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IFRS for SMEs
Section 27 *Impairment of Assets*

Presenter:
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Presenter

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Anton van Wyk is a **chartered accountant** and independent consultant in International Financial Reporting Standards (IFRS and IFRS for SMEs). As former subject head of Financial Accounting at various higher education providers (including the University of Johannesburg and Monash University South Africa), he has gained valuable insights into and understanding of the important principles underlying the International Financial Reporting Standards (IFRS). Anton is a well-known and popular presenter who has presented numerous IFRS updates for several accounting bodies across South Africa. He is known for his ability to simplify and highlight the most important principles contained in IFRS, whilst keeping the learning process enjoyable for attendees.

Welcome to the Webinar

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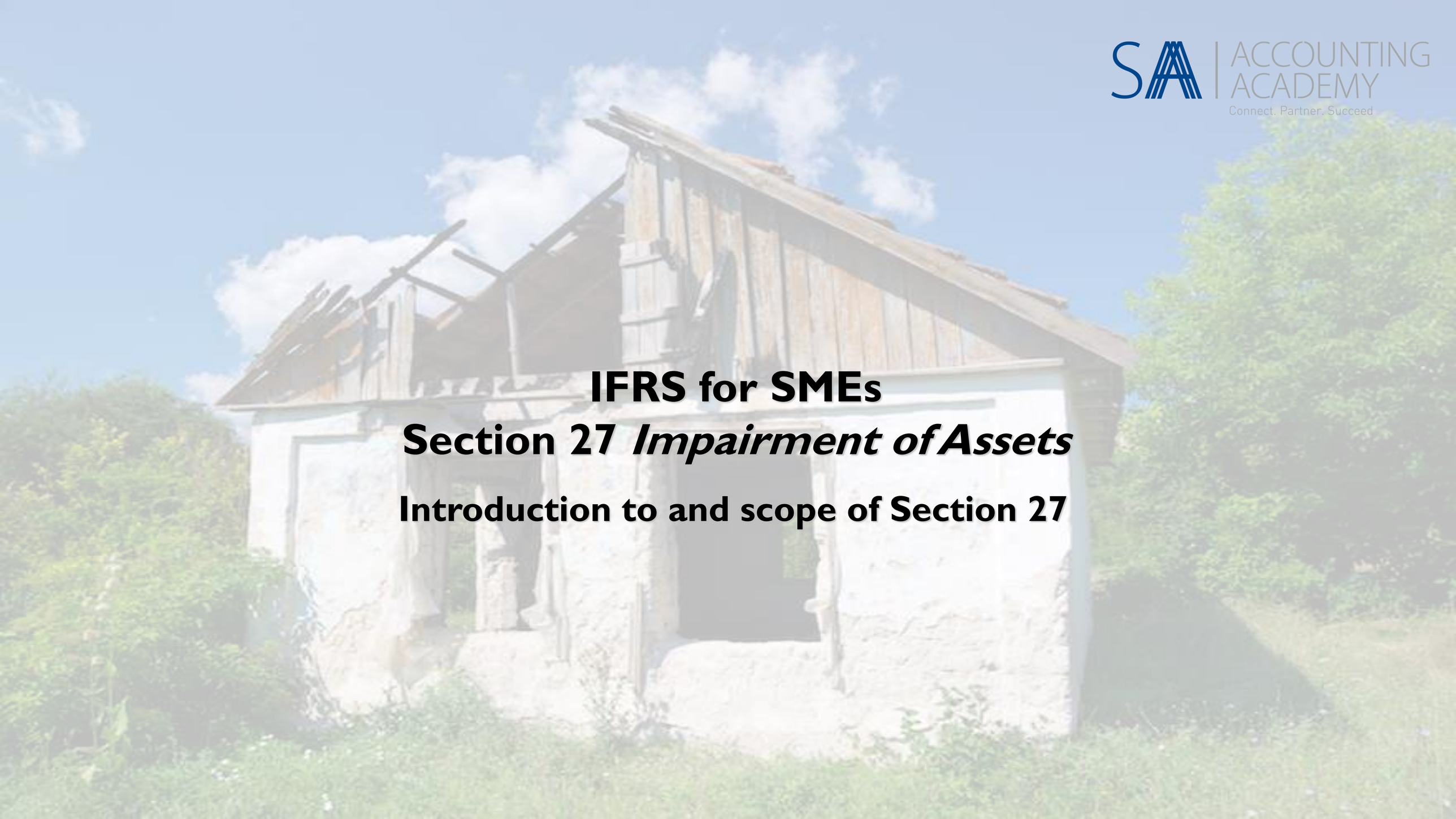
Welcome to this webinar dealing with **Section 27 *Impairment of Assets*** in the **IFRS for SMEs**

