IMPAIRMENT OF ASSETS: IAS 36

Scope

IAS 36 applies to **all assets except for**:

- inventories (see IAS 2 Inventories);
- assets arising from construction contracts (see IAS 11 Construction Contracts);
- deferred tax assets (see IAS 12 Income Taxes);
- assets arising from employee benefits (see IAS 19 Employee Benefits);
- financial assets (see IAS 39 Financial Instruments: Recognition and Measurement);
- investment property that is measured at fair value (see IAS 40 Investment Property);
- biological assets measured at fair value less costs to sell (see IAS 41 Agriculture);
- non-current assets (or disposal groups) classified as held for sale

Identifying an asset that may be impaired

- At the end of each reporting period, you need **to assess whether there is any indication** that an asset may be impaired. If any such indication exists, you need to estimate the **recoverable amount** of the asset
- Regardless of if there is any indications of impairment, you **must test the following for impairment on an annual basis:**
    - Intangible assets with indefinite useful life; and
    - Goodwill
- An asset is impaired when its **carrying amount exceeds its recoverable amount**
    - Recoverable amount is the **higher of:**
        (a) fair value less costs to sell; and
        (b) its value in use =
            - the present value of the future cash flows expected to be derived from the asset in its **present condition** from **continuing use and ultimate disposal**
- recoverable amount is calculated for each individual asset, but if an asset doesn't generate cash flows that are independent from other assets, we calculate recoverable amount for the cash generating unit
    - A **cash-generating unit** is the smallest identifiable group of **assets** that generates cash inflows that are independent of the cash inflows from other assets or groups of assets
- impairment loss = carrying value – recoverable amount

Factors that indicate impairment:

- an asset's market value has declined significantly more than expected
- significant adverse changes in the technological, market, economic or legal environment
- market interest rates have increased (increasing the value in use and recoverable amount)
- the carrying amount of the net assets of the entity is more than its market capitalisation
- obsolescence or physical damage of an asset.
- asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, plans to dispose of an asset before the previously expected date, and reassessing the useful life of an asset as finite rather than indefinite
- economic performance of an asset is, or will be, worse than expected.
- For an investment in a subsidiary, jointly controlled entity, or associate, the investor recognizes a dividends from the investment and evidence is available that:
    (a) the carrying amount of the investment in the separate F/S exceeds the carrying amounts in the F/S of the investee's net assets, including goodwill; or

(b) the dividend exceeds the total income of the subsidiary, jointly controlled entity or associate in the period the dividend is declared

Measuring the recoverable amount of an intangible asset with an indefinite useful life

For an intangible asset with an indefinite useful life, the most recent calculation of the recoverable amount made in a preceding period may be used in the impairment test for that asset in the current period, provided **all** of the following criteria are met:

i. the intangible asset is part of a **cash-generating unit** (see above), and the assets/liabilities making up that unit have **not changed significantly** since the most recent recoverable amount calculation; and
ii. the most recent recoverable amount calculation resulted in an amount that exceeded the asset's carrying amount by a **substantial margin**; and
iii. the **likelihood** that a current recoverable amount determination would be less than the asset's carrying amount is remote (very small)

Recognising and measuring an impairment loss

- when the carrying value is greater than the recoverable amount there will be an impairment loss
- impairment loss = carrying value – recoverable amount
- impairment loss is recognized in profit or loss (unless you use the revaluation model, you treat it as a revaluation loss in OCI to the extent of revaluation surplus, remainder is “impairment loss”)
- If the recoverable amount subsequently increases, you can reverse the impairment loss to the extent previously recorded (except for goodwill)

Cash-generating units (CGU) and goodwill

- If it is not possible to estimate the recoverable amount of the individual asset, an entity shall determine the **recoverable amount of the cash-generating unit** to which the asset belongs (the asset's cash-generating unit)
    - This often happens when the asset does not generate cash inflows that are largely independent of those from other assets
- Example provided in the Handbook:
    - 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 entity does not have the option to curtail any one bus route, the lowest level of identifiable cash inflows that are largely independent of the cash inflows from other assets 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
- Cash-generating units shall be identified consistently from period to period for the same asset or types of assets, unless a change is justified
- When the carrying value of the CGU> recoverable amount of the CGU, there will be an impairment loss equal to the excess
- The CGU includes assets that can be attributed directly, or allocated on a reasonable and consistent basis to the CGU
- The CGU does not include liabilities, unless the recoverable amount of the cash-generating unit cannot be determined without consideration of a liability

Goodwill

- Goodwill acquired in a business combination is allocated each of the acquirer's CGU that is expected to benefit from synergies
- 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
- operating segment = component of an entity that does business, whose operating results are reviewed by the entity's top management, and for which separate financial information is available
- **A CGU to which goodwill has been allocated** needs to be tested for impairment annually and whenever events indicate there is an impairment
- If the carrying amount of the CGU exceeds the recoverable amount of the CGU, the entity shall recognise the impairment loss
- The impairment loss shall be allocated to reduce the carrying amount of the assets of the CGU in the following order:
  - first, to reduce the carrying amount of any goodwill allocated to the CGU; and
  - then, to the other assets of the CGU pro rata on the basis of the carrying amount of each asset in the unit (group of units).
    - No individual asset can be written down below its own recoverable amount (if determinable)
    - Also no individual asset can be written down below Zero
- The most recent detailed calculation made in a preceding period of the recoverable amount of a CGU to which goodwill has been allocated may be used in the impairment test of that unit in the current period provided all of the following criteria are met:
  (a) the assets and liabilities making up the unit have not changed significantly since the most recent recoverable amount calculation;
  (b) the most recent recoverable amount calculation resulted in an amount that exceeded the carrying amount of the unit by a substantial margin; and
  (c) the likelihood that a current recoverable amount determination would be less than the current carrying amount of the unit is remote.

Reversal of Impairment Loss

- impairment losses recognized for goodwill is **not reversed;**
- at each reporting period, determine if previously recognized impairment still exists; If so, the entity shall estimate the recoverable amount of that asset
- Previously recorded impairment losses (other than for goodwill) can be reversed to the **lesser of:**
  - The previously recorded impairment loss
  - The new recoverable amount
  - The would be carrying value (net of amortization) had no impairment loss recognized in previous years
- A reversal of an impairment loss for a CGU shall be allocated to the assets of the unit, except for goodwill, pro rata with the carrying amounts of those assets.
- Because the value in use calculation depends on the time value of money, the recoverable amount (via value in use) may increase simply due to the passage of time; in this case the impairment loss is not reversed

Comparison to ASPE

- ASPE Section 3063 impairment of long-lived assets doesn't deal with goodwill and intangibles with indefinite useful lives (it is covered in section 3064)
- Under ASPE, we compare **undiscounted cash flows to the carrying value**, and if the carrying value exceeds the undiscounted cash flows, we write down the asset the **fair value**
- Under ASPE, impairment of goodwill is done differently (see section 3064)
- Grouping of assets
    - Under ASPE, assets are grouped to "asset groups" for purposes of impairment
    - Under IFRS, assets are tested individually, unless it doesn't generate cash flows independent of other assets (then it gets grouped into a cash-generating unit)
    - Under ASPE, an asset group can include liabilities
    - Under IFRS, only assets can be grouped to CGU (no liabilities)
- Under ASPE, reversal of impairment loss is not allowed
- Under IFRS, must test impairment annually and whenever events indicate **for goodwill and unlimited life intangible assets** (under ASPE, test only when events indicate)