Chapter 5

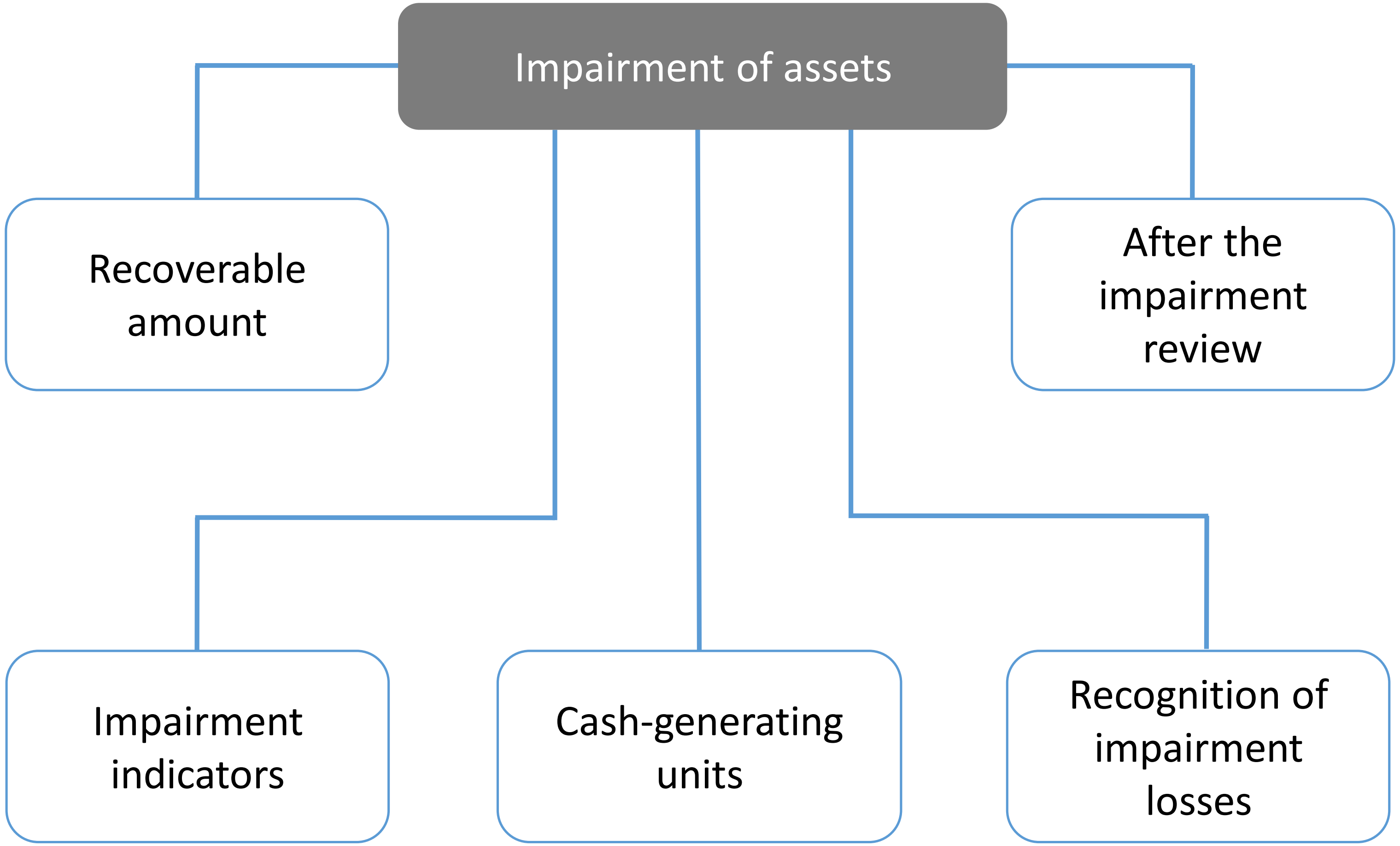
Impairment of assets

- IAS 36 *Impairment of assets*
- Cash generating units
- Goodwill and the impairment of assets

Syllabus learning outcomes

- Define an impairment loss
- Identify the circumstances that may indicate impairments to assets
- Describe what is meant by a cash generating unit
- State the basis on which impairment losses should be allocated, and allocate an impairment loss to the assets of a cash generating unit

Chapter summary diagram



IAS 36 *Impairment of assets* 1

- IAS 36 aims to ensure that the carrying amount of assets in the financial statements is not more than their recoverable amount.
- Carrying amount:
  - The value at which the asset is included in the financial statements
  - Cost/valuation less accumulated depreciation and impairment losses

IAS 36 *Impairment of assets* 2

Recoverable amount

Higher of

Fair value less costs to sell

Value in Use

IAS 36 *Impairment of assets* 3

- Fair value less costs to sell:
  - The price that would be received to sell the asset in an orderly transaction between market participants at the measurement date
  - Less the direct incremental costs attributable to the disposal of the asset
- Value in use:
  - The present value of future cash flows expected to be derived from the asset or cash-generating unit

IAS 36 *Impairment of assets* 4

- If the carrying value of an asset in the statement of financial position is higher than the recoverable amount of the asset then the asset is said to be impaired.
- The impairment loss is the amount by which the carrying amount exceeds the recoverable amount.
- An entity should consider whether there are indications that an asset might have been impaired at the end of each reporting period.