AGENDA POINTS TO COVER:

1. Introduction to and scope of **S27**
2. Impairment of inventories
3. Impairment of assets other than inventories
4. Additional requirements for the impairment of goodwill
5. Reversal of impairment losses & reversal ceilings
6. Disclosures (notes to AFS)



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Section 27 *Impairment of Assets*

Introduction to and scope of Section 27

Introduction to Section 27

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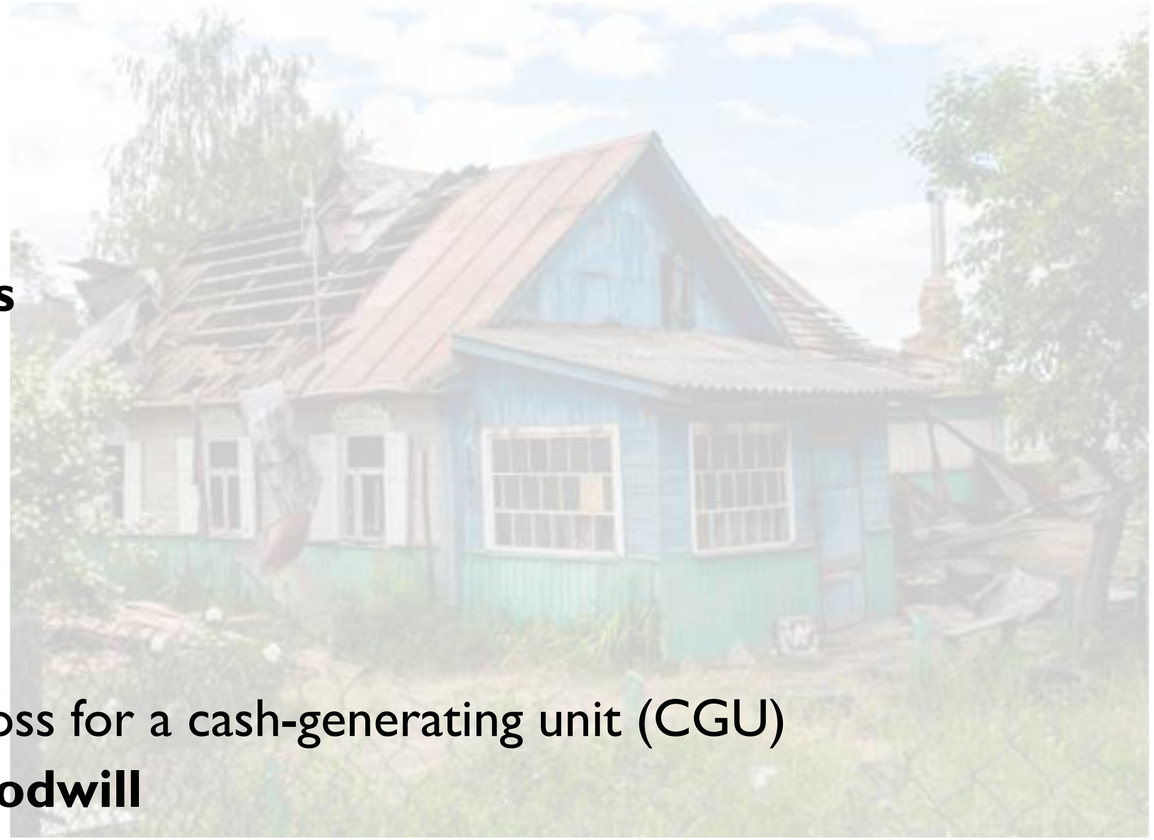
- Deals with **impairment of assets**
- **<u>Overview of content:</u>**
  - Scope exclusions
  - Impairment of **inventories**
  - Impairment of assets **other than inventories**
    - General principles
    - Indicators of impairment
    - Measuring the recoverable amount
      - Fair value less costs to sell
      - Value in use
    - Recognising and measuring an impairment loss for a cash-generating unit (CGU)
  - Additional requirements for impairment of **goodwill**
  - **Reversal** of impairment losses



