Impairment of Assets

Ind AS 36

Agenda

- Objective and scope
- External & Internal Indicators
- Impairment testing
- Accounting for impairment losses
- Frequency of Impairment
- Disclosures
- Key differences

Objective and scope

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Objective

The objective of this Standard is to prescribe the procedures that an entity applies to ensure that its assets are carried at no more than their recoverable amount.

Scope

This Standard shall be applied in accounting for the impairment of all assets, other than:

- Inventories
- Contract assets and assets arising from costs to obtain or fulfil a contract under Ind AS 115
- Deferred tax assets
- Assets arising from employee benefits
- Financial assets that are within the scope of Ind AS 109
- Investment property measured at fair value
- Biological assets
- Deferred acquisition costs, and intangible assets, arising from an insurer's contractual rights under insurance contracts within the scope of Ind AS 104
- Non-current assets (or disposal groups) classified as held for sale in accordance with Ind AS 105

Definitions

Definitions

Impairment Loss

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

Recoverable Amount

The higher of its fair value less costs of disposal and its value in use

Value in Use

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

External & Internal Indicators

External indicators

- Significant decline in the asset's value
- A significant adverse change in the market to which an asset is dedicated or in the technological, economic or regulatory environment in which the company operates
- An increase in interest rates or other market rates of return that affect the return required on the company's assets
- The company's reported net assets exceed its market capitalization

External indicators – example 1

- Gibbon owns a 60% holding in Pickett, an unquoted entity. Both entities operate in a country with a stable economy. The government of the country has recently announced an increase in interest rates.
- The increase will cause a fall in value of equity holdings. This is due to the fact that risk free investments offer a higher return making them relatively more attractive. The market value of equity will adjust downwards to improve the return available on this sort of investment.
- The increase is an indication that Gibbon's holding in Pickett might be impaired. Gibbon should make a formal estimate of the recoverable amount of its interest in Pickett.

External indicators – example 2

- Entity P produces a wide range of drinks and beverages. Its main product is a special filtered beer, whose sales represent 50% of annual revenues. According to the local tax regulation, filtered beers are rated as 'category 4' in the alcoholic beverages tax table. Tax charges are based on four categories 1 (with higher tax charges) to 4 (with lower tax charges). New legislation will shortly come into effect under which all alcoholic beverages will be taxable equally based on the former category 1 tax charge.

External indicators – example 2

- In this situation, the change in the country’s tax regulations should be considered an impairment indicator. The increase in the tax charge on entity P’s products, and specifically over its main product, may have a direct impact on the entity's sales volumes, margins and cash flows.
- Management should perform impairment tests, estimating the recoverable amount of its assets, based on the best available information (about fair values, future sales, and the assets' current condition).

External indicators – example 3

- Entity S is the biggest local supermarket chain in country X, a developing country.
- Recently, the global chain M, has decided to set up operations in the country. Entity M is well known worldwide, intends to establish its shops close to entity S's and to offer entity S's customers a wider range of products and international brands. However, management of entity S expects to retain most of its customer base.
- In this example, entity M's market entry is an impairment indicator. Management should perform impairment tests, estimating the recoverable amount of its assets, based on the best available information.

External indicators – example 4

- Entity X uses asset M to manufacture product A. There has been a significant reduction in demand for product A as a result of a change in consumer taste. Management has not assessed asset M for impairment because it can, subject to minimal reconfiguration, be used in the manufacture of its new product T.
- Entity X should review asset M for impairment. The change in use is itself an indicator of impairment. Entity X's management will need to assess the impact of both the change in consumer tastes and the asset's proposed change of use on the asset's recoverable amount.

