



LKAS 36 – Impairment of Assets

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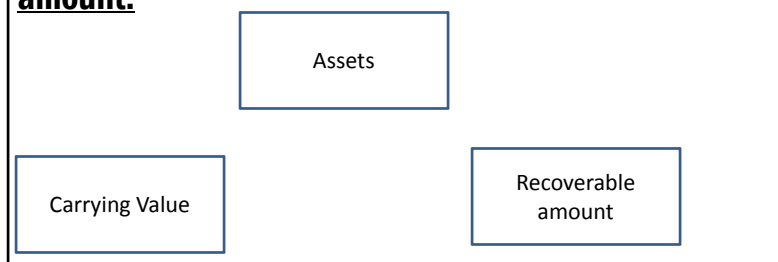
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Objective of the standard

Objective of the standard is to prescribe the procedures that an entity applies to ensure that its assets are carried at no more than their recoverable amount.



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Objective of the standard

Objective of the standard is to prescribe the procedures that an entity applies to ensure that its assets are carried at no more than their recoverable amount.

If



**then the Asset is impaired
Requires the entity to recognise the impairment loss**

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Scope

Applicable to all assets, other than the following:

- Inventories (LKAS 2)
- Assets arising from construction contracts (LKAS 11)
- Deferred tax assets (LKAS 12)
- Assets arising from employee benefits-LKAS 19
- FA covered within LKAS 39

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Scope - Contd...

- Investment property valued at FV- LKAS40
- Biological Assets related to agricultural activity measured at FV less cost to sell
- Deferred acquisition costs, and intangible assets ,arising from an insurer's contractual rights under insurance contracts within the scope of SLFRS 4
- Non-current assets classified as held for sale –SLFRS 5

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Identifying an asset that may be impaired

An entity shall assess at each reporting date(including interim date) whether there is any indication that asset may be impaired.

Aim at this stage is not to perform the impairment test, but to identify whether there are indications which warrant a impairment test.

If indicators exists management is required to perform the impairment test.

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Identifying an asset that may be impaired – Contd...

- However following shall be tested for impairment annually irrespective of existence of any impairment indicators

- Intangible assets with indefinite useful life

- Intangible asset not yet available for use

- Goodwill acquired in a business combination

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Identifying an asset that may be impaired – Contd... External indications of impairment

- Significant drop in market value of the asset

- Significant changes with an adverse effect on the entity ,in the technological , market , economic or legal environments in which entity operates.

- Increase in market interest rate or other rates of return on investments.

- CV of Net Assets > Market Capitalisation (i.e. Book value of a share > Mkt Value of it).

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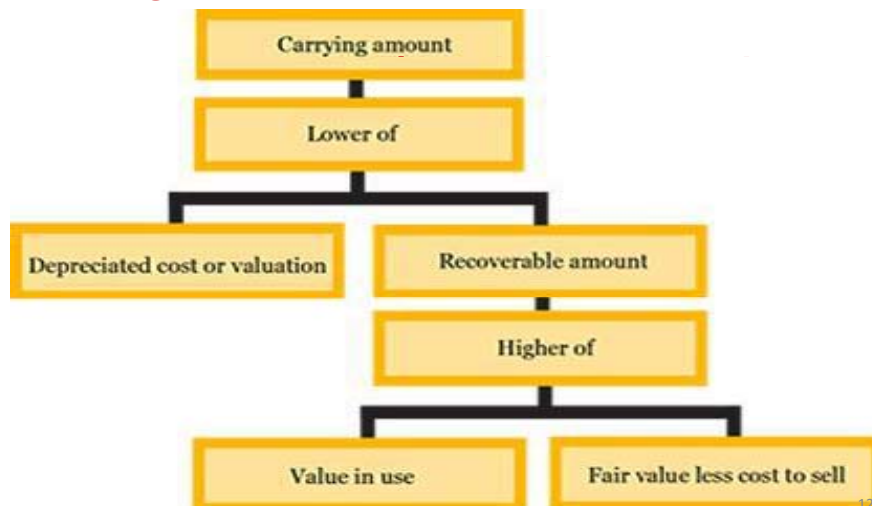
Identifying an asset that may be impaired – Contd...