Scope exclusions (Section 27)

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- **Impairment loss = CA of asset > Recoverable amount of asset**
- Impairment of ALL assets dealt with by s27, except for:

  - Deferred tax assets (s29)
  - Assets arising from employee benefits (s28)
  - Financial assets within the scope of s11 and s12
  - Investment property measured at fair value (s16)
  - Biological assets (related to agricultural activity) measured at fair value less estimated costs to sell (s34)

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Impairment of Inventories

Impairment of inventories

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- Impairment test on inventories must be **performed at <u>each</u> reporting date**
- CA of each inventory item (or group of items) compared to **selling price less costs to <u>complete</u> and <u>sell</u>**
- Any such reduction required is an **impairment loss**, and is recognised immediately in P/L (as part of cost of sales)
- If impracticable to determine the selling price less costs to complete and sell for each inventory item, the entity can **group items of inventory together** relating to the same product line that have similar purposes or end uses and are produced and marketed in the same geographic area for assessment of impairment
- Entity shall assess selling price less costs to complete and sell at the next reporting date – if circumstances causing original impairment no longer exist or there is clear evidence of an increase in selling price less costs to complete and sell because of changed economic circumstances, the entity shall **REVERSE the amount of the impairment** (reversal is limited to original impairment loss) – after reversal, the inventory shall be measured at the lower of the cost or selling price less costs to complete and sell

Full IFRS vs IFRS for SMEs?

- **Full IFRS**
  - IAS 2 *Inventories* requires inventory to be subsequently measured at the lower of cost and net realisable value
  - The impairment test of inventory is "built into" the subsequent measurement of inventory
  - Impairment is not done in terms of IAS 36 *Impairment of Assets*

- **IFRS for SMEs**
  - Section 13 *Inventories* does not deal with impairment of inventories
  - Inventory is tested for impairment annually, with or without indicators of possible impairment
  - Impairment test of inventory is performed in terms of Section 27 *Impairment of Assets*

Examples – please make notes

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- At the end of the reporting period an entity that retails perishable products holds 1 000 000 units of a product in inventory. The carrying amount of each unit cost is R10 (i.e. cost per unit before impairment assessment). The entity expects to sell only 800 000 of the units held. The expected selling price per unit is R21. Expected costs to sell are R1 per unit.
  CA = R10 000 000
  RA = R16 000 000
  Must the entity record an impairment loss?

- On 31 December 2020 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 price of R100 000. At 31 December 2020 the replacement cost of the raw materials is R80 000. On 31 December 2020 management estimates that it will cost R60 000 to convert the R100 000 of raw material into finished goods. Furthermore, they estimate that R25 000 will be incurred to sell those finished goods. The finished goods are expected to be sold for R200 000.
  Must the entity record an impairment loss?

