

IAS 36-Impairment Of Assets

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Learning Outcome Statement

- Describe the scope of IAS 36
- Explain the key definition in IAS 36
- What is impairment?
- Identifying assets for impairment testing
- Concept behind the impairment test
- Steps in the value in use test
- Elements to be reflected in the value in use calculation
- Recognition and measurement of impairment loss
- Procedure to reverse an impairment loss
- Disclosure requirements of IAS 36
- Test your understanding

Scope

➤ Scope:

Applies to all assets (including current assets) other than:

- ❖ Inventories (IAS 2 – Inventories)
- ❖ Assets arising from construction contracts (IAS 11– Construction Contracts)
- ❖ Deferred tax assets (IAS 12-Income Taxes)
- ❖ Assets arising from employee benefits (IAS 19-Employee Benefits)
- ❖ Financial Assets that are within the scope of IFRS 9 – Financial Instruments
- ❖ Investment Property (IAS 40 – Investment Property)
- ❖ Biological assets (IAS 41- Agriculture)
- ❖ Deferred acquisition costs, and intangible assets arising from Insurance contract (IFRS 4)
- ❖ Non-current asset (or disposal groups) classified as held for sale in accordance with IFRS 5

Definitions

➤ Impairment loss:

It is the amount by which the carrying amount of an asset or a cash-generating unit exceeds its recoverable amount

➤ Carrying amount :

It is the amount at which an asset is recognised after deducting any accumulated depreciation (amortisation) and accumulated impairment losses thereon

➤ Cash-generating unit:

It 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

❖ Apply CGU concept when the asset does not generate cash inflows which are independent from other assets and the asset's fair value less costs of disposal also can not be determinable. If asset's fair value less cost of disposal is higher than its carrying value then same asset has to be tested for impairment individually.

Definitions

Example of CGU:

- ✓ M has 5 stores including store X wherein purchase, pricing, marketing & advertising are done from corporate level i.e. HO. Can X be CGU?

Indicators of CGU:

- ❖ Internal management reporting is organised to measure performance on a store-by-store basis; and
- ❖ The business is run on a store-by-store profit basis or on a region/city basis
- ❖ But cash flows generated by store X are independent of cash flow from other stores

Ans: Yes

- ✓ Company A has two plant X and Y. Output of plant X is used by used by plant Y, however there is an active market for the output of plant X. Identify the CGU

Ans: Both X and Y are CGU

- ✓ An entity has a company office building which is used for the internal purpose, but the entity gives on the rent half of the office building to third party. Identify the CGU

Ans: Building in its entirety is CGU

Definitions

➤ Recoverable Amount:

Recoverable amount of an asset or cash generating unit is the higher of its fair value less costs of disposal and its value in use

➤ Fair Value:

Fair value is 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

➤ Value in use:

It is the present value of the future cash flows expected to be derived from an asset or cash-generating unit.

What is impairment ?

- The recoverable amount of an asset is less than its carrying amount (may be carried at cost or revalued amount)
 - ❖ The asset is impaired
 - ❖ The asset's carrying amount should be reduced to its recoverable amount

Asset i.e. Individual asset or Cash Generating Unit (CGU)

Identifying assets for impairment testing

- All assets in its scope shall be required for impairment testing where there is an impairment indicator at each reporting period
- However, in the case of goodwill acquired in a business combination, indefinite life intangible assets and intangible assets that are not yet ready for use must also be tested for impairment annually irrespective of whether there any indication of impairment

❖ Indications of Impairment:

