Impairment of Assets

IAS 36

Impairment of Assets

- Meaning of impairment
- Circumstances that lead to impairment
- Meaning of a Cash Generating Unit (CGU)
- Basis of allocation of impairment loss

Meaning

You bought a car from a showroom for $50,000.

The moment you take it out of the showroom, a truck comes and crashes the car completely.

Impairment Loss

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

Carrying Amount

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

Case study

- An asset is bought for $50,000. After it has been acquired, depreciation of $10,000 has been charged. The entity adopts the cost model.

- An asset is bought for $50,000. After it has been acquired, a revaluation was done which resulted in the value of $75,000. After revaluation, depreciation of $8,000 has been charged.

Recoverable amount

The amount which is expected to be recovered by use or sale of the asset, whichever is higher.

Case study

A machine can be sold by the entity for $50,000 net (fair value less costs to sell).

However, if the machine is used by the entity, would generate cash flows of $12,000 for each of next 5 years.

The present value of these cash flows is $45,000 (value in use).

Fair value less costs to sell

- Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price) (Defined under IFRS 9)

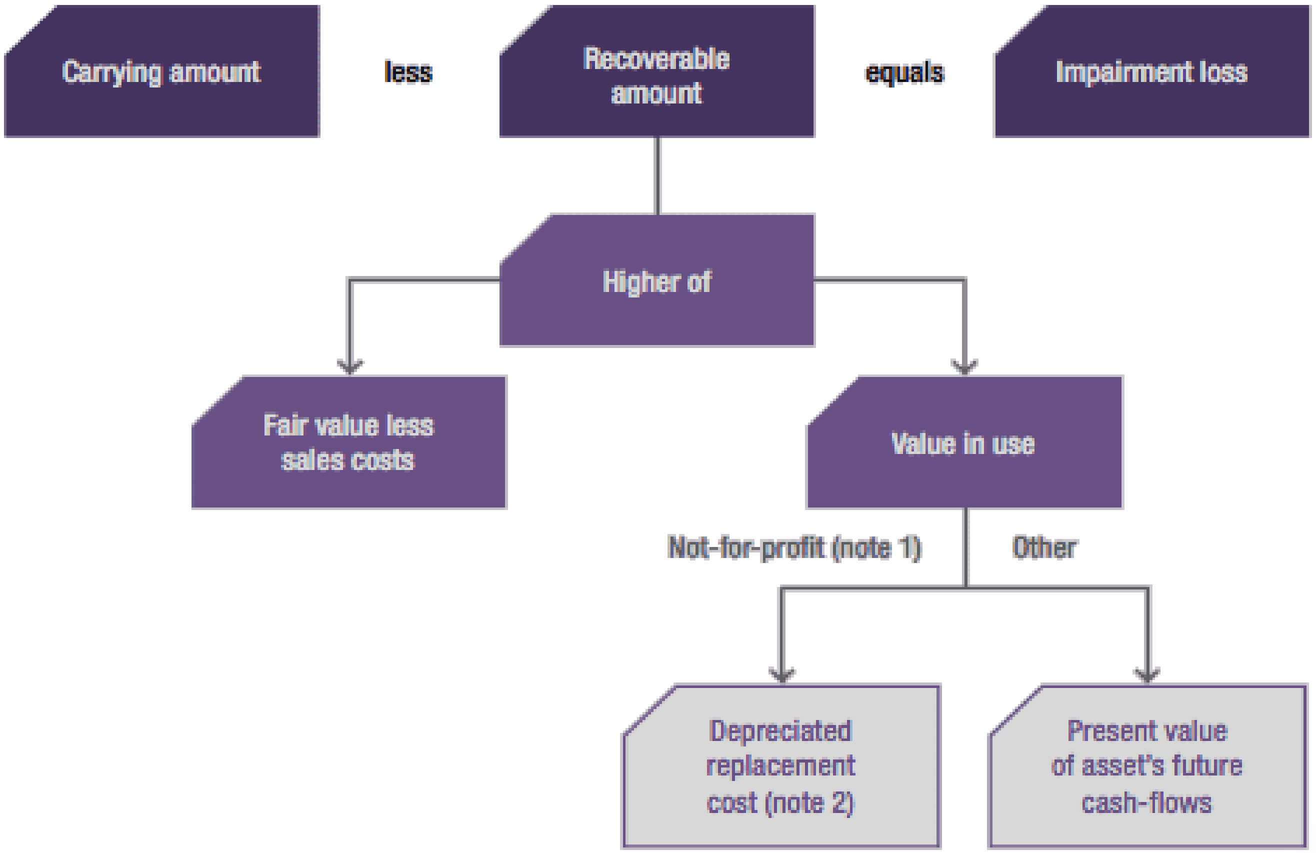
- Costs to sell would include legal costs of selling and direct incremental costs. For example, costs which would necessarily be incurred if the asset is sold.