IAS 36 *Impairment of assets* 5

Impairment indicators – external sources
Indicators that an asset's value has declined during the period significantly more than would have been expected due to the passage of time or normal use
Significant changes with an adverse effect on the entity in the technological. Market, economic or legal environment in which the entity operates
Increased market interest rates or other market rates of return affecting discount rates and therefore reducing value in use
The carrying amount of the entity's net assets exceeds market capitalisation

IAS 36 *Impairment of assets* 6

Impairment indicators – internal sources
Evidence of obsolescence or physical damage
Adverse changes to the asset's use
Internal evidence that the asset's performance will be worse than expected

Cash-generating units

Definition

- Where it is not possible to estimate the recoverable amount of an individual asset, an entity should determine the recoverable amount of the cash-generating unit to which the asset belongs.
- A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

Goodwill and the impairment of assets

- Goodwill and corporate assets (such as a head office) should be allocated to a cash-generating unit in order to determine its carrying amount and recoverable amount.
- Where an impairment loss is allocated to reduce the carrying amount of the assets in a cash-generating unit, it will firstly be taken against any goodwill allocated to the cash-generating unit.

Accounting treatment of an impairment loss 1

It may be possible to identify a specific asset which has suffered an impairment.

Where an individual asset is impaired:

- If the asset is held at historic cost, the impairment loss is recognised as an expense in profit or loss
- If the asset is held at a revalued amount, the impairment loss is charged:
  - Firstly to other comprehensive income (to remove any previous revaluation surplus relating to the asset)
  - Any remainder is recognised as an expense in profit or loss

Accounting treatment of an impairment loss 2

Where a cash-generating unit is impaired, the impairment loss is allocated in the following order.

- Firstly to an goodwill allocated to the cash-generating unit
- Then to the other assets of the unit on a pro-rata basis based on the carrying amount of each asset in the cash-generating unit

Accounting treatment of an impairment loss 3

After the recognition of an impairment loss the asset's carrying value should be depreciated/amortised over its remaining useful life.

Question: Invest

On 31 December 20X1 Invest purchased all the shares of MH for $2 million. The net fair value of the identifiable assets acquired and liabilities assumed of MH at that date was $1.8 million.

MH made a loss in the year ended 31 December 20X2 and at 31 December 20X2 the net assets of MH – based on fair values at 1 January 20X2 – were as follows.

	$'000
Property, plant and equipment	1,300
Capitalised development expenditure	200
Net current assets	250
	1,750

Question: Invest (cont'd)

An impairment review on 31 December 20X2 indicated that the recoverable amount of MH at that date was $1.5 million.

The capitalised development expenditure has no ascertainable external market value and the current fair value less costs of disposal of the property, plant and equipment is $1,120,000.

Value in use could not be determined separately for these two items.

Question: Invest (cont'd)

Required

Calculate the impairment loss that would arise in the consolidated financial statements of Invest as a result of the impairment review of MH at 31 December 20X2 and show how the impairment loss would be allocated.

Answer: Invest

		Asset values at 31.12.X2 before impairment	*Allocation of impairment loss (W1)/(W2)*	*Carrying amount after imp. loss*
		$'000	$'000	$'000
Goodwill	(2,000 – 1,800)	200		
PPE		1,300		
Development exp.		200		
Net current assets		250		
		1,950		

Answer: Invest (cont'd)

(W1) Calculation of impairment loss

	$'000	
Carrying value (1,750 + 200 (GW))		1,950
Recoverable amount	(1,500)	
	450	
Impairment loss to write off goodwill	200	
Impairment loss to write off other assets on a pro-rata basis	250	

Answer: Invest (cont'd)

		Asset values at 31.12.X2 before impairment	*Allocation of impairment loss (W1)/ (W2)*	*Carrying amount after imp. loss*
		$'000	$'000	$'000
Goodwill	(2,000 – 1,800)	200	(200)	–
PPE		1,300		
Dev exp		200		
Net current assets		250		
		1,950		

Answer: Invest (cont'd)

(W2) Allocation of impairment loss to other assets (pro-rata basis)

1,083

	$'000		*Loss allocated* $'000
PPE (250 × 1,300 / 1,500)	217	37	180
Dev exp (250 × 200 / 1,500)	33		70
	250		250

However, PPE cannot be reduced below FV – CTS of $1,120,000

Answer: Invest (cont'd)

		Asset values at 31.12.X2 before impairment	*Allocation of impairment loss (W1)/(W2)*	*Carrying amount after imp. loss*
		$'000	$'000	$'000
Goodwill	(2,000 – 1,800)	200	(200)	–
PPE		1,300	(180)	1,120
Dev. exp.		200	(70)	130
Net current assets		250	–	250
		1,950	(450)	1,500