Examples (continued)

- A retailer holds three items of inventory (X, Y, and Z) at 31 December 2020. It is likely that all items of inventory will be sold.
- Information provided by the entity's management:

	CA	Est SP @ acq.	Est SP @ y/e	CTS
Item X	R70 000	R80 000	R64 000	R4 000
Item Y	R86 000	R88 000	R94 000	R10 000
Item Z	R150 000	R200 000	R180 000	R22 000
Total	R306 000	R368 000	R338 000	R36 000

- **Based on the information provided in the table, is the entity required to record any impairment loss at 31 December 2020? If so, what amount?**

Examples (continued)

- A retailer holds three items of inventory (X, Y, and Z) at 31 December 2020. It is likely that all items of inventory will be sold. Information provided by the entity's management is as follows:

	CA
Item X	R70 000
Item Y	R86 000
Item Z	R150 000
Total	R306 000

- It is assumed by the retailer that it is **impracticable** to assess impairment on an item-by-item basis. The three items (X, Y and Z) have similar purposes and end uses and are produced and marketed in the same geographical area. At 31 December 2020 management estimated that incremental costs to sell do not differ by product and that it will incur selling costs of R36 000 to sell the collection of three items for R338 000.

- **Based on the information provided in the table, is the entity required to record any impairment loss at 31 December 20X0? If so, what amount?**

Examples (continued)

- Information about inventory at 31 December 2020:

	Orig CA	Acc i/loss	Net CA	Est SP	Est CTS
• Item X	R70 000	(R10 000)	**R60 000**	R69 000	R4 000
• Item Y	R86 000	(R2 000)	**R84 000**	R94 000	R5 500
• Item Z	R150 000	-	**R150 000**	R175 000	R26 000
Total	R306 000	(R12 000)	**R294 000**	R338 000	R35 500

- **What is the reversal of impairment loss at 31 December 2020, if any?**
  - ***Have you taken the reversal ceiling into account? ☺***

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Impairment of Assets other than Inventories

Impairment of other assets

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- **If recoverable amount < CA, the CA shall be reduced to the recoverable amount**
- Impairment losses are immediately recognised directly in <u>profit or loss</u>
- No deferral of impairment loss is ever possible…

- <u>Indicators of (possible) impairment:</u>
  - Should assess at each reporting date whether **indicators** of possible impairment exist. If not, no recoverable amount needs to be calculated!
  - *Remember: non-current assets held for sale = indicator of possible impairment!*
  - Indicators of possible impairment of an asset also trigger the review of the depreciation method, useful life and residual value
  - **If impossible to calculate the recoverable amount for an individual asset, the entity estimates the recoverable amount of the cash-generating unit to which the asset belongs**

Minimum info assessed annually

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- **External sources of information**
  - During reporting period, asset's MV has declined significantly more than would be expected due to passage of time or normal use
  - Significant changes with an adverse effect on entity, have taken place during the period (or near future) in the technological, market, economic or legal environment in which entity operates
  - Market interest rates (or ROI %) 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
  - CA of the NAV of the entity > market capitalisation or fair value of entity
- **Internal sources of information**
  - Evidence of obsolescence or physical damage to the asset
  - Significant changes with an adverse effect on entity, have taken place during the period (or near future) in the extent to which (or manner in which) an asset is used or expected to be used (e.g. asset will become idle, plans to discontinue or restructure the operations to which asset belongs, plans to dispose of an asset before the previously expected date, reassessing the useful life as finite i.s.o. indefinite)
  - Evidence that asset's performance is worse than expected (operating results and cash flows)

What is a CGU?

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- Sometimes individual assets do not generate cash flows themselves…

- A **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

Calculating the recoverable amount

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- **Recoverable amount (RA)** is the **HIGHER of**:
  - SALE: i.e. fair value less costs to sell ("FV – CTS") the asset and
  - USE and DISPOSAL: Value in use ("VIU") of the asset

- Both items need **not** be calculated… if ONE exceeds the CA, the asset cannot be impaired…
- VIU is the more complicated one to calculate
  - Hence: if VIU is not believed to materially exceed FV – CTS, RA = FV – CTS
  - Thus: try to prove that FV – CTS exceeds CA = easiest

FV – CTS => the easier one…

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- What can be obtained from the SALE of an asset
- In an arm's length transaction
- Between knowledgeable and willing parties
- Less the costs of disposal?

