LKAS 36
Impairment of Assets

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What regulators are saying?

"Failure to recognize impairment losses at the end of each reporting period when objective evidence exist, that a financial asset or group of financial assets is impaired – in 48 SBEs including 5 in SME sector. (Reference; LKAS 39 paragraph 58, **LKAS 36 paragraph 9** and SME Section 11 paragraph 11.21)"

(SLAASMB 2016)

Scope

Within the Scope

Outside the Scope

Timing of Impairment Testing

Goodwill
Intangible Assets - Indefinite Useful Life
Intangible Assets - Not yet available for use

Annually

Other Assets within the scope of LKAS 36

If indicators are present

Impairment Indicators

Internal Indicators

- Evidence of obsolesce or physical damage.
- Changes with adverse effect on the manner /extent of which asset is used/expected to be used.
- Adverse economic performance than expected.

Impairment Indicators (Contd..)

For an investment in a subsidiary, joint venture or associate, the investor recognises a dividend from the investment and evidence is available that:

(i) the carrying amount of the investment in the separate financial statements exceeds the carrying amounts in the consolidated financial statements of the investee's net assets, including associated goodwill; or

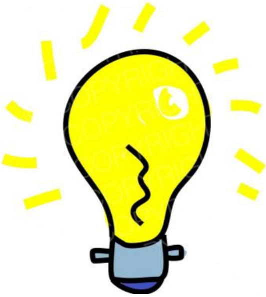
(ii) the dividend exceeds the total comprehensive income of the subsidiary, joint venture or associate in the period the dividend is declared.

Impairment Indicators (Contd..)

External Indicators

- Significant drop in the market value of the asset.
- Significant changes with 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 value of the investment.

Impairment Indicators (Contd..)



Assess whether **events after their reporting date provide any indication** that CGUs (assets) may have been impaired as at the reporting date.

Discussion Point 01

Impairment indicators – Investment property

Discussion Point 02

Impairment Indicators -Internally developed Software

Discussion Point 03

Impairment Indicators – Investment in subsidiary

Impairment Testing

Determining the Carrying Value

Cost/Revalued Amount − ACC Dep. − ACC Imp.

Impairment Testing

Determining the recoverable amount

Recoverable Amount

Value in Use

Higher

Fair Value –costs of disposal

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Impairment

If;

Carrying Value > Recoverable Amount

Impairment

Sri Lankan Examples

XYZ PLC had not recognized the loss on impairment of its factory buildings and plant and machinery to reflect its carrying value at recoverable amounts in the financial statements for the year ended 31 December 2011. The auditors had qualified their opinion on this issue.

Subsequent to the inquiries made by SLAASMB, the entity undertook to recognize the loss on impairment of the buildings and plant and machinery in the financial statements for the year ended 31 December 2012. This resulted in a decrease in the net assets of the entity by Rs.186 million.

Sri Lankan Examples (Contd..)

ABC PLC had not recognised the loss on impairment of the carrying value of investment in its fully-owned subsidiary and had not reduced the carrying value of related party receivables to reflect its recoverable amount in the financial statements for the year ended 31 March 2012. The Auditors had qualified their opinion on this issue.

Subsequent to the inquiries made by SLAASMB, the entity undertook to recognise the loss on impairment of the investment in the subsidiary and to make allowances for doubtful debts from the subsidiary in the financial statements for the year ended 31 March 2013. This resulted in a decrease in the net assets of the entity by Rs. 1.2 Billion.

Accounting for Impairment Losses

- Impairment loss is recognized immediately in P&L (Unless the asset is carried at revalued amount)

- If carried at revalued amount, impairment loss is treated as a reduction of revaluation gain.

Question 01

ABC Company acquired its head office on 01 Jan 2013 at a cost of Rs.5Million (excluding land). The Company's policy is to depreciate property on straight-line basis over 50 years with a residual value of zero.

On 31 December 2015, the Company revalued the non land element of its head office to Rs. 8Million.

In January 2017, localized flooding occurred and the recoverable amount of the non-land element of the head office property fell to Rs. 2.9Million.

Required;

- What impairment charge should be recognised in the profit or loss of ABC Company. arising from the impairment review in January 20X7 according to LKAS 36 Impairment of assets?
- If the Company has not applied the Revaluation model, what was the impairment charge?