Internal indicators

- Obsolescence or physical damage affecting the asset
- Significant adverse changes affecting the asset, such as plans to discontinue or restructure certain activities
- Internal reporting systems showing or predicting worse than expected performance from particular assets or business units

Internal indicators - example

- Hood is a small airline. It owns a Dash 8 aircraft which it purchased to service a contract for passenger flights to a small island. The rest of its business is long-haul freight shipping.
- It has been informed that its licence to operate the passenger service will not be renewed after the end of this current contract which finishes in 6 months time. It is proposing to use the aircraft in a new business venture offering pleasure flights.
- The change in the use of the asset that is expected to take place in the near future is an indication that the aircraft may be impaired. Hood should make a formal estimate of the recoverable amount of its Dash 8 aircraft

Impairment Testing

Determining Fair value less costs to sell (FVLCS)

- Fair value is determined under Ind AS 113 and is clearly an exit price.
- Costs of disposal are direct incremental costs to bring an asset into condition for its sale
- Examples of costs of disposal:-
  - legal costs,
  - stamp duty or other transaction taxes,
  - costs of removing the asset and any direct incremental costs of getting the asset into saleable condition.
- Other consequential costs that would arise if the asset were sold, such as redundancy costs, are not taken into account

An example - determining Fair value less costs to sell

The fair value of an asset is $ 10,000. The other costs are:-

- Cost of removing the asset is $ 2,000.
- Termination benefits are $ 2,500
- Legal fees are $ 1,000
- Documentary stamp tax is $ 500
- Reorganizational cost is $ 1,500

What is the Fair Value Less Cash to Sell of the Cash Generating Units?

The total costs of disposal are $ 3,500.
Re-organizational costs are not considered direct incremental costs of disposal of an asset.
The Fair value less costs to sell is $ 6,500

Determining value in use

Estimating the future net cash flows to be derived from continuing use of the asset and from its ultimate disposal

The following elements are considered in determining the value in use:

- Cash inflows and outflows specific to the asset/CGU
- Time value of money (market risk-free rate)
- Uncertainty inherent to the asset
- Expectations about possible variations in the amount or timing of those future cash flows
- Other factors (e.g. illiquidity, forecasting risk)

Determining value in use

Applying the appropriate discount rate to those future cash flows.

- Pre-tax discount rate and represents market assessment of the time value of money
- If the future cash flows are risk adjusted then the discount rate should be a pre-tax risk free rate

Weighted average cost of capital can be used as a starting point. However the rate does not depend on the entity's existing capital structure as the cash flows from the assets are independent of this factor.

Cash-generating unit – definition

Determine recoverable amount for the individual asset if possible

Apply the CGU concept if the asset's recoverable amount cannot be estimated, i.e. if the asset does not generate cash inflows independent from other assets and its value in use cannot be estimated to be close to its fair value less costs to sell

CGU is smallest identifiable group of assets that generates cash inflows that are largely independent from other (groups of) assets.

Cash-generating unit – Factors to be considered

Key factor: ability to generate independent cash inflows

- If an active market exists for the output of an asset group, then it is a CGU even if the output is only sold to another division with the entity
- The focus is on cash inflows, not net cash flows

Consider how management makes decisions about continuing or disposing of assets / operations

Consider how management monitors operations

An example – identification of CGU

- Entity P is a vertically integrated electricity utility. It has three distinguishable businesses: generation, distribution and supply. There are active markets for the output of the generation and distribution businesses. The generation business sells power to the distribution business, which distributes electricity to the supply business. Internal transfer pricing approximates market price.

- Each business is considered a separate CGU.
- Management should use external prices when determining value in use for a CGU in a vertically integrated operation.

Allocation of goodwill

- Allocate goodwill at the acquisition date to the cash-generating units that benefit from the synergies of the acquisition.
- This should be done at the lowest level at which goodwill is monitored internally, which must not be larger than an operating segment before any aggregation for reporting purposes.
- If the allocation is not completed in the period of acquisition, it must be done in the next period.

Accounting for impairment losses

Impairment loss accounting for individual assets

- If the carrying amount of an asset exceeds its recoverable amount, the carrying amount should be written down to the recoverable amount.
- The impairment loss is immediately expensed in the income statement unless the asset is carried at a revalued amount in accordance with another standard.
- When the asset is carried at a revalued amount, the impairment is accounted for as a decrease of the revaluation surplus. This means that the loss is charged first against the amount of any existing revaluation surplus on the asset and only thereafter to the income statement.

Impairment loss accounting for individual assets

- An asset should not be written down below zero. An entity may be required to recognize a separate liability under another standard when the recoverable amount of an asset is negative, but it will not provide for the impairment loss as a liability.
- The new carrying amount forms the basis for future depreciation over the asset's remaining life. Deferred tax has to be recalculated on the asset's new carrying value.