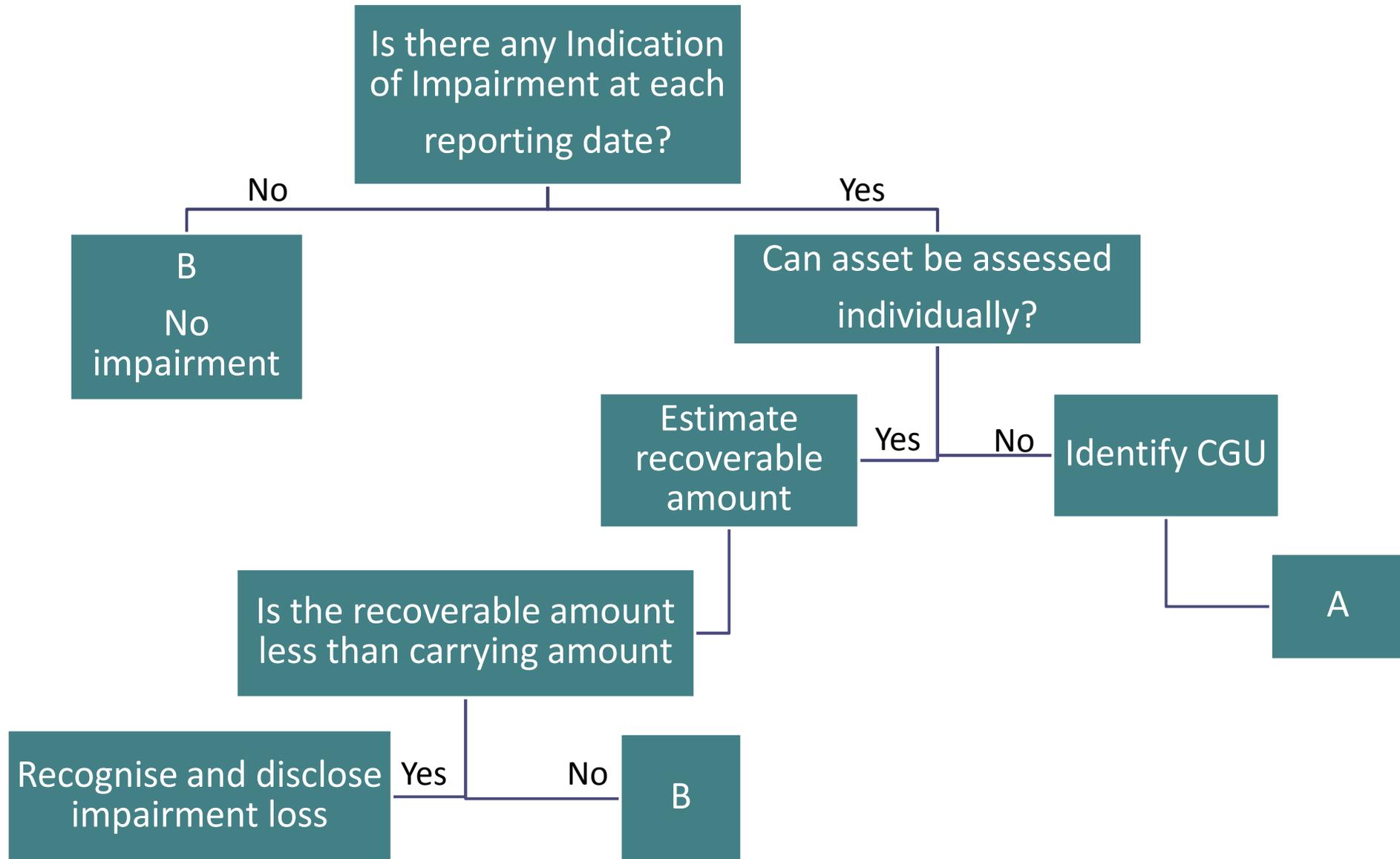
✓ External sources:

- a) Decline in market value
- b) Changes in technological, market, economic or legal environment that adversely affect the entity
- c) Increased interest rates or other rates of return on investments
- d) Net assets is more than its market capitalisation

