FINANCIAL REPORTING

IAS 36: IMPAIRMENT OF ASSETS

OBJECTIVE OF THE STANDARD

The objective is to set rules to ensure that the ***assets of an entity are not carried at more than their recoverable amount***.

DEFINITIONS

An impairment loss: The amount by which the carrying amount of an asset or a cash-generating unit exceeds its recoverable amount.

Carrying amount: The amount at which an asset is recognized after deducting any accumulated depreciation (amortization) and any accumulated impairment losses.

Recoverable amount: The higher of the (asset's or cash-generating unit's) fair value less costs of disposal and its value in use.

- **Value in use:** the present value of the future cash flows expected to be derived from an asset or cash-generating unit.

Cash-generating unit(CGU): The smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or group of assets.

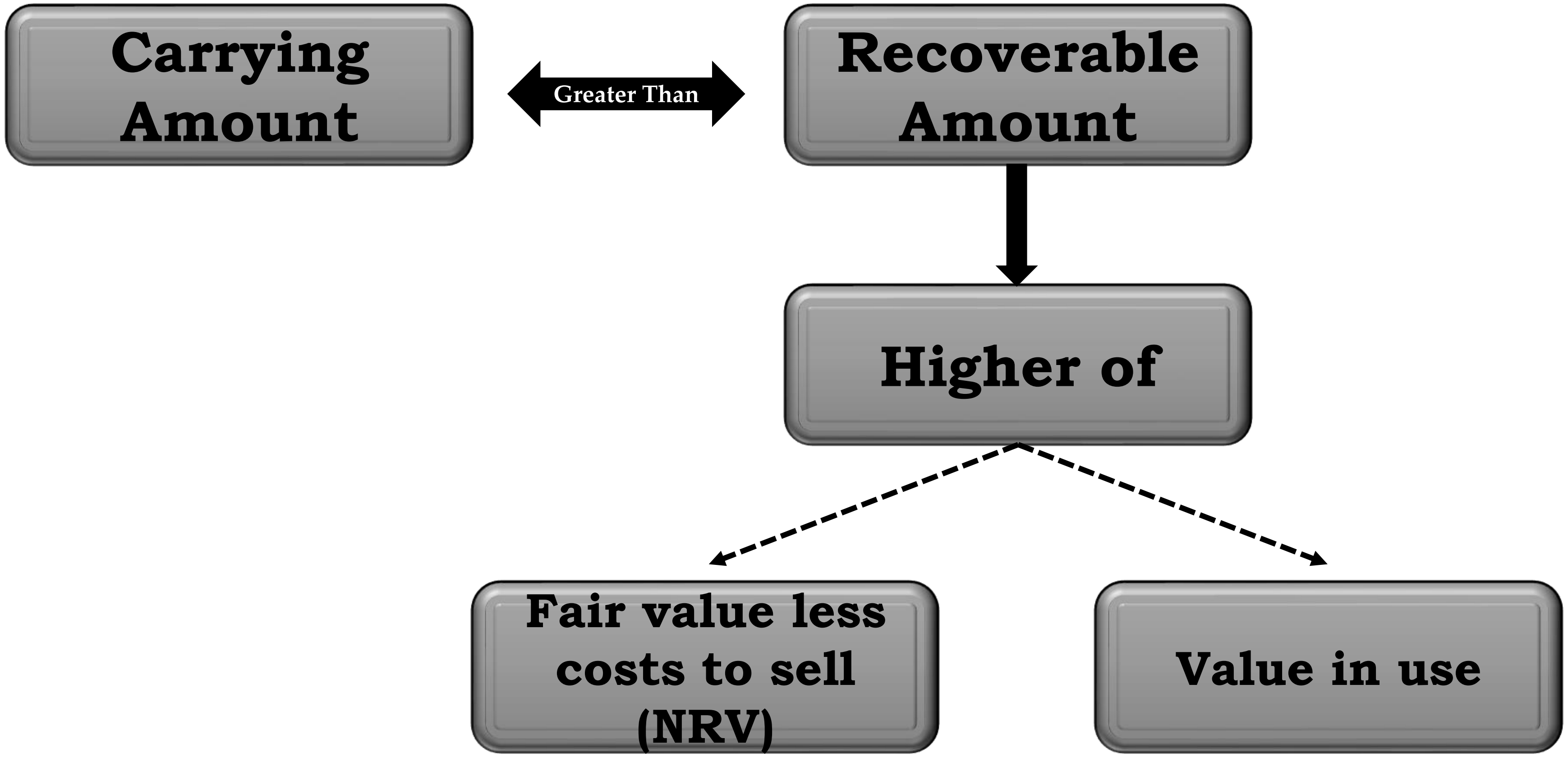
SCOPE OF THE STANDARD

The standard shall be applied to impairment of all assets except;

- inventories under IAS 2
- contract Assets under IFRS 15
- deferred tax assets under IAS 12
- assets arising from employee benefits under IAS 19
- financial assets under IFRS 9
- investment property measured at fair value under IAS 40
- non-current assets classified as held for sale under IFRS 5
- biological assets measured at fair value less costs to sell under IAS 41
- Insurance contract assets under IFRS 17

GROUND RULE

As a ground rule, an asset or CGU is considered impaired if its recoverable amount (RA) is below the asset's or CGU's carrying amount (CA).