Internal indications of impairment

- Evidence of obsolescence/physical damage
- Changes with adverse effect on the manner /extent of which asset is used/expected to use
(becoming idle, plans to discontinue/restructure, infinite to finite change)
- Adverse economic performance than expected

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Measuring recoverable amount

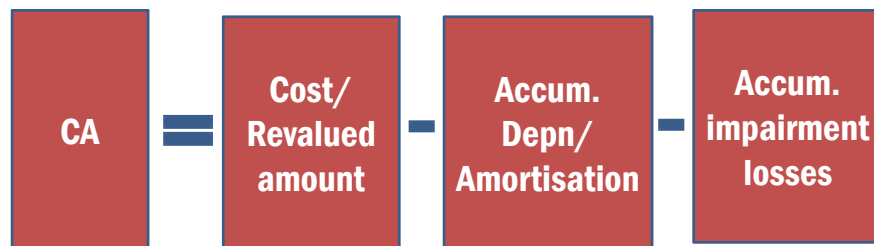


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Measuring recoverable amount

Definition of Carrying amount (CA)

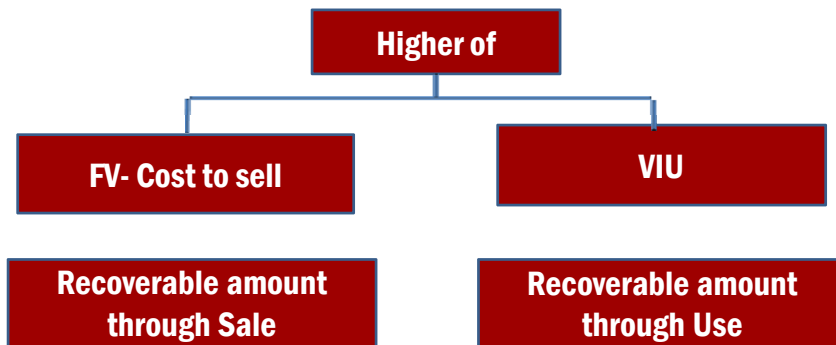
Carrying amount is the amount at which an asset is recognised after deducting any accumulated depreciation (amortisation) and accumulated impairment losses thereon.



Measuring recoverable amount - Contd...

Recoverable Amount

The recoverable amount of an asset or a cash-generating unit (CGU) is the higher of its fair value less costs to sell and its value in use.



Measuring recoverable amount – Contd...

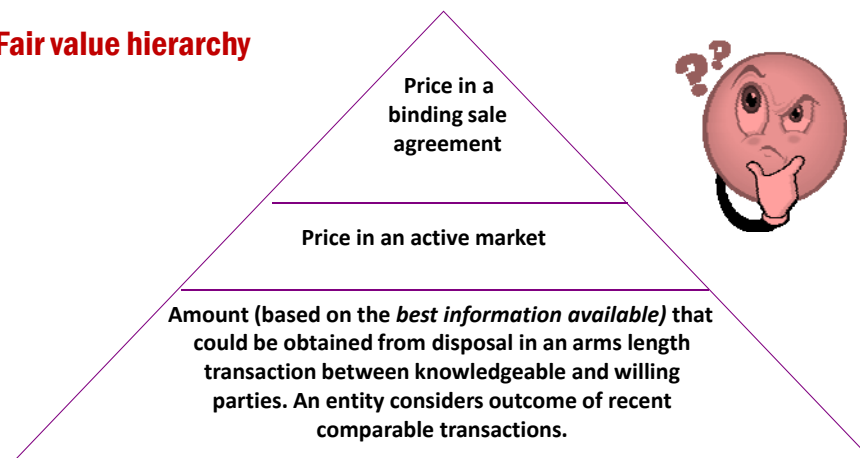
Fair value less costs to sell

- the amount obtainable
- from the sale of an asset or cash-generating unit
- in an arm's length transaction
- between knowledgeable, willing parties,
- less the costs of disposal.

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Measuring fair value less costs to sell

Fair value hierarchy



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Measuring recoverable amount – Contd...

