# IMPAIRMENT OF ASSETS (IAS 36)

**OBJECTIVE**

The objective of this IAS is to set rules to ensure that the assets of an enterprise are carried at no more than their recoverable amount.

**SCOPE**

It applies to all assets except: -

a) Inventories (IAS-2)
b) Construction contracts (IAS-11)
c) Deferred tax assets (IAS-12)
d) Assets arising from employee benefits (IAS-19)
e) Financial assets (IAS-32&39)
f) Investment property measured at fair value (IAS-40)
g) Non-current assets classified as held for sale (IFRS-5)
h) Biological assets (IAS-41)

**DEFINITIONS**

**Recoverable amount** is the higher of an asset's net selling price and its value in use.

**Value in use** is the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life.

**Net selling price** the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal

**Costs of disposal** are incremental costs directly attributable to the disposal of an asset, excluding finance costs and income tax expense.

**An impairment loss** is the amount by which the carrying amount of an asset exceeds its recoverable amount

**A cash-generating unit** is the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets.

**Corporate assets** are assets other than goodwill that contribute to the future cash flows of both the cash-generating unit under review and other cash-generating units.

**Identify that an asset is impaired**

An enterprise should assess at the end of each reporting period whether there is an indication that an asset may be impaired. If such indication exists the entity should estimate the recoverable amount. Irrespective of any indication of impairment, an entity shall also: -

a) Test in case of intangible assets having indefinite life or under development. The intangible asset under development or recognized during the year must be tested annually before it becomes available for use.
b) Test goodwill acquired in business combination for impairment annually

In assessing whether there is impairment in the asset, the entity at minimum considers the following indications.

**External sources of information**

a) Asset's market value has declined significantly more than expected;
b) Significant changes with an adverse effect in the technological, market, economic or legal environment in which the enterprise operates;
c) 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; and

d) The carrying amount of the net assets of the entity is more than its market value.

**Internal sources of information**

a) Obsolescence or physical damage

b) Significant changes with an adverse effect in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include plans to discontinue or restructure the operation to which an asset belongs.

c) Economic performance of an asset is worse than expected.

Other evidence from internal reporting may be: -

1) Cash flows for acquiring and maintaining the asset are significantly higher than the originally budgeted;
2) A significant decline in budgeted net cash flows or operating profit, or a significant increase in budgeted loss, flowing from the asset;
3) Actual cash flows are worst that the budgeted; and
4) Operating losses or net cash outflows when current period amounts are aggregated with the budgeted amounts for the future

**Measuring recoverable amount**

a) 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.

b) If it is not possible to determine selling price then value in use should be taken as recoverable value.

c) 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 net selling price.

d) 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 cash generating unit and impairment loss is calculated of this cash-generating unit.

**Measurement of net selling price**

(a) Price in Binding Sale Agreement less Disposal Cost.

(b) Cost of disposal includes legal costs, stamp duty and similar transaction taxes, costs of removing the asset, and direct incremental costs to bring an asset into condition for its sale.

**Measurement of Value in Use**

Estimating the value in use of an asset involves the following steps:

a) Estimating the future cash inflows and outflows to be derived from continuing use of the asset and from its ultimate disposal; and

b) Applying the appropriate discount rate to these future cash flows.

**Basis for the estimates of future cash flows**

1) Estimates of future cash flows should include:
   (a) Projections of cash inflows from the continuing use of the asset;
   (b) Projections of cash outflows that are necessarily incurred to generate the cash inflows from continuing use of the asset.
   (c) Net cash flows, if any to be received (or paid) for the disposal of the asset at the end of its useful life.

2) To avoid double counting. Estimates of future cash flows do not include:
   (a) Financial assets such as receivables;

(b) Payables, pensions or provisions.

3) Estimates of future cash flows should not include:
   (a) Cash inflows or outflows from financing activities; or
   (b) Income tax receipts or payments.

**Discount Rate**

1) The discount rate should be a pre-tax rate
2) The enterprise may take into account the following rates:
   (a) The enterprise's weighted average cost of the capital
   (b) The enterprise's incremental borrowing rate; and
   (c) Other market borrowing rates.

**Recognition and measurement of impairment loss**

a) If the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount. That reduction is an impairment loss.
b) An impairment loss should be recognized as an expense in the income statement immediately if the asset is carried under cost model. If the asset is carried at revalued amount under another International Accounting Standard, any impairment loss of a revalued asset should be treated as a revaluation decrease. 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 revaluation surplus for that **same** asset.
c) After the recognition of an impairment loss, the depreciation (amortization) charge for the asset should be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

**CASH GENERATING UNIT**

Identification of the Cash-Generating Unit to Which an Asset Belongs

1) If there is any indication that an asset may be impaired, recoverable amount should be estimated for the individual asset. If it is not possible to estimate the recoverable amount of the individual asset, an enterprise should determine the recoverable amount of the cash-generating unit to which the asset belongs.
2) The recoverable amount of an individual asset cannot be determined if:
   (a) The asset's value in use cannot be estimated to be close to its net selling price (for example, when the future cash flows from continuing use of the assets cannot be estimated to be negligible); and
   (b) The asset does not generate cash inflows from use that are independent of those from other asset. In such cases, value in use and, therefore recoverable amount, can be determined only for the asset's cash-generating unit.