Determining Present Value In Use

- An estimate of future cash flows expected from the asset;
- Expectations about possible variations in the amount and timing of these cash flows;
- Time value of money and <u>risk element</u> (risk free rate and premium);

Usually, the weighted average cost of capital is used as the discount rate

Impairment Loss



Impairment loss in case of revaluation

A machine costing $50,000 is revalued at $60,000.

During the year following its purchase, the machine has suffered impairment of $5,000.

During next year, the machine gets further impaired by $10,000

Depreciation on Impaired asset

K Ltd bought a car two years back costing $5,000. The useful life of the car is 10 years. The car is impaired, and the recoverable amount is now $1,600. Calculate the impairment loss and depreciation for the current year.

Indicators of Impairment

External Factors

- Significant decline in market value of the asset
- Changes in technological environment
- Changes in legal environment

Internal factors

- Physical damage or obsolescence of the asset
- Significant changes have taken place or are likely to take place which have an adverse affect on the entity or the manner of using the assets.

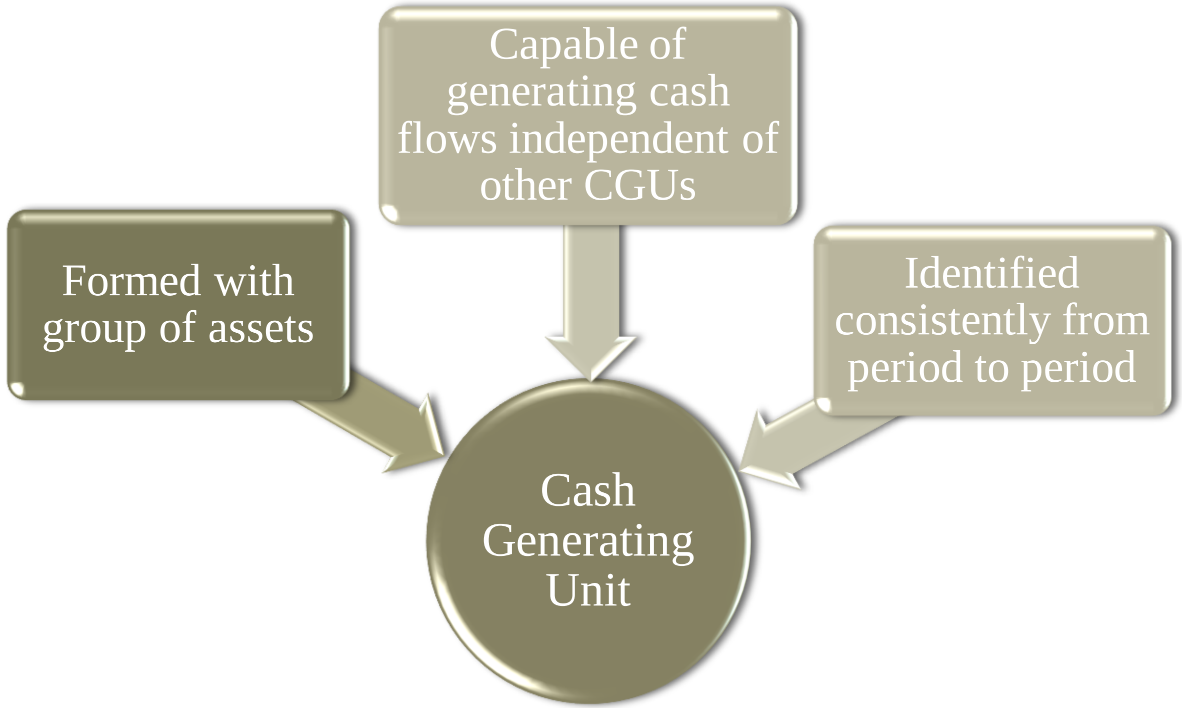
Cash Generating Unit (CGU)