Active Market

An active market is a market in which all the following conditions exist:

- (a) the items traded within the market are homogeneous;
- (b) willing buyers and sellers can normally be found at any time; and
- (c) prices are available to the public.

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Measuring recoverable amount – Contd...

Value in Use (VIU)

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

Steps to be followed in estimating VIU :

- Estimate future cash inflows and outflows from continuing use and disposal
- Applying the appropriate discount rate

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Measuring recoverable amount – Contd...

Basis for estimates of future cash flows (CF)

- Cash flow projections shall be made on reasonable and supportable assumptions
- Most recent budgets/forecasts approved by Management shall be used
- CF projections should exclude inflow/outflow expected on restructurings, improving or enhancing asset's performance

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Measuring recoverable amount – Contd...

Basis for estimates of future cash flows (CF) – Contd...

- CF projections may be limited to 5 years unless longer period is justifiable
- CF projections beyond 5 th year (longest justifiable period) – steady /declining growth shall be used(unless an increasing rate can be justified)

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Measuring recoverable amount – Contd...

Estimates of future cash flows shall include:

- Cash inflows from continuing use of the asset
- Outflows that are necessarily incurred to generate inflows from continuing use of the asset
- Net cash flows if any to be received /paid upon disposal at end of the useful life time

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Measuring recoverable amount – Contd...

Estimates of future cash flows Shall not include:

- CF related to restructuring –not yet committed
- CF for improving /enhancing asset's performance (CF shall be assessed in the asset's current condition)
- CF from financing activities
- Income tax receipts/payments

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Measuring recoverable amount – Contd...

Foreign currency future cash flows

- CFs are estimated in the currency in which they will be earned
- Use a discount rate appropriate for that currency
- Translate the PV using the spot rate at the date of calculation

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Measuring recoverable amount – Contd...

Discount rate

- Shall be a pre tax rate
- Must reflect the current market assessment of:
 - Time value of money
 - and
 - Risk specific to the asset for which future CF have not been adjusted

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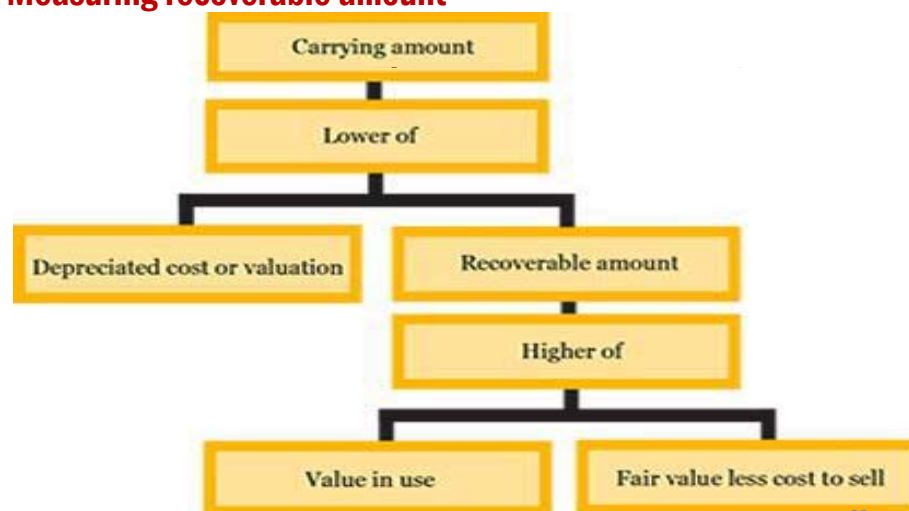
Measuring recoverable amount - Contd...

Discount rates - Contd...

- Market discount rates for similar assets should be used where these are available.
- In the absence of these the entity should consider the following as a starting point:
 - Its weighted average cost of capital.
 - Its incremental borrowing rate (this is the rate the bank would charge it for new borrowings).
 - Other market borrowing rates.