Impairment loss accounting for cash generating unit

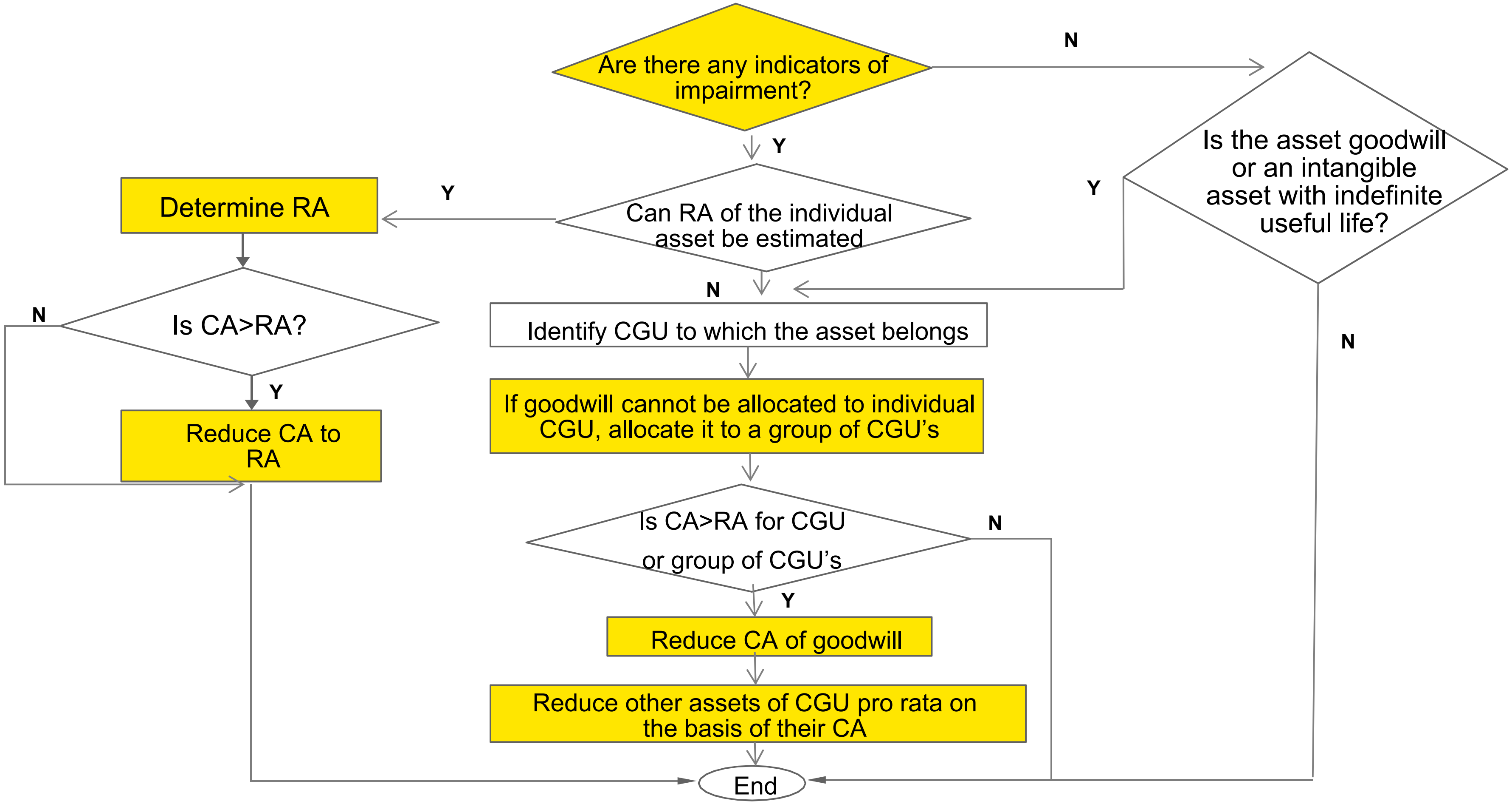
- First the impairment loss should be allocated to any goodwill allocated to the unit
- Next, it should be applied, on a pro rata basis, against the other assets in the unit, but not so as to write down any below the highest of:
  - Its Fair value less costs to sell, if measurable
  - Its Value In Use, if determinable
  - Zero
- Loss for a cash-generating unit ever be included as a liability only if another standard requires it and the liability will be measured according to the rules of that standard.