   **Example**

   A mining enterprise owns private railways to support its mining activities. The private railways could be sold only for scrap value and the private railway does not generate cash inflows from continuing use that are largely independent of the cash inflows from the other assets of the mine.

   It is not possible to estimate the recoverable amount of the private railway because the value in use of the private railways cannot be determined and it is probably different from scrap value. Therefore, the enterprise estimates the recoverable amount of the cash-generating unit to which the private railway belongs, that is, the mine as a whole.

3) An asset's cash generating unit is the smallest group of assets that includes the asset and that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets.

**Example**

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.

Because the enterprise does not have the option to curtain 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.

4) If an for an asset or group of assets there exists an active market then the asset or group of assets should be identified as a cash generating unit even if the out is consumed internally.

5) Cash generating unit should be identified consistently from period to period for the same asset unless a change is justified.

**Recoverable amount and carrying amount of cash generating unit**

The recoverable amount of a cash-generating unit is the higher of the cash-generating unit's net selling price and value in use.

**Carrying value of cash generating unit**

The carrying amount of a cash-generating unit includes the carrying amount of only those assets that can be attributed directly, or allocated on a reasonable and consistent basis, to the cash-generating unit and that will generate the future cash inflows estimated in determining the cash-generating unit's value in use.

**Allocation of the following to cash generating units**

**A Goodwill**

1. Goodwill does not generate cash flows independently from other assets or groups of asset and, therefore, the recoverable amount of goodwill as an individual asset cannot be determined. If there is an indication that goodwill may be impaired, recoverable amount is determined for the cash-generating unit to which goodwill belongs.
2. For the purpose of impairment testing, goodwill acquired in a business combination shall, from the acquisition date, be allocated to each of the acquirer's cash-generating units that are expected to benefit the combination. Each unit or group of units to which the goodwill is so allocated shall:
   (a) Represent the lowest level within the entity at which the goodwill is monitored for internal management purposes; and
   (b) Not be larger than an operating segment in accordance with IFRS 8.

**B Corporate asset**

1) Corporate assets e.g. building of a headquarters or a division of the enterprise, EDP equipment or a research center. Key characteristics of corporate asset are that they do not generate cash inflows independently from other assets or groups of assets their carrying amount cannot be fully attributed to the cash-generating unit under review.

2) In testing a cash-generating unit for impairment, an enterprise should identify all the corporate assets that relate to the cash-generating unit under review. For each identified corporate asset, an enterprise should apply following tests.
   (a) If the carrying amount of the corporate asset can be allocated on a reasonable and consistent basis to the cash-generating unit under review and shall compare the carrying amount of the unit including portion of corporate asset with its recoverable amount
   (b) If the carrying amount of the corporate asset cannot be allocated on a reasonable and consistent basis an entity shall: -
      - Compare the carrying amount of the unit excluding corporate assets with its recoverable amount and recognize any impairment loss;
      - Identify the smallest group of cash generating units that includes the cash generating unit under review and to which a portion of the carrying amount of the corporate asset can be allocated on a reasonable basis; and
      - Compare the carrying amount of that group of cash generating units with the recoverable amount and recognize any impairment loss.

**Recognition of Impairment Loss of Cash-Generating Unit**

1) An impairment loss should be recognized for a cash-generating unit if, and only if, its recoverable amount is less than its carrying amount. The impairment loss should be allocated to reduce the carrying amount of the assets of the unit in the following order:
   (a) First, to goodwill allocated to the cash-generating unit (if any); and
   (b) Then, to the other assets of the unit on a pro-rata basis based on the carrying amount of each asset in the unit.

   These reductions in carrying amounts should be treated as impairment losses on individual assets.
2) In allocating in 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-rate basis.

**Reversal of impairment loss**

1) An enterprise should assess at each balance sheet date whether there is any indication that an impairment loss recognized for an asset in prior years may no longer exist or may have decreased. If any such indication exists, the enterprise should estimate the recoverable amount of that asset.

**Reversal of an Impairment Loss for an Individual Asset**

1) The increased carrying amount of an asset due to a reversal on impairment loss should not exceed the carrying amount that would have determined (net of amortization or depreciation) had no impairment loss been recognized for the asset in prior years.
2) A reversal of an impairment loss been recognized as income immediately in the income statement, unless the asset is carried at revalued amount under another International Accounting Standard. Any reversal of an impairment loss on a revalued asset should be treated as a revaluation increase under that other International Accounting Standard.

