
IFRS® Interpretations Committee meeting

Date	November 2023
Project	Climate-related and Other Uncertainties in the Financial Statements
Topic	Impairment—measurement of value in use
Contacts	Gustavo Olinda (golinda@ifrs.org)

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Purpose of the paper

1. At its September 2023 meeting, the International Accounting Standards Board (IASB) discussed its project *Climate-related and Other Uncertainties in the Financial Statements*. In particular, the IASB discussed potential actions it could take to help address concerns about reporting the effects of climate-related risks in financial statements.
2. At that meeting, the IASB decided to consult the IFRS Interpretations Committee (Committee) on how entities apply the requirements in IAS 36 *Impairment of Assets* in measuring value in use when an asset is subject to highly variable future cash flows over an extended time horizon.¹
3. The objective of this paper is to:
 - (a) provide the Committee with background on the matter; and
 - (b) ask the Committee for input on the concerns identified.

¹ For ease of reference, we use the term 'asset' to refer equally to an individual asset, a cash-generating unit (CGU) or a group of CGUs.

Structure of this paper

4. This paper includes the following:
 - (a) background information; and
 - (b) questions for the Committee.
5. Appendix A includes an extract of some of the applicable requirements in IAS 36.

Background information

6. [Agenda Paper 14B](#) for the IASB's September 2023 meeting summarises information about the nature and potential causes of concerns related to reporting on the effects of climate-related risks in financial statements. That information was based on initial work performed by the project's staff, which included outreach with the IASB's consultative bodies and other stakeholders (including consultation with the Committee in June 2023).²
7. The staff's work highlighted some concerns related to how entities reflect climate-related risks in impairment calculations performed applying the requirements in IAS 36. In particular:
 - (a) paragraph 33(a) of IAS 36 requires that, in measuring an asset's value in use, an entity shall 'base cash flow projections on reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions that will exist over the remaining useful life of the asset.'
 - (b) paragraphs 33(b) of IAS 36 requires that an entity 'base cash flow projections on the most recent financial budgets/forecasts approved by management'. It also requires that 'projections based on these budgets/forecasts shall cover a maximum of five years, unless a longer period can be justified'.

² [Agenda Paper 14A](#) for that same meeting includes further information about the staff's work and the stakeholders consulted.

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- (c) paragraph 35 of IAS 36 explains that ‘management may use cash flow projections based on financial budgets/forecasts over a period longer than five years if it is confident that the projections are reliable and it can demonstrate its ability, based on past experience, to forecast cash flows accurately over a longer period.’
- (d) paragraph 36 of IAS 36 states that ‘cash flow projections until the end of an asset’s useful life are estimated by extrapolating the cash flow projections based on the financial budgets/forecasts using a growth rate for subsequent years.’
- (e) paragraph 38 of IAS 36 states that ‘in using information from financial budgets/forecasts, an entity considers whether the information reflects reasonable and supportable assumptions and represents management’s best estimate of the set of economic conditions that will exist over the remaining useful life of the asset.’
8. The effects of climate-related risks can result in the potential for high variability in future cash flows. Some of that variability may extend well beyond the five-year period specified in paragraph 33(b) of IAS 36 and also affect the extrapolation of cash flow projections based on financial budgets/forecasts, as required by paragraph 36 of IAS 36. Therefore, the potential for high variability in future cash flows over an extended time horizon may give rise to questions about how to apply the requirements in IAS 36. Specifically, the staff’s work highlighted concerns about potential:
- (a) *lack of compliance due to misunderstanding of the requirements*—some stakeholders said some entities might not fully understand some requirements. For example, entities may not be adequately factoring climate-related risks over extended time horizons into impairment calculations. Specifically, cash flow projections used in measuring value in use may not adequately ‘represent management’s best estimate of the range of economic conditions that will exist over the remaining useful life of the asset’ (paragraph 33(a) of IAS 36) or the terminal value estimated by extrapolating cash flow projections may not be representative of a steady state.

