the result of adding the components listed below and deducting the acquisition date net assets measured at fair value. The components to be added together are:

- fair value of the consideration;
- amount of the non-controlling interest; and
- fair value of any previously-held non-controlling stake in the acquiree.

IFRS 3 permits a choice of methods for measuring the amount of the non-controlling interest – at the proportionate share of net assets recognised at the acquisition date or at its acquisition date fair value. The latter ‘fair value’ method means that the non-controlling interests' share of goodwill is recognised in addition to the parent's ownership interest. The choice permitted in IFRS 3 is made on a transaction by transaction basis.

Appendix C of IAS 36 contains guidance on how to perform impairment tests on goodwill reflecting this choice, which is demonstrated by IAS 36's illustrative examples 7A, 7B and 7C (IE62 to IE68) and the two examples below. IAS 36 Appendix C

Non-controlling interests measured at proportionate share of net assets

When an entity measures non-controlling interests at the proportionate share of net assets, goodwill attributable to non-controlling interests is not recognised in the parent's consolidated financial statements. IAS 36 Appendix C4

However, part of the recoverable amount of the CGU is attributable to the non-controlling interest in goodwill. For example, the cash flows used in calculating value in use would reflect the entire acquired business, even if in fact the CGU is not wholly-owned.

To ensure the comparison of recoverable amount with carrying amount is like-for-like, the carrying amount of goodwill allocated to the CGU is grossed up to include notional goodwill attributable to the non-controlling interest.

If an impairment loss arises, only the loss relating to the parent's ownership interest is recognised as a goodwill impairment loss. The impairment loss attributable to non-controlling interests is not recognised as the related goodwill attributable to the non-controlling interests is not recognised in the parent's consolidated financial statements. IAS 36 Appendix C8

Allocation of impairment loss for subsidiary with non-controlling interest

When a subsidiary or part of a subsidiary is itself a CGU, an impairment loss is allocated between the parent and the non-controlling interest on the same basis as profit or loss is allocated. This is despite goodwill not necessarily being attributable on the same basis when non-controlling interests are measured at fair value at acquisition. IAS 36 Appendix C6

Example: non-controlling interest measured at the proportionate share of net assets

P acquired 75% of S on 1 June 20X2 for £1,450,000. The net assets of S at this date were £1 million. The goodwill arising on acquisition (measuring non-controlling interest at its proportionate share of net assets) was therefore:

	£	Comment
Consideration	1,450,000	
Non-controlling interest	250,000	25% x £1million
Net assets of S	(1,000,000)	
Goodwill	700,000	

P has identified S to be a CGU.

The business combination will benefit S and other CGUs.

For impairment testing purposes, £540,000 of the goodwill is allocated to S and £160,000 is allocated to other CGUs.

On 31 December 20X2, the recoverable amount of S was assessed to be £1,850,000. The carrying amount of the net assets of S, excluding goodwill, was £1,250,000. The aggregate carrying value including goodwill was therefore £1,950,000 (£1,250,000+£700,000) so it might appear that the CGU was not impaired. However, before being compared to the CGU's recoverable amount, the carrying amount of the CGU must be adjusted to include not only the amount of recognised goodwill allocated to S (£540,000) but also notional unrecognised goodwill attributable to the non-controlling interest.

	Goodwill £	Identifiable Net Assets £	Total £
Carrying value	540,000	1, 250,000	1,790,000
Notional unrecognised goodwill relating to the non-controlling interest (25/75 x540,000)	180,000	–	180,000
	720,000	1,250,000	1,970,000
Recoverable amount			(1,850,000)
Impairment loss			120,000

The impairment loss is allocated to the assets of the CGU by firstly reducing goodwill. As S is itself a CGU, the goodwill impairment loss is allocated between the controlling and non-controlling interest on the same basis as that on which profit or loss is allocated.

	Unrecognised Goodwill £	Recognised Goodwill £	Net Assets £	Total Recognised £
Notional value / carrying amount	180,000	540,000	1,250,000	1,790,000
Impairment	(30,000)	(90,000)	-	(90,000)
	150,000	450,000	1,250,000	£1,700,000

£30,000 (25% x £120,000) of impairment loss is allocated to notional goodwill and thus is not recognised in the financial statements. The remaining £90,000 is recognised in profit or loss.

Example: non-controlling interest measured at fair value

P acquired 75% of S on 1 June 20X2 for £1,450,000. The net assets of S at this date were £1 million. P elects to measure the non-controlling interest at its fair value of £350,000.

The goodwill arising on acquisition was therefore:

	£	Comment
Consideration	1,450,000	
Non-controlling interest	350,000	Fair value
Net assets of S	(1,000,000)	
Goodwill	£800,000	

P has identified S to be a CGU.

The business combination will benefit S and other CGUs.

For impairment testing purposes, £640,000 of the goodwill is allocated to S and £160,000 is allocated to other CGUs.

On 31 December 20X2, the recoverable amount of S was assessed to be £1,850,000. The carrying amount of the net assets of S, excluding goodwill, was £1,250,000.