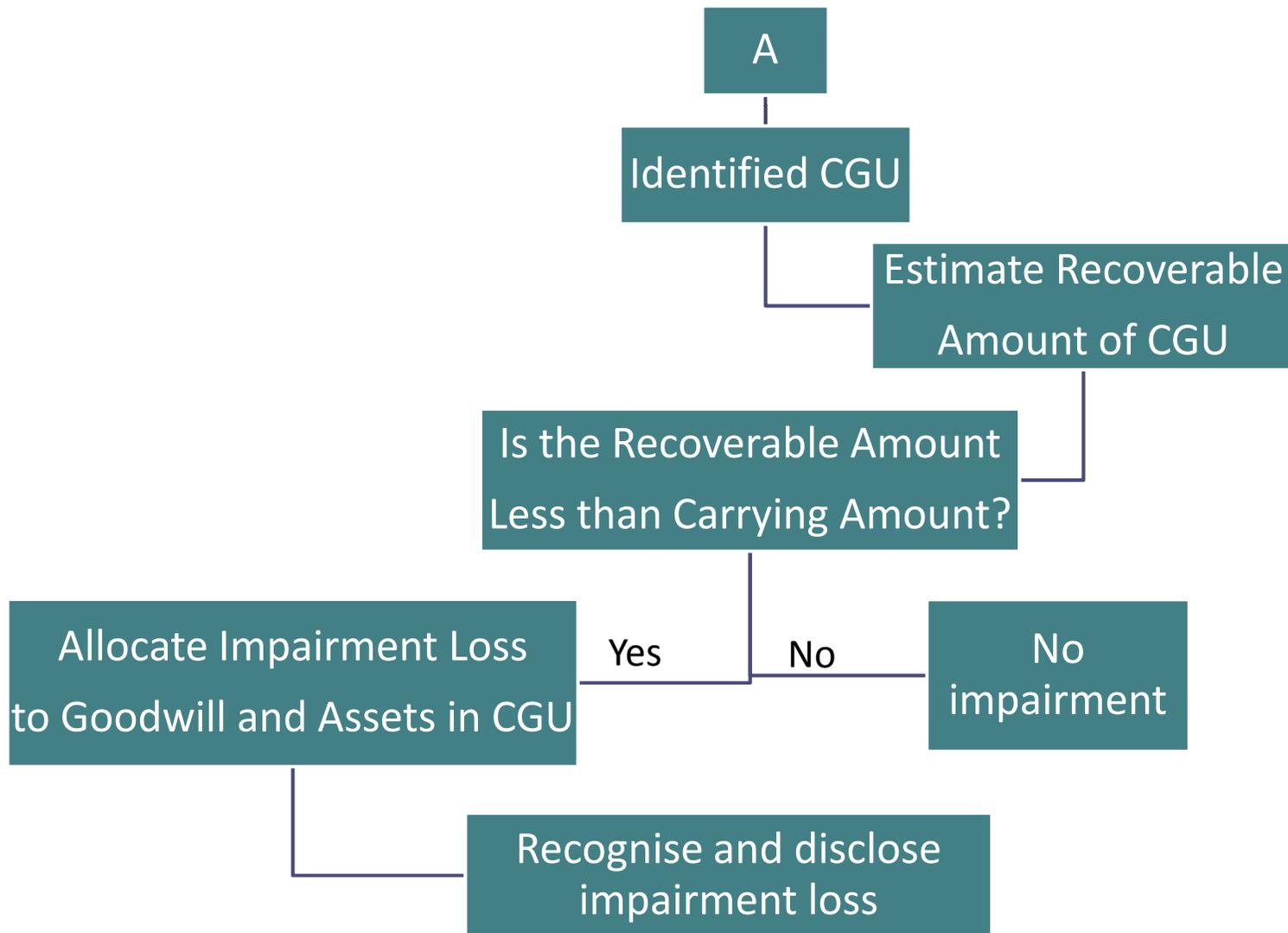
✓ Internal Sources:

- a) Evidence of obsolescence / physical damage
- b) Plans to discontinue / restructure operations
- c) Evidence from internal reporting

Impairment test



Impairment test



Value in use test

The future cash flows the entity expects to derive from the asset



Expectation about possible variations in the amount or timing of the cash flow



The time value of money, being the current market risk-free rate of interest



The price for bearing the uncertainty inherent in the asset



Other factors (such as liquidity) that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset

Elements of value in use calculation

➤ Cash flow projections:

- ❖ Cash inflows from the continuing use of the asset
- ❖ Cash outflows that are necessarily incurred to prepare the asset for continuing use and/or ready to use
- ❖ Net cash in / out flows, if any, from its disposal

Factors to consider

- ❖ Short term – maximum 5 years, unless longer can be justified (steady or declining growth)
- ❖ Based on recent financial budgets/forecasts approved by management
- ❖ Estimation for the asset in its current condition (i.e. Restructuring, reorganisation and capital expenditure on the assets ignored)

Elements of value in use calculation

➤ Discount rate should be:

- ❖ Pre-tax rate that reflects current market assessment of the time value of money and
- ❖ The risks specific to the asset

Factors to consider

- ❖ Discount rate is independent of the enterprise's capital structure
- ❖ The discount rate should be asset specific rate, if the same is not available then the following may be considered:
 - a) WACC
 - b) The enterprise's incremental borrowing rate or other market
 - c) Other market borrowing rate