Cash Generating Units

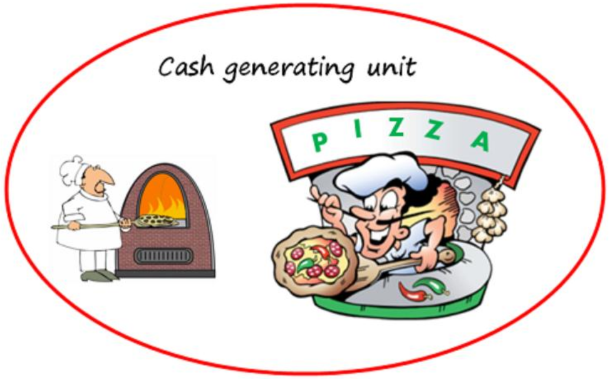
An entity should first attempt to apply the impairment test for individual assets.

If not possible;

That shall be determined based on relevant CGU.

CGUs (Contd..)

Smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.



Identification of CGUs

When identifying CGUs, management may consider:

- How the entity's operations are managed eg by product line, business or llocation.

- How decisions are made about continuing or disposing of the entity's operations and assets.

A group of assets is identified as a CGU when an active market exists for the output produced by the group; this is the case even where some of the output is used internally.

Identification of CGUs (Contd..)

Question 01

Store X belongs to a retail store chain M. X makes all its retail purchases through M's purchasing center. Pricing, marketing, advertising and human resources policies (except for hiring X's cashiers and sales staff) are decided by M.M also owns five other stores in the same city as X (although in different neighborhoods) and 20 other stores in other cities. All stores are managed in the same way as X. X and four other stores were purchased five years ago and goodwill was recognised.

What is the cash-generating unit for X (X's cash-generating unit)?

Identification of CGUs (Contd..)

Question 02

Lanka Bus Company provides services under contract with a municipality that requires a minimum service on each of five routes. Assets devoted to each bus route and cash flows arising from each route can be identified separately; one of the routes operates at a significant loss.

The management of the Lanka Bus Company has designated each of the five routes as a separate CGU for the purposes of impairment testing.

Is this correct?

Accounting for Impairment

Discussion Point 04

At the end of 20X0, entity T acquires entity M for CU10,000. M has manufacturing plants in three countries.

Schedule 1. Data at the end of 20X0

End of 20X0	*Allocation of purchase price*	*Fair value of identifiable assets*	*Goodwill*[a]
	CU	CU	CU
Activities in Country A	3,000	2,000	1,000
Activities in Country B	2,000	1,500	500
Activities in Country C	5,000	3,500	1,500
Total	10,000	7,000	3,000

Accounting for Impairment (Contd..)

Discussion point 04 (Contd..)

- Allocation of Goodwill
- Frequency of the impairment testing

Accounting for Impairment (Contd..)

At the beginning of 20X2, a new government is elected in Country A. It passes legislation significantly restricting exports of T's main product. As a result, and for the foreseeable future, T's production in Country A will be cut by 40 per cent.

The significant export restriction and the resulting production decrease require T also to estimate the recoverable amount of the Country A operations at the beginning of 20X2.

T uses straight-line depreciation over a 12-year life for the Country A identifiable assets and anticipates no residual value.

The recoverable amount of the Country A cash-generating unit is CU1,360.

Accounting for Impairment (Contd..)

Discussion Point 05 - Allocation of Impairment losses

Beginning of 20X2	*Goodwill*	*Identifiable assets*	*Total*
	CU	**CU**	**CU**
Historical cost	1,000	2,000	3,000
Accumulated depreciation (20X1)	–	(167)	(167)
Carrying amount	1,000	1,833	2,833
Impairment loss	(1,000)	(473)	(1,473)
Carrying amount after impairment loss	–	1,360	1,360

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Accounting for Impairment

Question 03

P acquired an 80% interest in a subsidiary for Rs. 16 million in 20X5 when the identifiable net assets of the subsidiary amounted to Rs. 18 million. The non controlling interest is measured as a proportion of net assets and the subsidiary isa CGU.

At 31 December 20X5, P’s year end, the recoverable amount of the subsidiary is Rs. 19.1 Mn and the carrying amount of its identifiable net assets is Rs. 18.4 million.

Calculate the impairment loss at 31 December 20X5.