IDENTIFYING IMPAIRED ASSETS

IAS 36 requires that at each reporting date, an entity must assess whether there are indicators of impairment to an asset or CGU.

The moment such indication exists, the entity shall estimate the recoverable amount of the asset or CGU.

Worth noting: For each of the following assets, an entity shall test them for impairment annually irrespective of whether there is an indication of impairment;

- An intangible asset with an indefinite useful life.
- Goodwill acquired in a business combination (purchased goodwill).
- an intangible asset not yet available for use

Indications may be derived from within the entity (internal sources) or the external market (external sources).

External sources of information include;

- Changes in the technological, market, economic or legal environment in which the entity operates or market to which asset is dedicated (causing adverse effects)
- Increase in interest rates, thus increasing the discount rate used in calculating the asset's value in use.
- Decline in the asset's market value because of passage of time or normal use.
- Carrying amount of the net assets of the entity is more than its market capitalization.

INDICATORS CONTINUED…

Internal sources of information

- Availability of evidence of obsolescence of, or damage to, the asset.
- If changes in the way the asset is used have occurred or are imminent (out of significant changes with adverse effects to an entity such as asset being idle.
- Evidence is available indicating that the economic performance of an asset is, or will be, worse than expected.

The point such (or any other) indicators manifest, an entity shall perform an impairment review on the asset or CGU.

Where no such indication exists, then no further action need to be taken in regard to the asset or CGU.

RECOGNITION OF IMPAIRMENT

Where there is an indication that an asset might be impaired, an impairment review should be carried out to determine the recoverable amount of the asset. In case the recoverable amount is found to be lower than the asset's carrying amount, the asset is impaired and therefore:

- the asset should be written down to recoverable amount
- the impairment loss should be immediately recognized in the statement of profit or loss.

The only exception to this is if the asset is carried at a revalued amount out of which a revaluation surplus was obtained and taken to the revaluation reserve.

In this case, the impairment loss will be taken first to the revaluation surplus (thru other comprehensive income) until the revaluation surplus is fully exhausted, then any excess is taken to the statement of profit or loss.

After the recognition of an impairment loss, the depreciation (amortization) charge for the asset shall subsequently be computed using the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life

MEASUREMENT CRITERIA

Measurement of impairment

Impairment shall be measured as the amount by which the recoverable amount of an asset exceeds the asset's carrying amount.

Measurement of the recoverable amount of an asset

The recoverable amount of an asset shall be the higher of the asset's fair value less costs to sell and its value in use.

Measurement of fair value less costs to sell

The value shall be the current market price (from an active market) less the cost to disposal.

Costs to disposal include;

- Legal costs
- Stamp duty and similar transaction taxes
- Cost of removing the asset
- Direct incremental costs to bring an asset into a condition of its sale.

Measurement of value in use

Value in use is determined by;

- Projecting cash inflows from the continuing use of the asset.
- Projecting cash outflows that are necessarily incurred to generate the cash inflows from continuing use of the asset.
- net cash flows, if any, to be received (or paid) for the disposal of the asset at the end of its useful life.
- Applying a suitable discount rate to these cashflows.

Please note that cash flows relating to financing activities or income taxes should not be included.

MEASUREMENT CONT'D

Illustration one: Determining the value in use

Capital College has made projections of cash flows from continued use one of its assets for the next five (5) years as follows:

Year	Net Future cash flows (Shs million)
1	3,000
2	2,800
3	2,500
4	2,000
5	1,200
Total	**11,500**

Required: Show how the above transaction will be accounted for in the books of ABC Limited with financial statements extracts for the year ended 31 December 2014 and 2015.

