

IAS 36	Impairment of Assets
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DEFINITIONS

Cash generating unit (CGU) Impairment loss Recoverable amount Value in use Fair value less cost to sell	<p>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.</p> <p>is the amount by which the carrying amount of an asset or a CGU exceeds its recoverable amount.</p> <p>of an asset or a CGU is the higher of its fair value less costs to sell and its value in use.</p> <p>is the present value of the future cash flows expected to be derived from an asset or CGU.</p> <p>Value in use is calculated by estimating future cash inflows and outflows from the use of the asset and its ultimate disposal, and applying a suitable discount rate to these cash flows.</p> <p>Therefore, there are two steps to the calculation.</p> <ol style="list-style-type: none"> (1) Estimate future cash flows from use and from disposal at the end of useful life. (2) Discounting (pre-tax risk adjusted discount rate should be used for calculating present value). <p>Basis for estimate of future cash flows:</p> <ul style="list-style-type: none"> ▪ cash flow projection should be based on reasonable and supportable assumptions and greater weight shall be given to external evidence ▪ projections based on these budgets/forecasts shall cover a maximum period of five years, unless a longer period can be justified ▪ estimate cash flow projections beyond the period covered by extrapolating the projections 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 <p>is the amount at which an asset could be sold in an orderly transaction between market participants less the costs of disposal.</p> <p>Possible indicators of fair value may be:</p> <ul style="list-style-type: none"> ▪ A binding sale agreement ▪ If an active market exists, the current market price less cost of disposal ▪ Failing either of the above indicators, the best information available must be relied on.
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EXAMPLE 36A**Situation 1**

A bus company provides services under contract with a municipality that requires minimum service on each of five separate routes. Assets devoted to each route and the cash flows from each route can be identified separately. One of the routes operates at a significant loss.

Situation 2

An entity comprises three stages of production, A (growing and felling trees), B (creating parts of wooden furniture) and C (assembling the parts from B into finished goods). The output of A is timber that is partly transferred to B and partly sold in an external market. If A did not exist, B could buy its timber from the market. The output of B has no external market and is transferred to C at an internal transfer price. C sells the finished product in an external market and the sales revenue achieved by C is not affected by the fact that the three stages of production are all performed by the entity.

Identify the cash generating unit(s) in both situations.

EXAMPLE 36B

The following information relates to three assets:

Asset	A \$000	B \$000	C \$000
Carrying value	100	150	120
Net selling price [FV-CTS]	110	125	100
Value in use	120	130	90
Recoverable amount?			
Impairment loss?			

OTHER DEFINITIONS

Cost of disposal	<p>are incremental costs directly attributable to the disposal of an asset or cash-generating unit, excluding finance costs and income tax expense.</p> <p>Cost of disposal might include:</p> <ul style="list-style-type: none"> ▪ Legal costs ▪ Stamp duty ▪ Costs relating to removal of sitting tenant <p>Redundancy and restructuring costs (to be incurred after the sale of business) are not cost of disposal.</p>
Corporate assets	<i>Corporate assets</i> are assets other than goodwill that contribute to the future cash flows of both the CGU under review and other CGUs.

TIMING OF IMPAIRMENT REVIEW

IAS 36 requires that at each reporting date, an entity must assess whether there are **indications** of impairment. Indications may be derived from within the entity (internal sources) or the external market (external sources).

Internal sources	<ul style="list-style-type: none"> ▪ Obsolescence or physical damage ▪ Significant changes with an adverse effect in the manner in which an asset is used or is expected to be used. ▪ Economic performance of an asset is worse than expected. ▪ Actual cash flows are worse than the budgeted
External sources	<ul style="list-style-type: none"> ▪ Asset's market value has declined significantly more than expected. ▪ Significant changes with an adverse effect in the technological, market, economic or legal environment in which the entity operates ▪ Market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect the discount rate used in calculating an asset's value in use and decrease the asset's recoverable amount materially. ▪ The entity's net assets are measured more than its market capitalisation.
Indication exists	If an indication of impairment exists then an impairment review must be performed. Where there is no indication of impairment, then no further action needs to be taken.
Annual review	<p>The following assets must be reviewed annually for impairment (in addition to when an indication exists):</p> <ul style="list-style-type: none"> ▪ Goodwill acquired in a business combination ▪ An intangible asset with an indefinite useful life ▪ An intangible asset not yet available for use