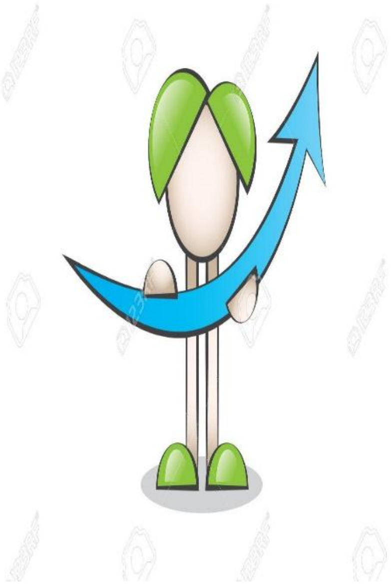
Accounting for Impairment (Contd..)

Where there is a **non-controlling interest** in a CGU to which goodwill is allocated, and the non-controlling interest is measured as a proportion of the net assets of the acquiree, adjustment is required to the carrying amount of goodwill before the impairment test is carried out.

Reversal of Impairment Losses

Goodwill Impairment – No reversal

Other Assets – Shall not exceed the CV that would have been determined had no impairment loss have been recognized for the asset in the prior years



Accounting for Reversal of Impairment Losses

Revalued Assets – As per the revaluation accounting

Other Assets – Recognized in the P&L

Accounting for Reversal of Impairment Losses (Contd..)

- A holds a property and accounts for it under cost model.
- The cost of the property is CU10 million and its useful life is 20 years. Depreciation each year is, therefore, CU0.5 million.
- At the end of Year 5, the property has a carrying amount of CU7.5 million. Due to changes in the economic environment, the directors perform a detailed impairment review and determine that the property’s recoverable amount is its value in use, which is CU5 million. Their estimate of the remaining useful life of the asset is 10 years.

Accounting for Reversal of Impairment Losses (Contd..)

- Therefore an impairment loss of CU2.5 million is recognised in Year 5. In Years 6 and 7, the property
- is depreciated by CU0.5 million per year so that its carrying amount at the end of Year 7 is CU4 million.
- Due to shortages in the supply of properties, the directors determine that the fair value less costs of disposal of the property at the end of Year 7 is CU8 million. The recoverable amount of the asset has therefore increased to CU8 million.

How to account for this?

Accounting for Reversal of Impairment Losses (Contd..)

Discussion point 06

- Accounting for impairment losses under revaluation model

Value in Use

VIU is the present value of the future cash flows expected to be derived from an asset or CGU.

VIU (Contd..)

Estimate the future cash inflows and outflows from continuing use and disposal.

Applying the appropriate discount rate.

Cash flow projections shall be made on reasonable and supportable assumptions.

Avoid Double Counting – Financial assets, provisions

VIU (Contd..)

How to deal with;

- Possible variations in amount and timing of the cash flows?
- Price for bearing the uncertainty inherent in the asset?
- Other Factors – Illiquidity, inflation

VIU (Contd..)

Estimation of the Cash flows

Most recent budgets/forecasts approved by the management shall be used.

CFs projections should exclude inflow/outflow expected on restructuring, improving or enhancing the asset’s performance.

VIU (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)

VIU (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

VIU (Contd..)

Foreign currency future cash flows

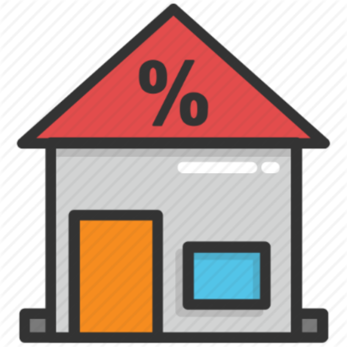
CFs are estimated in the currency in which they will be earned

Use a discount rate appropriate for that currency

Translate the PV using the spot rate at the date of calculation

VIU (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

VIU (Contd..)

Market discount rates for similar assets should be used where those 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.

Fair Value – Costs of Disposal

Fair Value → SLFRS 13

Costs of Disposal

Legal Costs	Y
Stamp Duty	Y
Costs to remove the asset	Y
Costs to bring the asset in to the salable condition	Y
Termination benefits paid to the employees	N
Costs to reorganize the business	N

Discussion Point 04

Assets + Liabilities

Disclosures

- Assets subjected/not subjected to the annual impairment testing
- Key Assumptions and Judgements
- CGUs

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Thank you