An example – impairment losses

- The carrying amount of one of Entity's J's Cash Generating Unit's is CY 1000 and the recoverable amount (higher of Fair value less costs to sell and Value In Use) is CY 900.
- The goodwill allocated to the Cash Generating Unit is CY 50. The other assets in the CGU comprise plant and machinery and technical knowhow with carrying amounts of CY 500 and CY 450, respectively.
- How should Entity J account for the impairment loss?

The total impairment loss for the CGU is CY 100. Entity J should first allocate the impairment loss against goodwill allocated to the impaired CGU for CY 50. The balance CY 50 loss should be allocated on a pro-rata basis between the plant and machinery based on their carrying amounts, at CY 26 and CY 24, respectively.

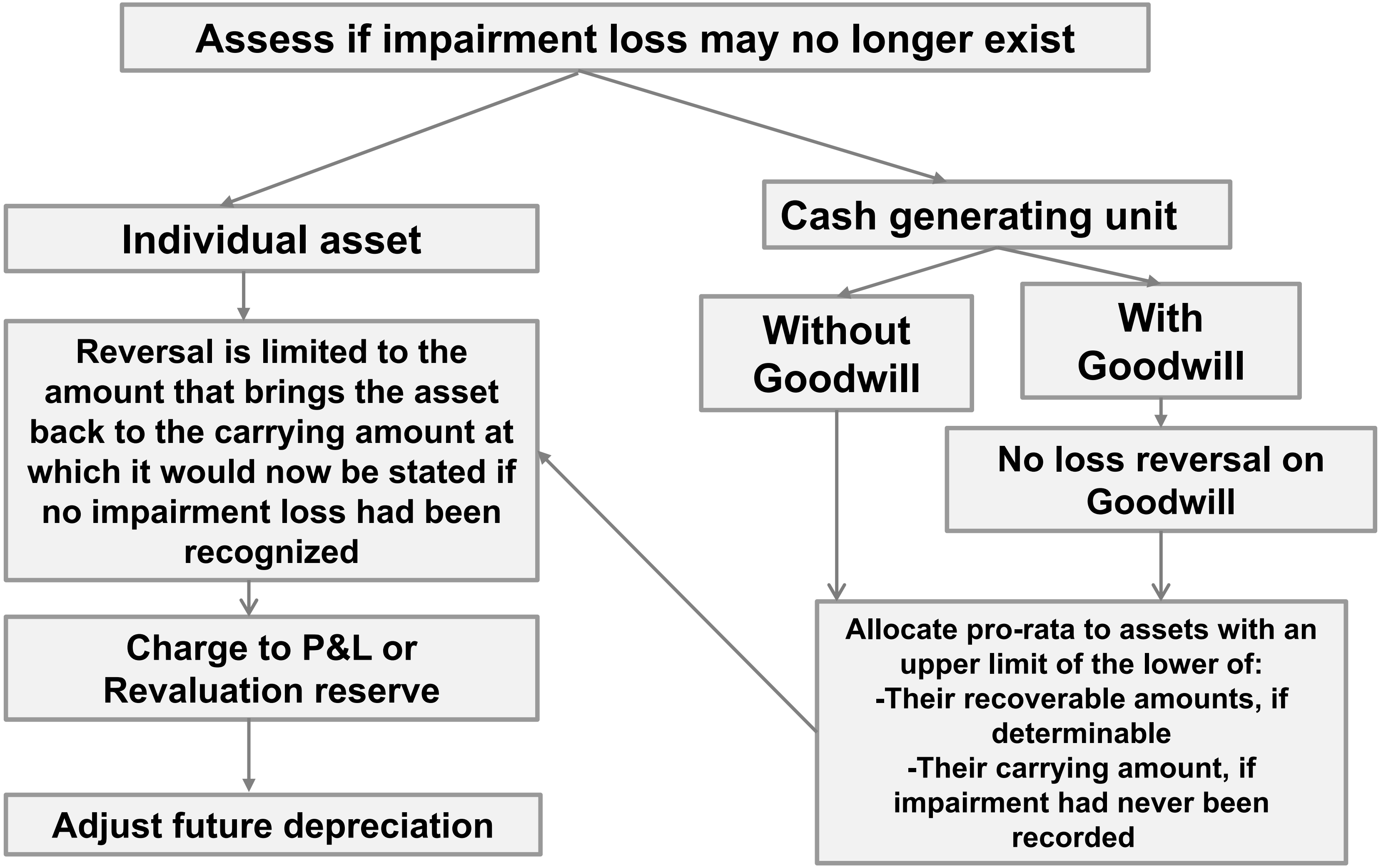
Accounting for impairment



RA = Recoverable amount CA = Carrying amount CGU = Cash generating unit

Impairment accounting —the basics of Ind AS36 *Impairment of Assets*

Reversal of impairment loss



An example – reversal of impairment loss

- In the previous year, Entity J had impaired one of its Cash Generating Unit's for a loss of CY 100, with CY 50 allocated to goodwill and the balance allocated to plant and machinery and technical knowhow for a loss of CY 26 and CY 24, respectively. Recoverable amount was not measurable.
- During the current year, the impairment test proves that the CGU is no longer impaired.
- How should Entity J account for the impairment loss of CY 100?

Particulars	P&M	Technical knowhow
Carrying amount at end of CY after impairment of CY 100 recorded in PY (a)	427	383
Carrying amount at end of CY if no impairment was recorded in PY (b)	450	405
(i) Reversal of impairment loss allocated based on (a)	(427/ 810)*100=53	(383/ 810)*100=47
(ii) Carrying amount based on reversal in (i)	427+53= 480	383+47= 430
(iii) **Reversal taken to profit or loss** (reversal shall be limited to not increasing the carrying amount above (b) **and not allowed for impairment loss for goodwill**)	450-427= 23	405-383= 22 Microsoft Excel Worksheet

Frequency of impairment

Frequency of Impairment

- Assets must be tested for impairment when indication of impairment exists

- However the following assets need impairment testing atleast annually:-
  - Cash Generating Units to which goodwill has been allocated
  - Intangible asset with an indefinite useful life
