



## **IFRIC submission: Identification of cash generating units in the retail industry**

### **The issue:**

How does a Company identify a cash-generating unit in a retail chain store when cash inflows are identifiable but independence of the cash inflows is challenged?

### **Fact Pattern:**

In the retail industry it is current practice that retail stores in one region are operated in integrated chains. The number of retail stores organised in such a chain can vary from below 20 to over 4.000. The region is defined in various ways, e.g. as a city, a geographic part of a country (district or county) or a country. An integrated chain may be characterised by several or all of the following features:

1. All stores have identifiable cash inflows as the goods are paid by the customer before leaving the store.
2. All supply contracts incl. negotiations on volume rebates and general marketing allowances, logistic contracts, marketing and advertising as well as employment contracts and remuneration for employees are processed and agreed upon centrally through the ultimate group or company management.
3. Pricing, range of product and services, set-up of stores, location of stores, investment and disposal decisions as well as marketing and advertising activities made by ultimate group or company management only.
4. The store manager and/or other employees are generally not remunerated based on store profitability. Key performance indicators include e.g. theft rate, cleanliness of the store, friendliness of employees and alike and represent key drivers for bonus payments.
5. All stores are operated in a uniform way under one corporate identity theme or brand.
6. Customer bonus, rebate or loyalty programs exist as homogenous group program for all stores (i.e. rewards can be earned in any store irrespective of its location and can be redeemed alike in any store of the chain).
7. For management purposes only the group view of the highly integrated and centralized business is applied to use the advantages of economies of scale (purchase power) especially in supply and logistics contracts.



### **Current practice:**

Current IFRS application practice is diversified. Some would consider a retail chain that is characterised by the above features as one cash-generating unit while others consider the individual store as a single cash-generating unit. The fact pattern is based on a retail store chain but the issue might not be limited to the retail industry.

### **Reasons for the IFRIC to address the issue:**

IAS 36.6 defines “a cash-generating unit as 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.” There seems to be unclear guidance in IAS 36 when cash inflows are not independent even though they are identifiable. Moreover, current practice is diverse, leading to significant differences in the timing the impairment loss recognition, the amount of the impairment loss to be recognised and the recognition of additional liabilities required by other Standards if an amount remains after the impairment loss allocation following IAS 36.104 and 105. The views expressed below should be read as examples and merely to illustrate why an IFRIC interpretation is needed and appropriate. There may be others, defending still other methods of accounting and there may be those who would defend any of the views mentioned below, but for different reasons.

#### **View 1**

Those who would argue that impairment should be tested for with reference to single stores argue that each store generates own cash inflows based on a customer base which is at least to a large extent specific to the individual store. Paragraph 6 of IAS 36 stresses cash inflow and does not take net cash flows into consideration when identifying a cash-generating unit. Also proponents point to Example 1A in the Illustrative Examples in IAS 36 (identification of a cash-generating unit in a retail store chain). The example concludes for a similar fact pattern that the single store likely serves as cash-generating unit.

Also proponents of the single store view argue that financial data are available on a single store basis and will de facto to some extent trigger disposal or closure decisions.

#### **View 2**

Those who would argue that impairment should be tested on the network of different stores (i.e. the retail chain) argue that the cash inflows are not independent on a single store basis. They argue that pricing is the significant driver to generate cash inflow as pricing combined with loyalty programs creates a single customer base and these customers would decide to buy at a specific chain as opposed to a specific store. Thus cash inflows are dedicated to the chain.

In addition, proponents of this view state “that the identification of an asset's cash-generating unit involves judgment” under IAS 36.68. Further IAS 36.69 makes clear “in identifying whether cash inflows from an asset (or group of assets) are largely in-



*dependent of the cash inflows from other assets (or group of assets), an entity considers various factors including how management monitors the entity's operations or how management makes decisions about continuing or disposing of the entity's assets and operations".*

Finally, proponents of this view challenge the applicability of Example 1A in IAS 36 as the example:

- (a) assumes an internal management reporting on a store-by-store basis also measuring the performance on this level;
- (b) concludes that customer bases of the different stores are probably different; and
- (c) excludes any interdependencies between the cash inflows of different stores operated as an integrated chain.