Req's may seem harsh, but they mostly relate to assets held for disposal

- Best evidence of FV – CTS 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 no binding sale agreement, or no active market, FV – CTS is based on best information available that reflects the amount that an entity COULD obtain (at reporting date) from the disposal of the asset in an arm's length transaction between knowledgeable willing parties after deduction costs of disposal
  - The entity considers the outcome of recent transactions for similar assets within the same industry…

VIU – the more complicated one…

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- VIU = PV of future cash flows expected to be derived from an asset (use + disposal)

- PV calculation involves these steps:
  - Estimate the future cash inflows/outflows from continuing use and ultimate disposal of the asset
  - Apply an **appropriate** discount rate to those future cash flows

- <u>What must be determined (key enabling elements)?</u>
  - Estimate of the future cash flows expected from the asset
  - Expectations about possible variations in the amount/timing of the future CF's
  - Time value of money (represented by current market risk-free rate of interest)
  - The price for bearing the uncertainty inherent in the asset (unique to asset)
  - Other factors (such as liquidity) that market participants would reflect in pricing the future CF's the entity expects to derive from the asset

VIU (continued)

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- **What is INCLUDED in future cash flows?**
  - Projections of cash **inflows** from continuing use of the asset
  - Projections of cash **outflows** necessarily incurred to generate cash inflows from continuing use of the asset and can be directly attributed
  - Net cash flows (if any) expected to be received or paid for the **disposal** of the asset at the end of its useful life in an arm's length transaction between knowledgeable and willing parties

- Recent budgets or forecasts can be used as basis for estimates

- Beyond most recent budgets/forecasts: steady or declining growth rate to be used for subsequent years, unless increasing rate can be justified…

VIU (continued)

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- What is EXCLUDED from future cash flows?
  - Cash inflows or outflows from financing activities; and
  - Income tax receipts or payments (i.e. pre-tax cash flows)

- Future cash flows to be based on **current condition of asset** and does not take into account cash inflows or outflows expected to arise from
  - Restructuring to which entity is not yet committed; or
  - Improving or enhancing the asset's performance

- The **discount rate(s)** used in the PV calculation shall be a pre-tax rate that reflects the market assessments of:
  - The time value of money; and
  - Risks specific to the asset for which the future cash flow estimates have not been adjusted (do not double count)

Allocation of i/loss to CGU

- Entity ABC (Pty) Ltd has the following cash generating unit (CGU) at reporting date:

	CA	RA	FV – CTS
• Goodwill	R100 000		
• Machine A	R200 000	R180 000	
• Machine B	R300 000		
• Machine C	R250 000		
Total CA	R850 000		R600 000

- CGU is therefore impaired by **R250 000** (i.e. R850 000 – R600 000)

- Impairment loss of **R250 000** allocated as follows:

	Impairment	**New CA**
• Goodwill	R100 000 (in full)	R-
• Machine A (R200/(R200+R300+R250) x R150k)	R40 000	R160 000
• Machine B (R300/(R200+R300+R250) x R150k)	R60 000	R240 000
• Machine C (R250/(R200+R300+R250) x R150k)	R50 000	R200 000
• **Total impairment allocated**	**R250 000**	**R600 000**

Allocation of i/loss to CGU (2)

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- **Problem: Machine A is over-impaired**
  - CA (after impairment) = R200 000 – R40 000 = R160 000
  - FV – CTS = R180 000
  - R20 000 re-allocated to machines B and C, as follows:

    - Machine B: R300 000 – R60 000 = R240 000
    - Machine C: R250 000 – R50 000 = R200 000
    - Total CA (after impairment) R440 000

  - Machine B: R240/R440 x R20k = R10 909
  - Machine C: R200/R440 x R20k = R9 091
  - Total i/loss re-allocated R20 000

  - Carrying amounts (final)
  - Goodwill (R100 000 – R100 000) R-
  - Machine A (R200 000 – R40 000 + R20 000) R180 000
  - Machine B (R300 000 – R60 000 – R10 909) R229 091
  - Machine C (R250 000 – R50 000 – R9 091) R190 909
  - Total CA of CGU **R600 000**

This is the RA for the CGU!