3) A reversal of an impairment loss on a revalued asset is credited directly to equity under the heading revaluation surplus. However, to the extent that an impairment loss on the same revalued asset was previously recognized as an expense in the income statement, a reversal of that impairment loss is recognized, as income in the income statement.

3) After a reversal of an impairment loss is recognized, the depreciation (amortization) charge for the asset should be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

**Reversal of an Impairment Loss for a Cash-Generating Unit**

1) A reversal of an impairment loss for a cash-generating unit should be allocated to increase the carrying amount of the asset of the unit in the following order:
   (a) First, asset other than goodwill on a pro-rata basis based on the carrying amount of each asset in the unit; and
   (b) **Reversal of an Impairment Loss for Goodwill:** An impairment loss recognized for goodwill shall not be reversed in a subsequent period.

**Disclosure**

1) For each class of assets, the financial statements should disclose:
   (a) The amount of impairment losses recognized in the income statement during the period and the line item(s) of the income statement in which those impairment losses are included;
   (b) The amount of reversals of impairment losses recognized in the income statement during the period and the line item(s) the income statement in which those impairment losses are reversed;
   (c) The amount of the impairment losses recognized directly in equity during the period; and
   (d) The amount of reversals of impairment losses recognized directly in equity during the period.

4) An enterprise that applies IAS 14, Segment Reporting, should disclose the following for each reportable segment based on an enterprise's primary format (as defined in IAS 14):
   (a) The amount of impairment losses recognized in the income statement and directly in equity during the period; and
   (b) The amount of reversal of impairment losses recognized in the income statement and directly in equity during the period.

# PAST PAPERS

Q.1

List down the conditions that the enterprise should consider in assessing that an impairment loss previously recognized might no longer exist. **(05)**

Q.2

3S Service Limited has an asset that is being reviewed for possible impairment in value. The cost of the asset is Rs.26 million with a salvage value of Rs.2 million and a remaining useful life of 4 years. The asset was being depreciated applying straight line method and estimated useful life of 6 years. This asset is a cash generating asset with the following expected cash flows:

| Year | Rs. |
|---|---|
| 2005 – 06 | 6.0 million |
| 2006 – 07 | 5.0 million |
| 2007 – 08 | 4.0 million |
| 2008 – 09 | 3.0 million |

The company uses a discount rate of 10% and presently, the asset has a market value of Rs.15 million. It is expected that the cost of disposal will be Rs.0.8 million. Calculate impairment loss as at June 30, 2005 under each of the following assumptions:

(a) The company will continue to use this asset in the future.

(b) The company intends to dispose of the asset in the coming year. **(08)**

Q.3

Ghalib Limited manufactures three products X, Y and Z. The management of the company considers plants relating to each product as a separate Cash-Generating Unit (CGU). The company has three Corporate Assets viz. a building, PABX system and a computer network. On June 30, 2007, the assets were valued as under:

| | **Carrying Amount* Rupees** | **Recoverable Amount* Rupees** |
|---|---|---|
| Cash-Generating Units excluding Corporate Assets | | |
| Plant 1 – for Product X | 2,500,000 | 1,200,000 |
| Plant 2 – for Product Y | 5,000,000 | 7,000,000 |
| Plant 3 – for Product Z | 10,000,000 | 6,400,000 |
| | 17,500,000 | 14,600,000 |
| Corporate Assets | | |
| Building | 2,800,000 | |
| PABX system | 1,400,000 | |
| Computer network | 2,100,000 | |
| | 6,300,000 | |
| | 23,800,000 | |

**Before impairment**

Based on a study carried out by the company which involved consideration of various factors, the management was able to determine that the building and the PABX system can be allocated to plant 1,2 and 3 in the ratio of 2 : 3 : 5. However, the management was unable to determine a reasonable and consistent basis for allocating the cost of computer network.

**Required:**

Calculate the carrying amount of each CGU and Corporate Asset for reporting on the balance sheet as at June 30, 2007 in accordance with IAS-36 'Impairment of Assets'. **(18)**

Q.4

On January 1, 2008, Misbah Holding Limited, dealing in textile goods, acquired 90% ownership interest in Salman Limited (SL), a ginning company, against cash payment of Rs. 450 million. At that date, SL's net identifiable assets had a book value of Rs. 350 million and fair value of Rs. 400 million.

It is the policy of the company to measure the non-controlling interest at their proportionate share of SL's net identifiable assets.

During the year ended December 31, 2008, SL incurred a net loss of Rs. 150 million. The impairment testing exercise carried out at the end of the year, by a firm of consultants, showed that the recoverable amount of SL's business is Rs. 200 million. However, the Board of Directors is inclined to take a second opinion as they estimate that the recoverable amount is Rs. 390 million.

**Required:**
Based on each of the two valuations, compute the amounts to be reported in the consolidated statement of financial position as of December 31, 2008 in respect of:

- Goodwill;
- Net identifiable assets, and
- Non-controlling interest. **(15)**