- (b) *limitations of the requirements*—as noted above, paragraph 35 of IAS 36 explains that, when estimating the recoverable amount of an asset, an entity can use cash flow projections for a period longer than five years if management is ‘confident that these projections are reliable and it can demonstrate its ability, based on past experience, to forecast cash flows accurately over that longer period’. A few stakeholders said some entities interpret this requirement as prohibiting them from forecasting cash flows for a longer period when calculating value in use. This perceived prohibition can result in entities calculating a terminal value based on cash flows expected in year five, even when those cash flows are not indicative of profitability in the long term. Other stakeholders, however, do not appear to be concerned about being unnecessarily constrained by these requirements.
- (c) *insufficiently clear requirements in IFRS Accounting Standards*—when measuring the value in use of an asset using the traditional approach, entities may not properly consider that cash flows (or discount rates) used should represent management’s best estimate of the range of economic conditions that will exist over the remaining useful life of the asset rather than a single most likely, minimum or maximum possible amount.
9. After considering this information, the IASB decided to seek input from the Committee on the concerns identified. This input will help the IASB decide whether to take any action to address these concerns. The box below sets out specific questions for Committee members.

Questions for the Committee

Questions for the Committee

1. In your experience:
 - (a) how do entities reflect the potential for high variability in future cash flows over an extended time horizon when calculating the value in use of an asset?

Questions for the Committee

- (b) is there diversity in how entities understand and apply the requirements in IAS 36 in reflecting such variability in value in use calculations?

Appendix A—Extract of requirements in IAS 36

A1. For ease of reference, this Appendix includes an extract of some requirements in IAS 36 that are applicable to the matter discussed in this paper. In addition to those requirements, Appendix A to IAS 36 provides further guidance on the use of present value techniques in measuring value in use.

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Value in use

30 The following elements shall be reflected in the calculation of an asset's value in use:

- (a) **an estimate of the future cash flows the entity expects to derive from the asset;**
- (b) **expectations about possible variations in the amount or timing of those future cash flows;**
- (c) **the time value of money, represented by the current market risk-free rate of interest;**
- (d) **the price for bearing the uncertainty inherent in the asset; and**
- (e) **other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset.**

31 Estimating the value in use of an asset involves the following steps:

- (a) estimating the future cash inflows and outflows to be derived from continuing use of the asset and from its ultimate disposal; and
- (b) applying the appropriate discount rate to those future cash flows.

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

Basis for estimates of future cash flows

- 33 In measuring value in use an entity shall:
- (a) base cash flow projections on reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions that will exist over the remaining useful life of the asset. Greater weight shall be given to external evidence.
 - (b) base cash flow projections on the most recent financial budgets/forecasts approved by management, but shall exclude any estimated future cash inflows or outflows expected to arise from future restructurings or from improving or enhancing the asset's performance. Projections based on these budgets/forecasts shall cover a maximum period of five years, unless a longer period can be justified.
 - (c) estimate cash flow projections beyond the period covered by the most recent budgets/forecasts by extrapolating the projections based on the budgets/forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified. This growth rate shall not exceed the long-term average growth rate for the products, industries, or country or countries in which the entity operates, or for the market in which the asset is used, unless a higher rate can be justified.
- 34 Management assesses the reasonableness of the assumptions on which its current cash flow projections are based by examining the causes of differences between past cash flow projections and actual cash flows. Management shall ensure that the assumptions on which its current cash flow projections are based are consistent with past actual outcomes, provided the effects of subsequent events or circumstances that did not exist when those actual cash flows were generated make this appropriate.
- 35 Detailed, explicit and reliable financial budgets/forecasts of future cash flows for periods longer than five years are generally not available. For this reason, management's estimates of future cash flows are based on the most recent budgets/forecasts for a maximum of five years. Management may use cash flow projections based on financial budgets/forecasts over a period longer than five years if it is confident that these projections are reliable and it can demonstrate its ability, based on past experience, to forecast cash flows accurately over that longer period.
- 36 Cash flow projections until the end of an asset's useful life are estimated by extrapolating the cash flow projections based on the financial budgets/forecasts using a growth rate for subsequent years. This rate is steady or declining, unless an increase in the rate matches

objective information about patterns over a product or industry lifecycle. If appropriate, the growth rate is zero or negative.

- 37 When conditions are favourable, competitors are likely to enter the market and restrict growth. Therefore, entities will have difficulty in exceeding the average historical growth rate over the long term (say, twenty years) for the products, industries, or country or countries in which the entity operates, or for the market in which the asset is used.
- 38 In using information from financial budgets/forecasts, an entity considers whether the information reflects reasonable and supportable assumptions and represents management's best estimate of the set of economic conditions that will exist over the remaining useful life of the asset.

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