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Impairment of Goodwill

Notes on impairment of goodwill

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- Cannot be tested on its own for impairment, hence must form part of CGU
- Goodwill (arising from B/C) to be allocated to each CGU benefitting from synergy of the B/C

- Goodwill testing in **consolidated AFS**:
  - If not a wholly-owned subsidiary: goodwill needs to be grossed up to account for NCI's share in the goodwill when tested in the CGU for impairment…

- *If goodwill cannot be allocated to a single CGU or group of CGU's:*
  - *Goodwill relates to a non-integrated entity: test the goodwill at the level of the acquired entity in its entirety*
  - *Goodwill relates to an integrated entity: test the goodwill at the level of the entire group of integrated entities*
    - *Integrated refers to dissolved/restructured*

- Impairment losses on goodwill **cannot subsequently be reversed**

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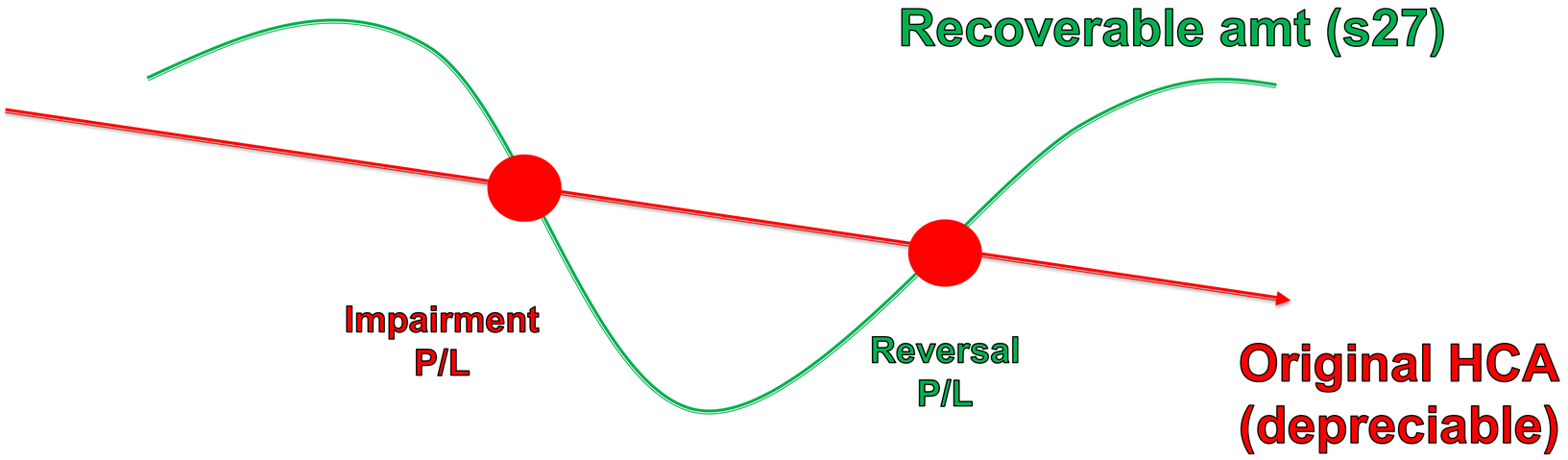
Reversal of Impairment Losses

