Accounting (Basics) - Lecture 5

Impairment of assets

Contents

- Impairment of inventories
- Impairment of assets other than inventories
- Additional requirements for impairment of goodwill
- Disclosures

Impairment of inventories

- An entity shall assess at each reporting date whether any inventories are impaired. The entity shall make the assessment by comparing the carrying amount of each item of inventory with its selling price less costs to complete and sell. If an item of inventory is impaired, the entity shall reduce the carrying amount of the inventory to its selling price less costs to complete and sell. That reduction is an impairment loss and it is recognized immediately in profit or loss.
- If it is impracticable to determine the selling price less costs to complete and sell for inventories item by item, the entity may group items of inventory relating to the same product line that have similar purposes or end uses and are produced and marketed in the same geographical area for the purpose of assessing impairment.
- An entity shall make a new assessment of selling price less costs to complete and sell (i.e. the circumstances that previously caused inventories to be impaired) at each subsequent reporting date.

Impairment of assets other than inventories

- If, and only if, the recoverable amount of an asset is less than its carrying amount, the entity shall reduce the carrying amount of the asset to its recoverable amount. That reduction is an impairment loss. An entity shall recognize an impairment loss immediately in profit or loss.
- An entity shall assess at each reporting date whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset.
- If it is not possible to estimate the recoverable amount of the individual asset, an entity shall estimate the recoverable amount of the cash-generating unit to which the asset belongs. An asset's cash-generating unit is the smallest identifiable group of assets that includes the asset and generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

Impairment of assets other than inventories

- In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, the following indications:

  External sources of information –

  a) an asset's market value has declined significantly more than would be expected as a result of the passage of time or normal use.
  b) significant changes with an adverse effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which an asset is dedicated.
  c) market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect materially the discount rate used in calculating an asset's value in use and decrease the asset's fair value less costs to sell.

Impairment of assets other than inventories

d) the carrying amount of the net assets of the entity is more than the estimated fair value of the entity as a whole.

Internal sources of information –

a) evidence is available of obsolescence or physical damage of an asset.
b) significant changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include plans to dispose of an asset before the previously expected date, and reassessing the useful life of an asset as finite rather than indefinite.
c) evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected.

Impairment of assets other than inventories

- If there is an indication that an asset may be impaired, this may indicate that the entity should review the remaining useful life, the depreciation (amortization) method or the residual value for the asset and adjust it in accordance with the section of this IFRS applicable to the asset, even if no impairment loss is recognized for the asset.
- The recoverable amount of an asset or a cash-generating unit is the higher of its fair value less costs to sell and its value in use. If it is not possible to estimate the recoverable amount of an individual asset (e.g. fair value less costs to sell, value in use) referring to an asset should be read as indicators referring also to an asset's cash-generating unit.
- It is not always necessary to determine both an asset's fair value less costs to sell and its value in use. 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.

Impairment of assets other than inventories

- If there is no reason to believe that an asset's value in use materially exceeds its fair value less costs to sell, the asset's fair value less costs to sell may be used as its recoverable amount. This will often be the case for an asset that is held for disposal.
- Fair value less costs to sell is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal. The best evidence of the fair value less costs to sell of an asset is a price in a binding sale agreement in an arm's length transaction or a market price in an active market. If there is no binding sale agreement or active market for an asset, fair value less costs to sell is based on the best information available to reflect the amount that an entity could obtain, at the reporting date, from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the costs of disposal. In determining this amount, an entity considers the outcome of recent transactions for similar assets within the same industry.

Impairment of assets other than inventories

- Value in use is the present value of the future cash flows expected to be derived from an asset. This present value calculation involves first the estimation of the future cash inflows and outflows to be derived from continuing use of the asset and from its ultimate disposal, and, then, application of the appropriate discount rate to those future cash flows.
- The following elements shall be reflected in the calculation of an asset's value in use:
  a) an estimate of the future cash flows the entity expects to derive from the asset.
  b) expectations about possible variations in the amount or 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 for bearing the uncertainty inherent in the asset.
  e) other factors, e.g. illiquidity of the asset

Impairment of assets other than inventories

- The entity may wish to use any recent financial budgets or forecasts to estimate the cash flows, if available. To estimate cash flow projections beyond the period covered by the most recent budgets or forecasts an entity may wish to extrapolate the projections based on the budgets or forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified.

Impairment of assets other than inventories

- Estimates of future cash flows shall not include cash inflows or outflows from financing activities, or income tax receipts or payments.
- Future cash flows shall be estimated for the asset in its current condition. Estimates of future cash flows shall not include estimated future cash inflows or outflows that are expected to arise from a future restructuring to which an entity is not yet committed, or improving or enhancing the asset's performance.
- The discount rate (rates) used in the present value calculation shall be a pre-tax rate (rates) that reflect(s) current market assessments of the time value of money, and the risks specific to the asset for which the future cash flow estimates have not been adjusted. The discount rate (rates) used to measure an asset's value in use shall not reflect risks for which the future cash flow estimates have been adjusted, to avoid double-counting.

