# Impairment of assets

1. Impairment test for inventories is carried out by:
   a) comparing the carrying amount of each item of inventory (or group of similar items) with its net selling price.
   b) comparing the carrying amount of each item of inventory (or group of similar items) with its net fair value.
   c) comparing the carrying amount of each item of inventory (or group of similar items) with its net recoverable amount.

2. Impairment test for assets other than inventories is carried out by:
   a) comparing the carrying amount of each item of other assets (or group of similar items) with its net selling price.
   b) comparing the carrying amount of each item of other assets (or group of similar items) with its net fair value.
   c) comparing the carrying amount of each item of other assets (or group of similar items) with its recoverable amount.

3. If there is an indication that an asset may be impaired, this may indicate that the entity should review:
   a) the remaining useful life of such asset.
   b) the replacement cost of such asset.
   c) the technical appreciation terms for such asset.
   d) all mentioned above.

4. If asset's fair value less costs to sell and its value in use exceed asset's carrying amount, then:
   a) such asset is not impaired.
   b) such asset is impaired.
   c) its fair value should be reviewed.
   d) its replacement cost should be reviewed.

5. Impairment loss shall be allocated to reduce the carrying amount of the assets of the unit in the following order:
   a) first, to reduce the carrying amount of all assets other than goodwill, which comprise a cash-generating unit, and then to any goodwill allocated to the cash-generating unit.
   b) first, to reduce the carrying amount of any goodwill allocated to the cash-generating unit, and then, to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the cash-generating unit.
   c) to reduce the carrying amount of all assets, which comprise a cash-generating unit.

Example 1: Inventory impairment

A retailer holds three items of inventory (X, Y, and Z) at 31 December 20X0. It is likely that all items of inventory will be sold. Based on the information provided in the table below, is the entity required to record any impairment loss at 31 December 20X0?

| | **Carrying amount** | **Selling price estimated at 31/12/20X0** | **Costs to sell estimated at 31/12/20X0** |
|---|---|---|---|
| Item X | 50 000 | 55 000 | 5 000 |
| Item Y | 75 000 | 75 000 | 10 000 |
| Item Z | 100 000 | 115 000 | 20 000 |

| | **Item X** | **Item Y** | **Item Z** |
|---|---|---|---|
| Carrying amount | | | |
| Selling price estimated at 31/12/20X0 | | | |
| Costs to sell estimated at 31/12/20X0 | | | |
| Selling price less cost to sell | | | |
| Impairment loss for the year ended 31/12/20X0 | | | |
| Carrying amount of the inventory after recognition of impairment loss | | | |

Example 2: Inventory impairment

On 31 December 20X1 an entity holds raw materials to be consumed in the manufacturing of Product A. Before testing for impairment the entity carries the raw materials at their cost of CU 100 000. At 31 December 20X1 the replacement cost of the raw materials is CU 80 000.

On 31 December 20X1 management estimate that it will cost CU 60 000 to convert the CU 100 000 of raw material into finished goods. Furthermore, they estimate that CU 25 000 will be incurred to sell those finished goods. The finished goods are expected to be sold for CU 200 000.

Must the entity record an impairment loss?

Example 3: Inventory impairment

On 30 September 20X6 a fire destroyed inventory that had a carrying amount of CU 500 000. The entity immediately registered a claim of CU 700 000 for the replacement cost of the inventory with an insurance company. However, the insurance company disputed the claim, citing negligence on the part of the entity. On 15 November 20X6, the fire authorities completed their investigation and found an electrical fault to be the cause of the fire. As a result of these findings the insurance company notified the entity that its claim for CU 700 000 would be settled in full. The insurance company paid the entity CU 700 000 on 30 November 20X6.

How would the entity account for its inventories for the year ended 31 December 20X6?

Example 4: Inventory impairment reversal

A retailer holds three items of inventory (X, Y, and Z) at 31 December 20X0. All three inventories stay unsold at 31 December 20X1.

| | **Cost** | **Accumulated impairment loss at 31/12/20X0** | **Carrying amount at 31/12/20X1 before impairment reversal test** | **Selling price estimated at 31/12/20X1** | **Costs to sell estimated at 31/12/20X1** |
|---|---|---|---|---|---|
| Item X | 70 000 | 10 000 | 60 000 | 69 000 | 4 000 |
| Item Y | 86 000 | 2 000 | 84 000 | 94 000 | 5 500 |
| Item Z | 150 000 | - | 150 000 | 175 000 | 26 000 |

Decide about reversal of impairment and calculate the values:

| | **Item X** | **Item Y** | **Item Z** |
|---|---|---|---|
| Carrying amount | | | |
| Accumulated impairment loss at 31/12/20X0 | | | |
| Carrying amount at 31/12/20X1 before impairment test | | | |
| Selling price estimated at 31/12/20X1 | | | |
| Costs to sell estimated at 31/12/20X1 | | | |
| Selling price less cost to sell | | | |
| Impairment loss for the year ended 31/12/20X1 | | | |
| Reversal of impairment loss for the year ended 31/12/20X1 | | | |

Example 6: Impairment of assets other than inventories

At the end of 20X0 an entity tests a machine for impairment. The machine was bought five years earlier for CU 300 000, when its useful life was estimated to be 15 years and the estimated residual value was nil. At 31 December 20X0, after recognizing the depreciation charge for 20X0, the machine's carrying amount was CU 200 000 and its remaining useful life was estimated at 10 years.