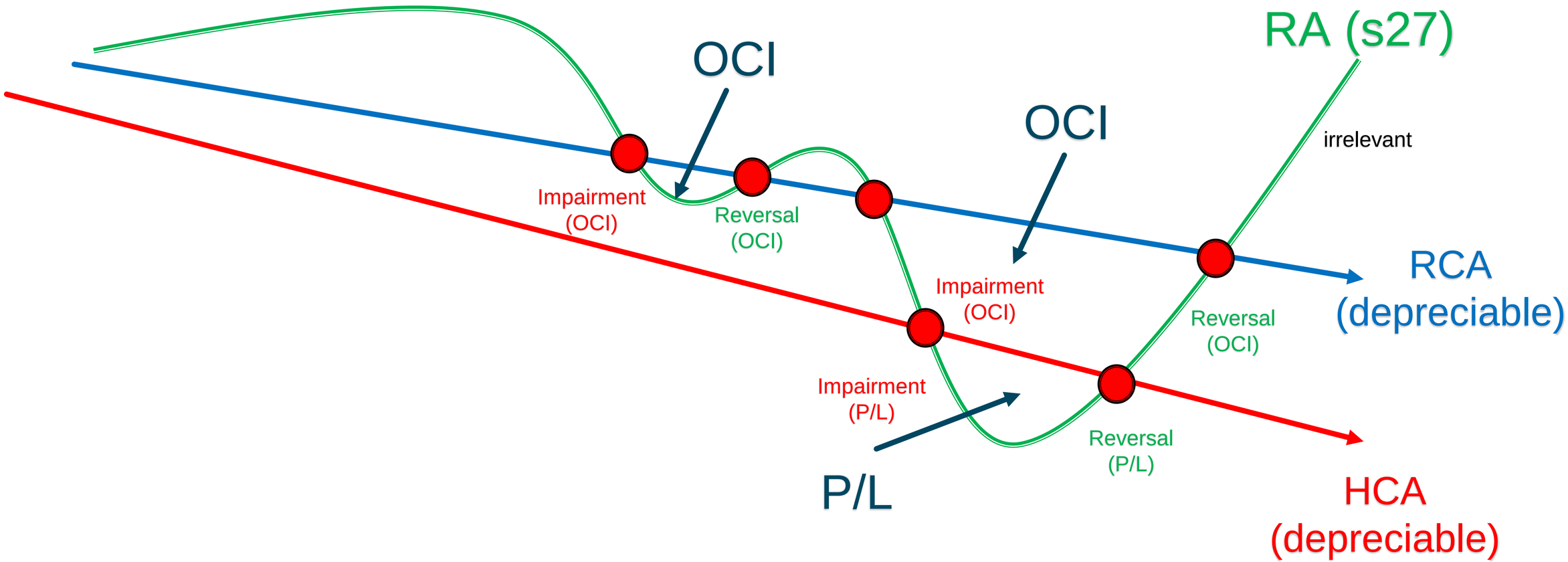
Reversal of impairment losses

- An entity must assess **at each reporting date**, whether indicators exist that an impairment loss recognised in a prior period, may no longer exist or has decreased…

- The same approach is followed as per allocation of impairment losses, to either individual asset or CGU (i.e. pro rata allocation)
  - Impairment loss i.r.o. goodwill may never be reversed
  - Reversal of i/loss i.r.o. other assets, is subject to the following ceiling:



Reversal of i/loss: revalued asset



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Disclosures

Disclosures

- For each class of assets:
  - Amount of **impairment losses** recognised during the reporting period and the line-items in which the loss is included in the SOCI (or I/S)
  - Amount of **reversal of impairment losses** recognised in P/L during the reporting period and the line-items in which the reversal is included in the SOCI (or I/S)

- Which **classes** of assets?
  - Inventories
  - PP&E (including investment property for which no FV is available)
  - Goodwill
  - Intangible assets other than goodwill
  - Investments in associates
  - Investments in joint ventures

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Thank you for your participation

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