  - Intangible asset not yet available for use

Frequency of impairment

The most recent detailed calculation of recoverable amount made in an earlier period can continue to be used, provided **all** of the following conditions are met:

- If the intangible asset is part of a cash-generating unit, the cash-generating unit's assets and liabilities have not changed significantly since the previous calculation
- The earlier calculation resulted in an amount that exceeded the carrying amount by a substantial margin
- Analysis of intervening events shows that the likelihood of impairment is remote

- The impairment test may be performed at any time during an annual period, provided the test is performed at the same time every year.

Disclosures

Key disclosures

- By each class of asset
  - Amount of impairment losses recognized/ reversed during the period in the statement of profit or loss
  - Amount of impairment losses/ reversals on revalued assets recognised in other comprehensive income during the period
  - If recognized in profit or loss, disclosure of where items are included
  - Segment reporting information
  - Events or circumstances leading to impairment
  - Disclosures when impairment losses are material for an individual asset.

Key disclosures

- By each class of asset
  - Information on basis used for determining recoverable amount
  - Discount rate used
  - Estimates used to measure recoverable amounts of Cash Generating Unit containing goodwill/ Impairment Asset with indefinite useful life
  - Unallocated goodwill, if any, alongwith reasons.

Key differences

Key differences (cont.)

Issue	Ind AS 36	Indian GAAP
Annual Impairment test for goodwill and intangibles	The following are tested for impairment atleast annually:- ► Goodwill, ► Intangible asset not yet available for use and ► Indefinite life Intangible asset	Goodwill and Intangible assets are tested for impairment only when impairment indicators exist. The following are tested for impairment atleast annually:- ► Intangible asset not yet available for use and ► Intangibles amortized over a period exceeding 10 years

Key differences (cont.)

Issue	Ind AS 36	Indian GAAP
Reversal of impairment loss for Goodwill	Prohibition of reversal of recognized loss	Impairment loss reversed if:- ► caused by specific external event that is not expected to recur,& ► subsequent external events occur that reverse the effect of that event.

Thank You!