The machine's value in use is calculated using a pre-tax discount rate of 14 per cent per year. Budgets approved by management reflect expected cash inflows net of the estimated costs necessary to maintain the level of economic benefit expected to arise from the machine in its current condition

Assume, for simplicity, that the expected future cash flows occur at the end of each reporting period. The discounted cash flow will be:

| Year | Estimated future cash flow | Probability | Probability-weighted future cash flow | Present value factor14% | Discounted cash flow |
|---|---|---|---|---|---|
| 20X1 | 23939 | 0.95 | | | |
| 20X2 | 27878 | 0.9 | | | |
| 20X3 | 31522 | 0.85 | | | |
| 20X4 | 44371 | 0.8 | | | |
| 20X5 | 53313 | 0.75 | | | |
| 20X6 | 59941 | 0.7 | | | |
| 20X7 | 66865 | 0.65 | | | |
| 20X8 | 78907 | 0.6 | | | |
| 20X9 | 85976 | 0.55 | | | |
| 20X0 | 93148 | 0.5 | | | |
| **Value in use** | | | | | |

Carrying amount before impairment loss:

Recoverable amount:

Impairment loss:

Carrying amount after impairment loss (i.e. recoverable amount):

Example 7: Impairment of items from cash-generating unit

An entity produces a product in a continuous process using three press-machines (ie the output of Machine A is the input (raw material) for Machine B, the output of which is the raw material for Machine C. The output from Machine C is the entity's only marketable product. After recognising depreciation for the year ended 31 December 20X1 the carrying amount of Machines A, B and C are:

| | Machine A | Machine B | Machine C |
|---|---|---|---|
| Carrying amount | 13 000 | 29 250 | 22 750 |
| Machine's carrying amount in relation to the cash-generating unit's carrying amount (%) | 20% | 45% | 35% |

The entity must conduct an impairment test because of a significant market downturn for its products. There is no active market for products produced by Machines A and B. Machines A, B and C are assets of the cash-generating unit for which the impairment test is performed. The value in use of the cash-generating unit is CU 55 000.

Determine of the impairment and the allocation of the impairment loss to Machines A, B and C, and the new carrying amount after impairment.

Example 8: Impairment of items from cash-generating unit

The facts are the same in example 7. However, in this example, at 31 December 20X1 Machine A's fair value less costs to sell is determined as CU12 500. Management could neither determine the fair value less costs to sell nor the value in use of any other individual asset within the cash-generating unit.

Determine of the impairment and the allocation of the impairment loss to Machines A, B and C, and the new carrying amount after impairment.

Example 9: Impairment of items from cash-generating unit with goodwill

On 31 December 20X1, Entity T acquires 100% of voting rights in Entity M for CU 10 000. Entity M has manufacturing plants in three countries. The data below relates to the end of 20X1

| | **Allocation of purchase price** | **Fair value of identifiable assets** | **Goodwill** |
|---|---|---|---|
| Activities in Country A | 3 000 | 2 000 | |
| Activities in Country B | 2 000 | 1 500 | |
| Activities in Country C | 5 000 | 3 500 | |

Goodwill arising on the acquisition of Entity M has been allocated to three cash-generating units (Countries A, B and C).

During 20X2, a new government is elected in Country A. It passed legislation that significantly restricts exports of the main product produced by Entity T and its subsidiaries (ie Group T). As a result, and for the foreseeable future, Group T's production in Country A will be cut by 40 per cent. The significant export restriction and the resulting production decrease require Group T to estimate the recoverable amount of Country A's cash-generating unit at the end of 20X2. Management estimates cash flow forecasts for Country A operations and determines the cash-generating unit's recoverable amount to be CU1,360.

| | **Goodwill** | **Identifiable assets** | **Total** |
|---|---|---|---|
| Historical cost | | | |
| Accumulated amortization/depreciation (20X2) | | | |
| Carrying amount | | | |
| Impairment loss | | | |
| Carrying amount after impairment loss | | | |

At the end of 20X2, Entity T compares the carrying amount of Country A's assets CU 2 633 with their recoverable amount CU 1 360 and records an impairment loss of CU 1 273. The impairment loss is recorded first against the carrying amount of goodwill CU800 and next against the carrying amount of identifiable assets CU 473.