A CGU comprises of assets or group of assets whose cash flows are independent of cash flows of other group of assets

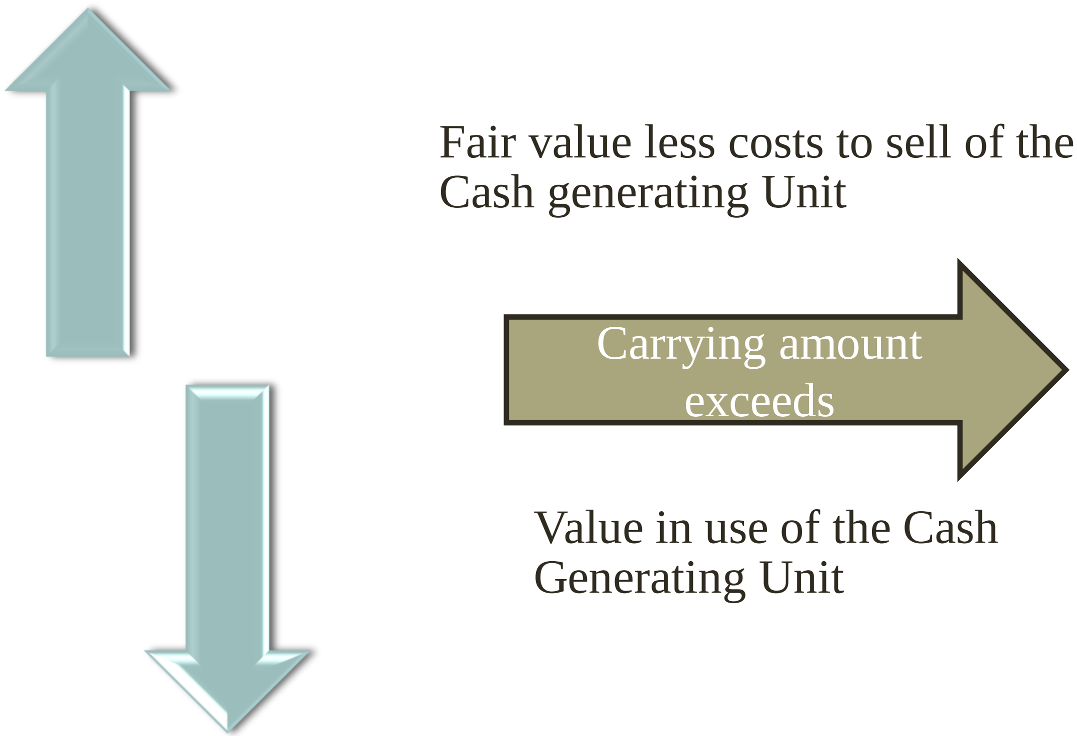
CGU

- A bus operator acquires 3 licences to operate buses in 3 different routes in the city. Of these routes, 2 are profitable routes, and 1 is not a profitable route.
- The government, to ensure that transport service is available at all the routes for the public, has put a condition that all the routes must be run together. Otherwise, the bus operator cannot be allowed to run any transport facilities.

Cash Generating Units



Impairment loss for a CGU



Steps to allocate impairment loss to a CGU

Step1-Specific asset to the extent it has been impaired

Step2-Carrying amount of goodwill allocated to the CGU

Step3-the balance impairment loss, if any, to be charged to remaining assets in proportion to their carrying amounts

Case Study

Asset		Carrying Amount
Goodwill		28 million
A 1		100 million
A 2		80 million
A 3		60 million
Generator to run the CGU		20 million
TOTAL		288 million

The CGU suffered an impairment loss of $80 million.
The loss is generic to the business, and cannot be allocated to any individual asset.

Case Study

Asset		Carrying Amount
Goodwill		28 million
A 1		100 million
A 2		80 million
A 3		60 million
Generator to run the CGU		20 million
TOTAL		288 million

The CGU suffered an impairment loss of $80 million.
Recoverable amount of assets is given as under:

	Fair value less costs to sell	Value in Use
A 1	90 million	86 million
A 2	40 million	46 million

Summary

What we learnt today

- Meaning of impairment
- Circumstances that lead to impairment
- Meaning of a Cash Generating Unit (CGU)
- Basis of allocation of impairment loss

Thanks

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