	Goodwill £	Identifiable Net Assets £	Total £
Carrying value	640,000	1,250,000	1,890,000
Recoverable amount			(1,850,000)
Impairment loss			£40,000

All of the impairment loss is allocated to goodwill with 25% (ie, £10,000) being allocated to the non-controlling interest. The total impairment loss of £40,000 is recognised in profit or loss.

Note that the amount of impairment allocated to the non-controlling interest is determined on the same basis as the allocation of profit or loss (in this case, 25% to the non-controlling interests). This is required even though the proportion of goodwill originally recognised in respect of non-controlling interests was not 25% of the total. (Goodwill attributable to the non-controlling interest was £100,000, being £350,000 – (25% x £1 million), which represents 12.5% of the total goodwill recognised).

Section 10

Reversing an impairment loss

General principles

Impairment losses on individual assets and CGUs are generally capable of being reversed. IAS 36.110-111

An impairment loss recognised for goodwill, however, cannot be reversed. IAS 36.124

At the end of each reporting period, an entity must assess whether an indication exists that impairment losses recognised in prior periods may have decreased or no longer exist. If such an indication exists, the recoverable amount of the asset or CGU is assessed and compared to the carrying amount.

Indications that an impairment loss may have reversed mirror those indications that an impairment loss has occurred (see section 6).

Practical tip: indications of impairment losses reversing

Indications that previously recognised impairment losses may have decreased or no longer exist could potentially include:

- decreases in interest rates;
- changes in selling prices or costs arising from movements in exchange rates; and
- improvements in economic outlook.

Reversing an impairment loss for an individual asset

The impairment loss can be reversed to the extent that the increased carrying amount of an individual asset does not exceed the amount at which the asset would have been carried (net of amortisation or depreciation) had there been no initial impairment. IAS 36.117

Reversing an impairment loss for a CGU

The reversal is allocated pro rata to the assets of the CGU, except for goodwill. IAS36.122

In the case of an asset within a CGU, the increased carrying amount cannot exceed the lower of: IAS36.123

- its recoverable amount; and
- the amount at which the asset would have been carried (net of amortisation or depreciation) had there been no initial impairment.

Recognising a reversal

A reversal of an impairment of a non-revalued asset is recognised in profit or loss. IAS36.119-120

A reversal of an impairment of a revalued asset is recognised in other comprehensive income and increases the revaluation surplus for that asset. However, to the extent that an impairment loss on the same revalued asset was previously recognised in profit or loss, a reversal of that impairment loss is also recognised in profit or loss.

Example: reversing an impairment loss

A CGU that comprises goodwill of £40m and other identifiable assets of £100m becomes impaired because the product that it makes is overtaken by a technologically more advanced model made by a competitor. The recoverable amount of the CGU falls to £65m, resulting in an impairment loss of £75m (the excess of carrying value of £40m+£100m=£140m above the recoverable amount of £65m). Under IAS 36, the impairment loss is allocated first to goodwill (reduced by £40m, to nil) and then to the CGU's other identifiable assets on a pro rata basis (reduced by £75-£40=£35m, to £65m).

After three years the competitor's product is found to generate harmful side effects, resulting in demand returning for the entity's product. The recoverable amount of the CGU rises to £90m. At this time the other identifiable assets' carrying value is £50m, and it would have been £80m had the original impairment not occurred (ie, after taking account of subsequent depreciation or amortisation).

The impairment of the goodwill cannot be reversed. However, part of the impairment of the other identifiable assets can be reversed. Their carrying amount would be increased by £30m to £80m ie, the lower of their recoverable amount of £90m and the amount at which they would have been carried had the impairment not originally been incurred, £80m.

Subsequent measurement following an impairment reversal

The carrying amount after reversal of the impairment, less any residual value, should be depreciated over the asset's remaining useful life. IAS 36.121

IFRIC 10 Interim Financial Reporting and Impairment

IFRIC 10 *Interim Financial Reporting and Impairment* addresses the issue of whether impairment losses recognised on goodwill in an interim period can be reversed if a smaller loss, or no loss, would have been recognised if the impairment assessment had only been made at the end of a subsequent reporting period. IFRIC 10 clarifies that impairment losses on goodwill recognised in previous interim periods cannot be reversed. IFRIC 10.7-8

Section 11

Disclosure requirements

Disclosures required for an impairment or impairment reversal in the period

The main disclosure requirements are as follows:

- Amounts of impairments or reversals of impairments recognised in profit or loss for the period and the line items in which they are included.
- Amounts of impairments or reversals of impairments recognised in other comprehensive income during the period. IAS 36.126-132
- The events and circumstances leading to the impairment or reversal.
- A description of the nature of the asset or CGU.
- Any changes in the aggregation of assets into CGUs for which an impairment or reversal has been recognised.
- The recoverable amount and whether it is value in use or fair value less costs of disposal.
- If the recoverable amount is fair value less costs of disposal, the level of IFRS 13's fair value hierarchy within which the fair value measurement of the asset or CGU is categorised together with additional detailed disclosures if it is within level 2 or level 3 of that hierarchy.
- The discount rate used when the recoverable amount is calculated using present value techniques.
- If any portion of goodwill acquired in a business combination during the period has not been allocated to a CGU at the end of the reporting period, the amount of unallocated goodwill should be disclosed along with the reasons why it remains unallocated. IAS 36.133

Further disclosure in relation to segments is required when IFRS 8 is relevant.