MEASURING RECOVERABLE AMOUNT

Entities have to bear in mind the following steps and considerations when evaluating an asset's recoverable amount:

No need to calculate both amounts	It is not always necessary to determine both an asset's net selling price and its value in use. For example, if either of these amounts exceeds the asset's carrying amount, the asset is not impaired and it is not necessary to estimate the other amount
FV – CTS not determinable	If it is not possible to determine fair value less cost to sell then value in use should be taken.
Assets held for disposal	If asset is held for disposal then present value of cash flow from the use of asset until its disposal are likely to be negligible, in this case recoverable amount shall be equal to the FV – CTS.
Asset or CGU	Recoverable amount is determined for an individual asset. If the asset does not generate cash flows independent from other assets. This asset is clubbed to CGU and impairment loss is calculated of this CGU.

RECOGNITION OF IMPAIRMENT LOSS

Recognising expense	An impairment loss should be recognized as an expense in the income statement immediately, unless the asset is carried at revalued amount.
On revalued asset	An impairment loss on a revalued asset is recognized directly against any revaluation surplus for the asset to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset.
Depreciation etc.	The depreciation (or amortisation) of an impaired asset shall be charged on its revised amount.

EXAMPLE 36C

An entity owns a property which was originally purchased for \$300,000. The property has been revalued to \$500,000 with the revaluation of \$200,000 being recognised as other comprehensive income and recorded in the revaluation reserve. The accumulated depreciation related to property after revaluation is \$40,000 and therefore its carrying amount is \$460,000 but the recoverable amount of the property has just been estimated at only \$200,000.

What is the amount of impairment and how should this be treated in the financial statements?

IMPAIRMENT OF CGU

Order	The impairment loss should be allocated to reduce the carrying amount of the assets of the CGU in the following order: (a) First, to any asset specifically impaired (b) Second, to goodwill allocated to the CGU (if any); and (c) Then, to the other assets of the unit on a pro-rata basis based on the carrying amount of each asset in the unit.
Treatment	These reductions in carrying amounts should be treated as impairment losses on individual assets.
Extent	In allocating an impairment loss, the carrying amount of an asset should not be reduced below the highest of: (a) Its net selling price (if determinable); (b) Its value in use (if determinable); and (c) Zero The amount of the impairment loss that would otherwise have been allocated to the asset should be allocated to the other assets of the unit on a pro-rata basis.

EXAMPLE 36D

A company runs a unit that suffers a massive drop in income due to the failure of its technology on 1 January 2008. The following carrying values were in the books immediately prior to the impairment:

	\$m
Goodwill	20
Technology	5
Brands	10
Land	50
Buildings	30
Other net assets	40
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	155

The recoverable value of the unit is estimated at \$85 million. The technology is worthless, following its complete failure. The other net assets include inventory, receivables and payables. It is considered that the book value of other net assets is a reasonable representation of its net realizable value.

Required:

- (a) Show the impact of the impairment on 1 January 2008.
- (b) Show the impact of the impairment on 1 January 2008 assuming that net selling price of land is \$29 million

ALLOCATING ASSETS TO CGUs

The net assets of the business (including recognised goodwill, but excluding tax balances and interest bearing debt) are allocated to CGUs. There are two particular problem areas.

Corporate assets	assets that are used by several CGUs (e.g. a head office building or a research centre). They do not generate their own cash inflows, so do not themselves qualify as CGU.
Goodwill	which does not generate cash flows independently of other assets and often relates to a whole business.
Reasonable allocation	It may be possible to allocate corporate assets and/or goodwill over CGUs on a reasonable basis.
Allocation not possible	If no reasonable allocation of corporate assets or goodwill is possible, then a group of CGUs must be tested for impairment together in a two-stage process.
Annual impairment	A CGU or a group of CGUs to which goodwill has been allocated must be tested for impairment at least annually.

