LKAS 36
Impairment of Assets

Chathumin Gunarathne
Manager - Technical

Scope of the Standard

Excludes following items;

Inventories	LKAS 2
Construction contract assets	LKAS 11
Deferred tax assets	LKAS 12
Financial assets in LKAS 39	LKAS 39
Employee benefit assets	LKAS 19
Investment property at fair value	LKAS 40
Biological assets at fair value less costs to sell	LKAS 41
Insurance contracts: deferred acquisition costs and intangible assets	SLFRS 4
Non-current assets held for sale	SLFRS 5

Objective

Prescribe the procedures that an entity applies to ensure that its assets are carried at not more than their recoverable amount.

Carrying Value ⟷ Recoverable Amount

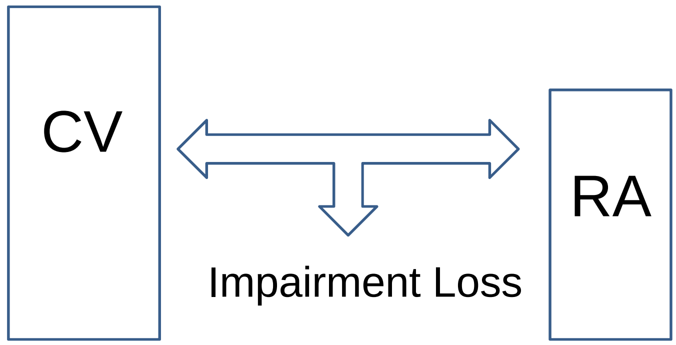
Carrying Value (CV)

The amount at which an asset is recognized after deducting any accumulated depreciation(amortization) and accumulated impairment losses thereon.

Recoverable Amount (RA)

Higher of fair value less costs of disposal (FVLCOD) and value in use (VIU) of an asset or a cash generating unit (CGU).

Impairment Loss



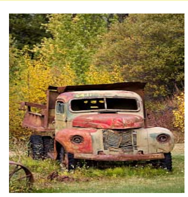
Identifying an asset that may be impaired

Frequency of Testing

Goodwill, Indefinite-lived intangible, Intangible not yet ready

Mandatory annual testing
+
If indicator of impairment

Other Assets



If indicator of impairment

Indicators of impairment

- Observable indication of significant decline in asset value
- Technological, market, legal environment
- Market cap < Book values
- Increased interest rates

External sources

- Change in use of asset
- Obsolescence or physical damage
- Planned disposal / restructuring
- Performance of assets declining

Internal sources

Measuring Recoverable Amount

Individual asset whenever possible

↓ If does not generate cash flows independent from other assets or group of assets.

Determine for the cash-generating unit

Cash Generating Unit

- Smallest identifiable group of assets with largely independent cash INFLOWS
- Consider how management monitors operations / decisions are made
- CGU should remain consistent each period unless change is justified
- If active market for the output of an asset group, then must be a separate CGU

Question 01

Store X belongs to a retail store chain M. X makes all its retail purchases through M's purchasing centre. 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 neighbourhoods) 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)?

Question 02

A significant raw material used for plant Y's final production is an intermediate product bought from plant X of the same entity. X's products are sold to Y at a transfer price that passes all margins to X. Eighty per cent of Y's final production is sold to customers outside of the entity. Sixty per cent of X's final production is sold to Y and the remaining 40 per cent is sold to customers outside of the entity.

For each of the following cases, what are the cash-generating units for X and Y?

Case 1: X could sell the products it sells to Y in an active market. Internal transfer prices are higher than market prices.

Case 2: There is no active market for the products X sells to Y.

Question 03

At the end of 2016, an enterprise purchased a computer for 100 for general use in its operations. The computer is depreciated over 4 years on a straight-line basis. Residual value is estimated to be nil. At the end of 20X2, the carrying amount of the computer is 50. There is an active market for second-hand computers of this type. The market value of the computer is 30.The enterprise does not intend to replace the computer before the end of its useful life.

Whether the computer has impaired ?

Fair Value Less cost of Disposal

- Fair Value (Based on SLFRS 13)

- Cost of Disposal
  - Direct incremental costs bringing an asset into condition for its sale
  - Legal costs and stamp duty
  - Cost of removing the asset
  - Not include termination benefits (LKAS 19) , cost on reducing and reorganization the business

Value in Use

Following elements shall be reflected;

(a) An estimate of the future cash flows of the entity expects to derive from the asset

(b) Expectations about possible variations in the amount of timing of those future cash flows

(c) The time value of money, represented by the current market risk free rate of interest

(d) The price of bearing the uncertainty inherent in the asset

(e) Other factors – illiquidity

Value in Use (Contd…)

Steps

- Estimate the future cash inflows and outflows
- Applying the appropriate discount rate

Estimate the Future Cash Flows

- **Reasonable and supportable assumptions – specific to CGU**
- **Represent management's best estimate over the remaining useful life of the asset**
- **Base on most recent financial budgets/ forecasts**
- **Exclude future restructuring, improvements or enhancement of the asset**
- **Greater weight to external evidence**
- **Projections and Extrapolations**

Estimate the Future Cash Flows (Contd…)

- Not include
  - Cash inflows or outflows from financing activities
  - Income tax receipts and payments

- Foreign Currency Future Cash flows
  - Estimate in the currency which the cash flows generates
  - Use discount rate appropriate to the currency
  - Translate the present value using the spot rate at the date of valuation

Discount Rate

- Pre – tax rates that reflects
  - the time value of money
  - the risks specific to the asset for which the future cash flow estimates have not been adjusted