Recognition and Measurement

➤ IF Recoverable Amount < Carrying Amount of an Asset

Impairment Loss = Carrying Amount less Recoverable Amount

➤ Impairment loss to be recognised:

- ❖ As an expense in the P&L account (if there is no revaluation)
- ❖ As a decrease in revaluation reserve (if carried at revalued amount)

➤ After recognition:

- ❖ Adjust depreciation / amortisation charge for the asset in future periods
- ❖ Allocate the asset's revised carrying amount less residual value, on a systematic basis over its remaining useful life



Impairment
model - life cycle

Recognition of impairment loss for a CGU

- First write-down any goodwill allocated to the CGU
- Then, to the other assets of the CGU on pro rata on the basis of the carrying amount of each asset in the CGU
- The carrying amount of an asset (which is part of CGU) should not be reduced below the highest of :
 - ❖ its net selling price (if determinable)
 - ❖ its value in use (if determinable)
 - ❖ Zero
- The amount of the impairment loss that would otherwise have been allocated to the asset should be allocated to the other assets of the CGU on a pro-rata basis

Reversal of Impairment

➤ Points to check at each reporting period:

- ❖ Whether accumulated impairment loss may no longer exist or may have decreased (look for indicators –external and internal)
- ❖ Impairment loss except goodwill can be reversed if, and only if, there has been a change in estimates (not because of increase in PV of cash flows as they become closer)
- ❖ Increased carrying amount not to exceed the carrying amount that would otherwise exist if no impairment loss had been recognised.

Disclosure

- For each class of assets, the financial statements should disclose:
 - ❖ Amount of impairment loss
 - ❖ line item(s) of the income statement in which those impairment losses are included
 - ❖ Amount of reversals of impairment losses
 - ❖ Line item(s) of the income statement in which those impairment losses are reversed
 - ❖ Amount of impairment losses recognized directly against revaluation surplus
 - ❖ Amount of reversals of impairment losses recognized directly against revaluation surplus

Disclosure- Material Loss or Reversal

➤ Enterprise should disclose:

- ❖ Events and circumstances
- ❖ Amount of loss or reversal recognised
- ❖ Nature of asset/CGU
- ❖ Reported segment of asset/CGU
- ❖ CGU – if grouping has changed, describe current and former grouping and reasons for the change in grouping

Disclosure- Material Loss or Reversal

- Enterprise should disclose:
 - ❖ Recoverable amount – net selling price or value in use. Describe basis etc
 - ❖ Main classes of assets affected by impairment losses or reversals
 - ❖ Main events and circumstances that led to loss/reversal

Example: Recognition of impairment loss for a CGU

Step 1:-Calculation of a weighted allocation of the carrying amount of the headquarters building

Particulars	A	B	C	Total
Carrying amount	100	150	200	450
Useful Life	10	20	20	
Weighting based on use life	1	2	2	
Carrying amount after weighting	100	300	400	800
Pro rata allocation of building	12%	38%	50%	100%
Allocation of the carrying amount of the building	19	56	75	150
Carrying amount (After allocation of building)	119	206	275	600

Step 2:-Impairment testing of A, B and C

	A	B	C
Carrying amount (after allocation of building)	119	206	275
Recoverable amount	199	164	271
Impairment loss	0	(42)	(4)

Recognition of impairment loss for a CGU

Step 3:-

	A	B
Building	(12) (42*56/206)	(1) (4*75/275)
CGU	(30) (42*150/206)	(3) (4*200/275)
Total	(42)	(4)

Step 4:-

Particulars	A	B	C	Bldg	Research centre	M
Carrying amount	100	150	200	150	50	650
Impairment loss arising from the first step of the test	-	(30)	(3)	(13)	-	(46)
first step of the test	100	120	197	137	50	604
Recoverable amount						720
Impairment loss for the 'larger' cash-generating unit						0

Test the understanding

- An asset is impaired when _____ amount is more than the _____ amount.
- When determining value in use, what are the cash flows that shall be reflected in the calculation of an assets' value in use ?
- How is the cash generating unit defined ?
- When identifying a cash generating unit, on what do we base our judgment ?
- What should be considered when splitting a partial sale that requires goodwill to be apportioned ?
- Is it permissible to reverse goodwill under IAS 36 ?
- The amount of the reversal of an impairment loss is limited to what amount ?
- Should a liability be recognized for an impairment loss for a cash-generating unit ?



Questions ?

Thank you

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