EXAMPLE 36E

An entity acquires a business comprising three CGUs, D, E and F, but there is no reasonable way of allocating goodwill to them.

After three years, the carrying amount and the recoverable amount of the net assets in the CGUs and the purchased goodwill are as follows:

	D \$000	E \$000	F \$000	Goodwill \$000	Total \$000
Carrying amount	240	360	420	150	1,170
Recoverable amount	300	420	360		1,080

How the impairment would be recognised in the above case.

IMPAIRMENT OF GOODWILL

FULL GOODWILL – MEASURING NCI at FAIR VALUE

Goodwill	In this case, goodwill shown in SFP represents goodwill relating to parent and NCI both. Therefore, the carrying amount of a CGU is comparable on like to like basis with recoverable amount of the CGU.
Impairment	Any impairment of goodwill is therefore allocated between the group and NCI based upon their shareholding.

PARTIAL GOODWILL – MEASURING NCI at PROPORTION OF NET ASSETS

Goodwill	<p>In this case, goodwill shown in SFP represents goodwill relating to parent only. Therefore, the carrying amount of a CGU is <u>not</u> comparable on like to like basis with recoverable amount of the CGU.</p> <p>The goodwill must be grossed up to include goodwill attributable to NCI before testing CGU for impairment. The grossed up goodwill is known as 'total notional goodwill'.</p>
Impairment	<p>In case of impairment loss, the loss is allocated to goodwill and then to other assets on pro-rata basis.</p> <p>As only parent share of goodwill is recognised, any impairment of goodwill is therefore charged for parent's share only.</p>
Steps	<ol style="list-style-type: none"> 1. Calculate partial goodwill 2. Gross up 3. Calculate impairment loss 4. Net the impairment loss for goodwill 5. Pass journal entry

EXAMPLE 36F

P owns 80% of S. At 31 December 2011 the carrying amount of S's net assets is \$60 million, excluding goodwill of \$8 million that arose on the original acquisition. The non-controlling interest is valued using the proportion of net assets method.

Calculate the impairment loss if the recoverable amount is:

- (a) \$64 million
- (b) \$50 million

REVERSAL OF IMPAIRMENT LOSS

Indications	Impaired assets should be reviewed at each reporting date to see whether there are indications that the impairment has reversed.
Recognition	<p>A reversal of impairment loss is recognised immediately as income in profit or loss.</p> <p>The reversal must not take value of an asset above the amount it would have been if the original impairment would have never been recorded (depreciated carrying value).</p> <p>An amount above <u>depreciated carrying value</u> may be credited to <u>other comprehensive income</u> (revaluation surplus) only if the entity uses revaluation model.</p>
Goodwill	An impairment loss recognised for goodwill cannot be reversed.

EXAMPLE 36G

An asset was purchased for \$100,000 with 10 years useful life and nil residual value on 1 January 2001. On 31 December 2002, it was tested for impairment and its recoverable amount was \$64,000, therefore an impairment loss of \$16,000 was charged. On 31 December 2003, there were indications that the impairment loss might have been reversed and the recoverable amount was estimated at \$73,000 on this date.

Discuss the accounting treatment.

ANSWER 36A**Situation 1**

Because the company does not have the option to curtail any one bus route, the lowest level of identifiable cash from continuing use that are largely independent of the cash inflows from other asset or groups of assets is the cash inflows generated by the five routes together. The cash-generating unit for each route is the bus company as a whole.

Situation 2

A forms a cash generating unit and its cash inflows should be based on the market price for its output. B and C together form one cash generating unit because there is no market available for the output of B. In calculating the cash outflows of the cash generating unit B + C, the timber received by B from A should be priced by reference to the market, not any internal transfer price.

ANSWER 36B

The following information relates to three assets:

Asset	A \$000	B \$000	C \$000
Carrying value	100	150	120
Net selling price [FV-CTS]	110	125	100
Value in use	120	130	90
Recoverable amount?	120	130	100
Impairment loss?	0	20	20

ANSWER 36C

Impairment = Carrying amount \$460,000 – recoverable amount 200,000 = \$260,000 impairment loss

Of this \$200,000 is debited to the revaluation reserve to reverse the previous upwards revaluation (and recorded as other comprehensive income) and the remaining \$60,000 is charged to the income statement.