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Measuring recoverable amount



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Recognising and measuring impairment loss

- **Impairment loss is recognised immediately in P&L (unless the asset is carried at revalued amount)**
- **If carried at revalued amount, impairment loss is treated as reduction in revaluation gain.**

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Recognising and measuring impairment loss

- **If Impairment loss > CV, a liability shall be recognised only if it is required by another standard.**
- **Future depreciation charge need to adjust to reflect allocation of revised CV over remaining useful life time**

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Cash generating units (CGUs)

- An entity should first attempt to apply the impairment test to the individual asset.
- If it is not possible to estimate the recoverable amount of the individual asset, that shall be determined based on relevant CGU .
- RA of individual asset cannot be determined if:
 - VIU cannot be estimated to close to its FV-cost to sell
 - And
 - Asset does not generate cash flows largely independent from other assets

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Cash generating units (CGU) - Definition

The smallest group of assets that generates largely independent cash inflows.

This may be a single asset. Where the recoverable amount of an individual asset cannot be measured reliably that asset is grouped together with other assets (within the scope of IAS 36) at the lowest level that will allow recoverable amount to be calculated. This grouping is a CGU.

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Cash generating units - Contd...

Example

A mining entity owns a private railway to support its mining activities. The private railway could be sold for scrap value and does not generate cash inflows that are largely independent of the cash flows of the other assets of the mine.

Are we to perform the impairment test for railway alone or entire entity as a CGU?

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Cash generating units - Contd...

Example

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

Can you identify the CGU/CGUs to be considered?

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Cash generating units - Contd...

Example

A machine has suffered physical damage but is still working, although not as well as before it was damaged. The machine's fair value less costs to sell is less than its CA.

Machine does not generate independent cash inflows. The smallest identifiable group of assets that includes the machine and generates cash inflows that are largely independent of CF from other assets is the production line to which the machine belongs.

RA of the production line as a whole shows that it is not impaired.

Should we recognise an impairment loss ?

Assumption 1 – approved budgets/forecasts reflect no commitment to replace the machine

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Cash generating units - Contd...

Example

A machine has suffered physical damage but is still working, although not as well as before it was damaged. The machine's fair value less costs to sell is less than its CA. Machine does not generate independent cash inflows. The smallest identifiable group of assets that includes the machine and generates cash inflows that are largely independent of CF from other assets is the production line to which the machine belongs.

RA of the production line as a whole shows that it is not impaired.

Should we recognise an impairment loss ?

Assumption 2 – approved budgets/forecasts reflect s commitment to replace the machine & CF from use until disposal estimated to be negligible.

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Cash generating units (CGUs)

- **If there is an active market for the out put ,such group of assets is identified as a CGU even if entire output is currently used for internal use.**
- **If CGUs cash flows are affected by transfer pricing, adjustments are required.**
- **CGU shall be identified consistently from period to period(unless a change is justifiable).**

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Cash generating units (CGUs)

- **CA of a CGU shall be determined on a basis consistent with the recoverable amount is determined.**
- **Goodwill acquired in a business combination shall be allocated to acquirers benefited CGUs.**
- **CGUs to which goodwill is allocated shall be tested for impairment annually.**

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CGUs -Timing of Impairment testing

- **CGUs to which goodwill is allocated shall be tested for impairment annually.**
- **Test shall be performed at anytime during an annual period, provided the test is performed at the same time every year.**
- **Existence of Corporate assets impacts CA of CGUs**
- **Allocation of impairment loss to reduce the CA of CGU follows an order(GW first and then other assets on pro rata on the basis of CA)**

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Recoverable amount of an indefinite lived intangible assets

- Impairment test shall be performed annually
- Most recent detailed calculation made in preceding period may be used if all of the following are met:
 - Tested on CGU basis and assets and liabilities of such CGU have not significantly changed
 - Gap between CV and Recoverable value was substantial
And
 - Based on the subsequent events its remote that current recoverable value is less than the CV.

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Reversal of impairment loss

- An impairment loss recognised for an asset in prior years should be reversed if, and only if, there has been a change in the estimates used to determine the asset's recoverable amount
- In the rare circumstances when there has been a significant increase in the service potential or the market value of the asset, the impairment loss shall be reversed
- however, the carrying amount of the asset shall not exceed its original cost (before the impairment loss), net of depreciation up to the evaluation date .

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Reversal of impairment loss - Contd...