Additional disclosures required when a CGU includes goodwill or intangible assets with indefinite useful lives

The additional disclosures include: IAS 36.134-135

- A description of key assumptions on which management has based recoverable amount (be it value in use or fair value less costs of disposal).
- A description of management's approach to determining the value assigned to each key assumption.
- When value in use is recoverable amount:
  - The period over which cash flows are projected.
  - The growth rate used to extrapolate cash flow projections.
  - The discount rate applied to cash flow projections.
- When fair value less costs of disposal is recoverable amount:
  - The level of IFRS 13's fair value hierarchy within which the fair value measurement is categorised.
  - If there has been a change in valuation techniques, the nature of the change and the reasons for making it.
  - If fair value less costs of disposal is measured using discounted cash flow projections, the period over which cash flows are projected, the growth rate used to extrapolate cash flow projections and the discount rate applied to cash flow projections.

- If a reasonably possible change in a key assumption would cause a CGU's carrying amount to exceed its recoverable amount:
  - The amount by which recoverable amount exceeds carrying amount.
  - The value assigned to the key assumption.
  - The amount by which the value assigned to the key assumption must change in order for the CGU's recoverable amount to be equal to its carrying amount.
- Aggregate amounts of goodwill and intangible assets with indefinite useful lives when they are allocated across multiple CGUs such that allocated amounts are not significant.

Practical tip: comparison with IAS 1 disclosure requirement

IAS 1 para 125 requires an entity to disclose information about sources of estimation uncertainty that have a significant risk of resulting in a material adjustment to the carrying amounts of assets (and liabilities) within the next financial year. An entity may disclose the sensitivity of carrying amounts to the assumptions and estimates underlying their calculation.

There are a number of differences between the IAS 1 requirements and the requirements of IAS 36 paras 134-135 regarding changes in a key assumption (see above):

- IAS 36's requirements apply to a single change in a key assumption, whereas IAS1's requirements apply to multiple assumptions;
- IAS 36's requirements are applicable to a CGU with goodwill or an intangible asset with an indefinite useful life, whereas IAS 1 applies to any asset;
- IAS 36's requirement has no timeframe attached, whereas IAS 1's requirement specifies a material adjustment within the next financial year;
- IAS 36 specifically requires disclosure of the amount by which the value must change for the CGU's recoverable amount to equal its carrying amount, whereas IAS 1 suggests disclosing a range of reasonably possible outcomes within the next financial year.

Practical tip: disclosure of climate as a key assumption

As discussed in section 7, consideration of climate-related factors may be a necessary part of a value in use calculation. When the recoverable amount of a CGU containing goodwill (or an intangible asset with an indefinite useful life) is based on value in use and climate-related factors have been a significant factor in that calculation, the key assumptions applied should be disclosed together with a description of management's approach to determining the value(s) assigned to each key assumption. This disclosure is the same as for any other long-term risks that have been a significant factor in the value in use calculation.

Practical tip: a robust and transparent process

Regulators continue to emphasise that the impairment review process should be robust and transparent and they look to the disclosures made about the review process to gauge whether or not this is the case. The FRC's *Thematic Review: Impairment of non-financial assets* (October 2019) noted companies still give disclosures that are more generic than specific in nature, with narrative information about the way in which key assumptions are identified and quantified tending to be vague. Generic and inappropriately aggregated information hinders the ability of investors and lenders to understand the factors relevant to the impairment review process and hinders the evaluation of management's estimates.

Some companies do not explain adequately why assumptions have changed significantly from the previous year. Also, entities are required to make sensitivity disclosures when a reasonably possible change in a key assumption would result in an impairment. In such circumstances it may be helpful to disclose when the combined impact of varying individual assumptions might result in an impairment. If disclosing additional information that might be helpful to users, it should not displace the required disclosures.

The European Securities and Markets Authority's (ESMA) report *of Enforcement and Regulatory Activities of European Accounting Enforcers* in 2018 may also be of interest. Impairment of non-financial assets continued to be an area where most infringements were identified by European enforcers.

Practical help in a complex world

Contacts and further help

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This factsheet is part of a series designed to provide practical help for Financial Reporting Faculty members in exercising their professional judgement.

The faculty cannot offer interpretations of standards or give views on the application of standards to particular companies or transactions.

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To check for current standards and recent amendments go to the faculty's standards trackers at: icaew.com/frfstandardstracker.

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IFRS 9 Financial Instruments - overview
IFRS 15 Revenue from Contracts with Customers
IFRS 16 Leases

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Contact us
Our postal address is: The Financial Reporting Faculty Chartered Accountants' Hall Moorgate Place London EC2R 6EA
T +44 (0)20 7920 8533
E frfac@icaew.com
icaew.com/frf
Follow us on twitter: @ICAEW_FRF

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