MEASUREMENT CONT'D

Illustration two:

ABC limited purchased an item of property, plant and equipment at a cost of USD 15,000 with an estimated useful life of 20 years on 01 January 2010. The following additional costs were incurred by ABC to get the asset ready for its intended use:

	Amount (Shs 000)
Import duties (20% claimable)	25,000
Installation	2,000
Testing	2,500

An impairment review was performed on the item on 31 December 2014 and the fair value of the item was Shs 58,000,000 with estimated selling costs of Shs. 5,200,000. According to the company's management accounts, the item was expected to make cashflows of Shs. 7,000,000 per annum for the next 15 years commencing 01 January 2015. The company's cost of capital is 10% and the exchange rate on 01 January 2010 was 1USD:UGX3,500.

Required: Show how the above transaction will be accounted for in the books of ABC Limited with financial statements extracts for the year ended 31 December 2014 and 2015.

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IMPAIRMENT OF A CGU

Where an impaired asset is part of a larger group of assets which together form a cash generating unit, it might be hard to ascertain the recoverable amount of that individual asset because of the impracticability of that asset to generate distinguishable cashflows (independent cashflows). In such a scenario, the entity determines the recoverable amount of the cash-generating unit to which the asset belongs.

However, identifying an asset's CGU involves a lot of judgment. Therefore, if the recoverable amount of an individual asset cannot be determined, the entity has to identify the smallest aggregation of assets that largely independent cashflows.

Computation of impairment of a CGU

In this case, impairment is computed by;

- Assuming the CGU is a single asset.
- Comparing the carrying amount of the CGU to its recoverable amount.

An impairment exists when the carrying amount exceeds the recoverable amount.

Impairment of CGU = **CA of CGU** (CA of all assets in CGU added together) − **RA of CGU** (RA of all assets in CGU)

IMPAIRMENT OF CGU CONT'D

Likewise, the recoverable amount of the CGU shall be the higher of the CGU's fair value less cost of disposal and its value in use.

After computing the impairment loss of the CGU, the loss must be allocated to reduce the carrying amounts of the assets in the CGU in the order below.

An impairment loss is chronologically allocated to:

- any specifically impaired asset (e.g. because they are physically damaged).
- the carrying amount of any purchased goodwill allocated to the CGU.
- other assets in the CGU on a pro rata basis basing on the carrying amount of each asset in the CGU.

As the allocation is made, caution should be taken not to write down an individual asset below its **recoverable amount** or **zero** whichever is higher.

The above notwithstanding, unless specifically impaired, **current assets** are unlikely to be impaired as part of a CGU, as they are already likely to be carried at their recoverable amounts.

IMPAIRMENT OF CGU CONT'D

Illustration three: impairment of a CGU

A Bakery (considered as a cash generating unit) comprises the followings assets:

Asset	**Value (Shs'000)**
Building	7,000,000
Plant & Equipment	2,000,000
Goodwill	900,000
Current Assets	200,000
Total	**10,100,000**

The following information is relevant:

a) One of the equipment, carried at Shs 400,000,000, is damaged and will have to be scrapped.

b) The recoverable amount of the cash generating unit is estimated at Shs 7,500,000,000

Required:

1) Calculate the CGU's impairment loss, if any.

2) Allocate the loss to the CGU in accordance with the provisions of IAS 36: Impairment of assets.

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REVERSAL OF IMPAIRMENT LOSSES

- Impaired assets should be reviewed at each reporting date to see whether there are indications that the impairment has reversed (decreased or no longer exists).
- In case such indicators exist, an entity shall estimate the recoverable amount of the asset or CGU and reverse the previous write down.
- The reversal of an impairment loss is immediately recognized as income in profit or loss unless the previous impairment was charged against a revaluation surplus in which case the reversal shall be recognized through OCI and credited to the revaluation reserve.
- The reversal must not take the value of the asset above its depreciated historical cost, i.e., the amount it would have been if the original impairment had never been recorded (The depreciation that would have been charged in the meantime must be considered).
- The depreciation charge for future periods should be revised to reflect the changed carrying amount.
- **An impairment loss recognized for goodwill cannot be reversed in a subsequent period. This is because the subsequent increase in the recoverable amount of that goodwill is likely to be an increase in internally generated goodwill which can never be recognized as per IAS 38.**

INDICATORS OF REVERSAL OF IMPAIRMENT

Internal indicators

- Favorable changes in the use of the asset.
- Improvements in the asset's economic performance.

External indicators

- Increases in the asset's market value.
- Decreases in interest rates.
- Favorable changes in the technological, market, economic or legal environment.

DISCLOSURES

- The amount of impairment losses recognized in profit or loss and/or OCI during the period for each class of assets.
- The amount of reversals of impairment losses recognized in profit or loss and/or OCI during the period for each class of assets.
- The amount of impairment losses on revalued assets recognized in other comprehensive income during the period for each class of assets.
- The amount of reversals of impairment losses on revalued assets recognized in other comprehensive income during the period for each class of assets.
- Among others……..