Impairment of assets other than inventories

- An impairment loss shall be recognized for a cash-generating unit only if the recoverable amount of the unit is less than the carrying amount of the unit. The impairment loss shall be allocated to reduce the carrying amount of the assets of the unit in the following order: first reduction of the carrying amount of any goodwill allocated to the cash-generating unit, and then reduction of it for other assets of the cash-generating unit.
- However, an entity shall not reduce the carrying amount of any asset in the cash-generating unit below the highest of:
  a) its fair value less costs to sell (if determinable);
  b) its value in use (if determinable); and
  c) zero.
- For all assets other than goodwill, an entity shall assess at each reporting date whether there is any indication that an impairment loss recognized in prior periods may no longer exist or may have decreased.

Impairment of assets other than inventories

- When the prior impairment loss was based on the recoverable amount of the individual impaired asset, the following is applied:
  a) The entity shall estimate the recoverable amount of the asset at the current reporting date.
  b) If the estimated recoverable amount exceeds asset's carrying amount, the entity shall increase the carrying amount to recoverable amount. That increase is a reversal of an impairment loss and it should be recognized in profit or loss.
  c) The reversal of an impairment loss shall not increase the carrying amount of the asset above the carrying amount that would have been determined had no impairment loss been recognized for the asset in prior years.
  d) After a reversal of an impairment loss is recognized, the entity shall adjust the depreciation (amortization) charge for the asset in future periods to allocate asset's revised carrying amount, less its residual value on a systematic basis over its remaining useful life.

Impairment of assets other than inventories

- When the original impairment loss was based on the recoverable amount of the cash-generating unit to which the asset belongs, the following is applied:
  a) The entity shall estimate the recoverable amount of that cash-generating unit at the current reporting date.
  b) If the estimated recoverable amount of cash-generating unit exceeds its carrying amount, that excess is a reversal of an impairment loss and it should be allocated to assets of that unit, except for goodwill, pro rata with the carrying amounts of those assets. Those increases in carrying amounts are reversals of impairment losses for individual assets and are recognized immediately in profit or loss.
  c) In allocating a reversal of an impairment loss for a cash-generating unit, the reversal shall not increase the carrying amount of any asset above the lower of its recoverable amount and the carrying amount that would have been determined had no impairment loss been recognized for the

Impairment of assets other than inventories

asset in prior periods.

d) Any excess amount of the reversal of the impairment loss that cannot be allocated to an asset shall be allocated pro rata to the other assets of the cash-generating unit, except for goodwill.

e) After a reversal of an impairment loss is recognized, if applicable, the entity shall adjust the depreciation (amortization) charge for each asset in the cash-generating unit 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.

Additional requirements for impairment of goodwill

- Goodwill, by itself, cannot be sold. Nor does it generate cash flows to an entity that are independent of the cash flows of other assets. Thus, the fair value of goodwill cannot be measured directly. Therefore, the fair value of goodwill must be derived from measurement of the fair value of the cash-generating unit(s) of which the goodwill is a part. For the purpose of impairment testing, goodwill acquired in a business combination shall be allocated to each of the acquirer's cash-generating units that is expected to benefit from synergies of the combination, irrespective of whether other assets or liabilities of the acquire are assigned to those units.
- Part of the recoverable amount of a cash-generating unit is attributable to the non-controlling interest in goodwill. For the purpose of impairment testing a non-wholly-owned cash-generating unit with goodwill, the carrying amount of that unit is notionally adjusted, before being compared with its recoverable amount, by grossing up the carrying amount of goodwill allocated to the unit to include the goodwill attributable to the non-controlling interest.

Additional requirements for impairment of goodwill

This notionally adjusted carrying amount is then compared with the recoverable amount of the unit to determine whether the cash-generating unit is impaired.

- If goodwill cannot be allocated to individual cash-generating units on a non-arbitrary basis, then for the purposes of testing goodwill the entity shall test the impairment of goodwill by determining the recoverable amount of either (a) or (b):
  a) the acquired entity in its entirety, if the goodwill relates to an acquired entity that has not been integrated.
  b) the entire group of entities, excluding any entities that have not been integrated, if the goodwill relates to an entity that has been integrated.
- In applying this paragraph, an entity will need to separate goodwill into goodwill relating to entities that have been integrated and goodwill relating to entities that have not been integrated.
- An impairment loss recognized for goodwill shall not be reversed in a subsequent period.

Disclosures

- An entity shall disclose the following for each class of assets indicated in that Section:
  a) the amount of impairment losses recognized in profit or loss during the period and the line item(s) in the statement of comprehensive income (and in the income statement, if presented) in which those impairment losses are included.
  b) the amount of reversals of impairment losses recognized in profit or loss during the period and the line item(s) in the statement of comprehensive income (and in the income statement, if presented) in which those impairment losses are reversed.