Dr. Accumulated depreciation	\$40,000
Dr. Revaluation reserve (OCI)	\$200,000
Dr. Profit or loss (Impairment loss)	\$60,000
Cr. Property	\$300,000

ANSWER 36D**Part (a)**

An impairment of \$70 million is required (\$155m carrying amount - \$85m recoverable amount)

Items	Carrying value before impairment	Impairment allocated	Carrying value after impairment
	\$m	\$m	\$m
Goodwill	20	(20)	0
Technology	5	(5)	0
Brands	10	(5)	5
Land	50	(25)	25
Buildings	30	(15)	15
Other	40	(0)	40
CGU	155	(70)	85

Total impairment: \$70m

Allocated

- Technology (\$ 5m)
- Goodwill (\$20m)
- Remaining (\$45m)

Prorate based on carrying value:

- Brands $\$45m \times 10/(10 + 50 + 30) = \$5m$
- Land $\$45m \times 50/(10 + 50 + 30) = \$25m$
- Buildings $\$45m \times 30/(10 + 50 + 30) = \$15m$

Part (b)

An impairment of \$70 million is required (\$155m carrying amount - \$85m recoverable amount)

Items	Carrying value before impairment	Impairment allocated	Carrying value after impairment
	\$m	\$m	\$m
Goodwill	20	(20)	0
Technology	5	(5)	0
Brands	10	(5)+(1)=(6)	— 4
Land	50	(25) (21)	— 25 29
Buildings	30	(15)+(3)=(18)	— 15 12
Other	40	(0)	40
CGU	155	(70)	85

Total impairment: \$70m

Allocated

- Technology (\$ 5m)
- Goodwill (\$20m)
- Remaining (\$45m)

Prorate based on carrying value:

- Brands $\$45m \times 10/(10 + 50 + 30)$ = \$5m
- Land $\$45m \times 50/(10 + 50 + 30)$ = \$25m
- Buildings $\$45m \times 30/(10 + 50 + 30)$ = \$15m

The maximum loss that can be charged to land is \$21m as carrying amount of land cannot be taken below \$29m. The pro rata loss is \$25m for land. The remaining loss of \$4m shall be again pro-rated in other assets.

Prorate based on carrying value:

- Brands $\$4m \times 10/(10 + 30)$ = \$1m
- Buildings $\$4m \times 30/(10 + 30)$ = \$3m

ANSWER 36E

Step 1: Review the individual units for impairment

F is impaired. A loss of \$60,000 is recognised and its carrying amount is reduced to \$360,000.

Step 2: Compare the carrying amount of the business as a whole, including the goodwill, with its recoverable amount.

The total carrying amount of the business (group of CGUs) is \$1,110,000 (i.e. \$1,170,000 - \$60,000). A further impairment loss of \$30,000 must then be recognised in respect of the goodwill (\$1,110,000 - \$1,080,000).

ANSWER 36F**Part (a)**

	Goodwill \$m	Net assets \$m	Total \$m
Carrying amount	8	60	68
Notional NCI (20/80)	2		2
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	10	60	70
Recoverable amount			64
Impairment loss			6

The impairment loss only related to goodwill and only proportion related to parent shall be recognised.

Goodwill shall be impaired by \$4.8 million (i.e. \$6m x 80%).

Part (b)

	Goodwill \$m	Net assets \$m	Total \$m
Carrying amount	8	60	68
Notional NCI (20/80)	2		2
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	10	60	70
Recoverable amount			50
Impairment loss			20

The impairment loss of \$10m relates to goodwill and \$10 related to other assets. The goodwill shall be impaired by \$8m (i.e. \$10m x 80%) and other assets shall be impaired by \$10 million on pro rata basis.

ANSWER 36G

Had the asset been never impaired its carrying value would have been \$70,000 (i.e. \$100,000 – depreciation of 3 years).

The actual carrying value of the asset is \$56,000 (i.e. \$64,000 - \$64,000/8years).

The impairment loss of \$14,000 (i.e. \$70,000 – 56,000) shall be reversed only in profit or loss.

Dated: 03 September 2016