- **CGU - reversal of impairment loss shall be allocated among assets (except for GW) on pro rata basis on CV**
- **however, the carrying amount of the asset shall not exceed lower of;**
 - **Its recoverable amount (if determinable), and**
 - **it its original cost (before the impairment loss), net of depreciation up to the evaluation date.**

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Disclosure requirements

- **IAS 36 requires extensive disclosure of impairments by segment and, where material, by cash-generating unit.**
- **In addition there is extensive narrative disclosure required on the impairment testing process and in certain circumstances, disclosure of the key assumptions made in impairment tests and sensitivity analysis be disclosed.**

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Disclosure requirements - Contd...

Detailed disclosures for each class of assets impacted by impairments or their reversals.

Detailed disclosures for each reportable segment based on the entity's primary reporting format.

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Disclosure requirements – Contd...

- **Detailed disclosure for each material impairment loss recognised or reversed in the period for an individual asset (including goodwill) or a cash-generating unit**
- **Details of aggregate impairment losses and reversals where these are not individually material.**
- **If recoverable amount is based on value in use or fair value less costs to sell determined using discounted cash flows the discount rate(s) applied to the cash flow projections should be disclosed.**

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What would you ask management about this?

VIU calculation

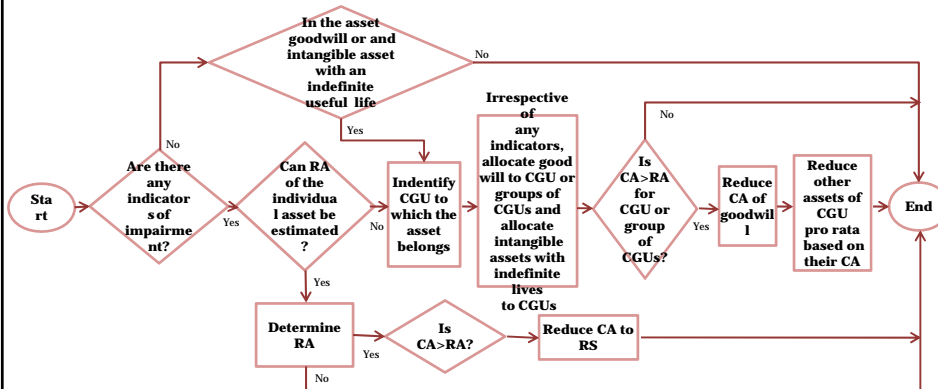
| £ million | Actual 2010 | Actual 2011 | Forecast 2012 | Forecast 2013 | Forecast 2014 | Forecast 2015 | Forecast 2016 |
|---|----------------|----------------|------------------|------------------|------------------|------------------|------------------|
| EBIT | 10.0 | (5.0) | (30.0) | 40.0 | 50.0 | 70.0 | 90.0 |
| Add depreciation | 8.0 | 12.0 | 10.0 | 15.0 | 15.0 | 14.0 | 14.0 |
| Less capital expenditure | (6.0) | (9.0) | (30.0) | (12.0) | (8.0) | (5.0) | (5.0) |
| Less working capital | 1.0 | (2.0) | (1.0) | 3.0 | 4.0 | 5.0 | 7.0 |
| Pre-tax cash flow | 13.0 | (4.0) | (51.0) | 46.0 | 61.0 | 84.0 | 106.0 |
| Less tax | (2.1) | 1.1 | 10.0 | (10.0) | (10.0) | (14.0) | (22.5) |
| Post tax cash flow | 10.9 | (2.9) | (41.0) | 36.0 | 51.0 | 70.0 | 83.5 |
| Discounted post tax cash flow | | | (37.3) | 29.8 | 38.3 | 47.8 | 51.8 |
| Discounted Terminal value (based on 2016) | | | | | | | 735.5 |
| Total present value | | | | | | | 866.0 |

Transitional Provisions and effective date

Operative for F/Ss covering periods beginning on or after 1 January 2012. Earlier application is encouraged, if early adopted it shall disclose that fact

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Illustrate the process to follow when determining an impairment under SLFRS



| Key | |
|-----|------------------------|
| RA | = Recoverable amount |
| CA | = Carrying amount |
| CGU | = Cash-generating unit |

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Thank you.