- Use Assets specific rate, if not available use Surrogates to estimate the rate

Recognizing and Measuring Impairment Loss

- Individual Assets other than goodwill;

  - Reduce the carrying amount of the asset in to the recoverable amount

  - Recognize the loss

    Immediately in profit or loss or

    Revalued Assets – Consider as revaluation decrease

Recognizing and Measuring Impairment Loss (Contd…)

- Cash generating units;

  -First to reduce the carrying amount of any goodwill allocated

  - Then to other asset on pro –rata basis of the carrying amount of the asset

Reversal of impairment loss: Individual Assets

- Assess if impairment loss may no longer exist
- Reverse to extent of increase in recoverable amount (not > carrying amount in the absence of impairment loss)
- Charge to profit or loss, or other comprehensive income as applicable
- Adjust future depreciation

Reversal of impairment loss: CGU

Step-by-step approach	
Assess if impairment loss may no longer exist	
Cash-generating unit	
Without goodwill	With goodwill: no reversal on goodwill
Allocate pro- rata against the carrying amount of other assets	
Follow procedures as for an individual asset	

Question 04

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

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

(a) Activities in each country represent the lowest level at which the goodwill is monitored for internal management purposes (determined as the difference between the purchase price of the activities in each country, as specified in the purchase agreement, and the fair value of the identifiable assets).

Question 04 (Contd…)

Because goodwill has been allocated to the activities in each country, each of those activities must be tested for impairment annually or more frequently if there is any indication that it may be impaired (see paragraph 90 of IAS 36).

The recoverable amounts (ie higher of value in use and fair value less costs of disposal) of the cash-generating units are determined on the basis of value in use calculations. At the end of 20X0 and 20X1, the value in use of each cash-generating unit exceeds its carrying amount. Therefore the activities in each country and the goodwill allocated to those activities are regarded as not impaired.

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.

Question 04 (Contd…)

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.

Question 04 (Contd…)

Year	*Long-term growth rates*	*Future cash flows*	*Present value factor at 15% discount rate*[a]	*Discounted future cash flows*
		CU		CU
20X2 (n=1)		230[b]	0.86957	200
20X3		253[b]	0.75614	191
20X4		273[b]	0.65752	180
20X5		290[b]	0.57175	166
20X6		304[b]	0.49718	151
20X7	3%	313[c]	0.43233	135
20X8	(2%)	307[c]	0.37594	115
20X9	(6%)	289[c]	0.32690	94
20Y0	(15%)	245[c]	0.28426	70
20Y1	(25%)	184[c]	0.24719	45
20Y2	(67%)	61[c]	0.21494	13
Value in use				1,360

(a) The present value factor is calculated as $k = 1/(1+a)^n$, where a = discount rate and n = period of discount.
(b) Based on management's best estimate of net cash flow projections (after the 40% cut).
(c) Based on an extrapolation from preceding year cash flow using declining growth rates.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

Question 04 (Contd…)

Schedule 3. Calculation and allocation of the impairment loss for the Country A cash-generating unit at the beginning of 20X2

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

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

Question 04 (Contd…)

In 20X3, the government is still in office in Country A, but the business situation is improving. The effects of the export laws on T's production are proving to be less drastic than initially expected by management. As a result, management estimates that production will increase by 30 per cent. This favourable change requires T to re-estimate the recoverable amount of the net assets of the Country A operations (see paragraphs 110 and 111 of IAS 36). The cash-generating unit for the net assets of the Country A operations is still the Country A operations.

Calculations similar to those in Example 2 show that the recoverable amount of the Country A cash-generating unit is now CU1,910.

Question 04 (Contd…)

Schedule 1. Calculation of the carrying amount of the Country A cash-generating unit at the end of 20X3

	Goodwill	Identifiable assets	Total
	CU	CU	CU
Beginning of 20X2 (Example 2)			
Historical cost	1,000	2,000	3,000
Accumulated depreciation	–	(167)	(167)
Impairment loss	(1,000)	(473)	(1,473)
Carrying amount after impairment loss	–	1,360	1,360
End of 20X3			
Additional depreciation (2 years)[(a)]	–	(247)	(247)
Carrying amount	–	1,113	1,113
Recoverable amount			1,910
Excess of recoverable amount over carrying amount			797

(a) After recognition of the impairment loss at the beginning of 20X2, T revised the depreciation charge for the Country A identifiable assets (from CU166.7 per year to CU123.6 per year), based on the revised carrying amount and remaining useful life (11 years).

Question 04 (Contd…)

In accordance with paragraph 124 of IAS 36, the impairment loss on goodwill is not reversed.

Schedule 2. Determination of the depreciated historical cost of the Country A identifiable assets at the end of 20X3

End of 20X3	*Identifiable assets*
	CU
Historical cost	2,000
Accumulated depreciation *(166.7 × 3 years)*	(500)
Depreciated historical cost	1,500
Carrying amount (Schedule 1)	1,113
Difference	387

Question 04 (Contd…)

Schedule 3. Carrying amount of the Country A assets at the end of 20X3

End of 20X3	*Goodwill*	*Identifiable assets*	*Total*
	CU	**CU**	**CU**
Gross carrying amount	1,000	2,000	3,000
Accumulated amortisation	–	(414)	(414)
Accumulated impairment loss	(1,000)	(473)	(1,473)
Carrying amount	–	1,113	1,113
Reversal of impairment loss	0	387	387
Carrying amount after reversal of impairment loss	–	1,500	1,500

Disclosures

- Individual asset vs CGU
- Key assumptions
- Impairment losses and reversals