

# IFRS

## *IAS 36 Impairment of Assets*

Presenter:  
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## Anton van Wyk M. Com CA (SA)

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

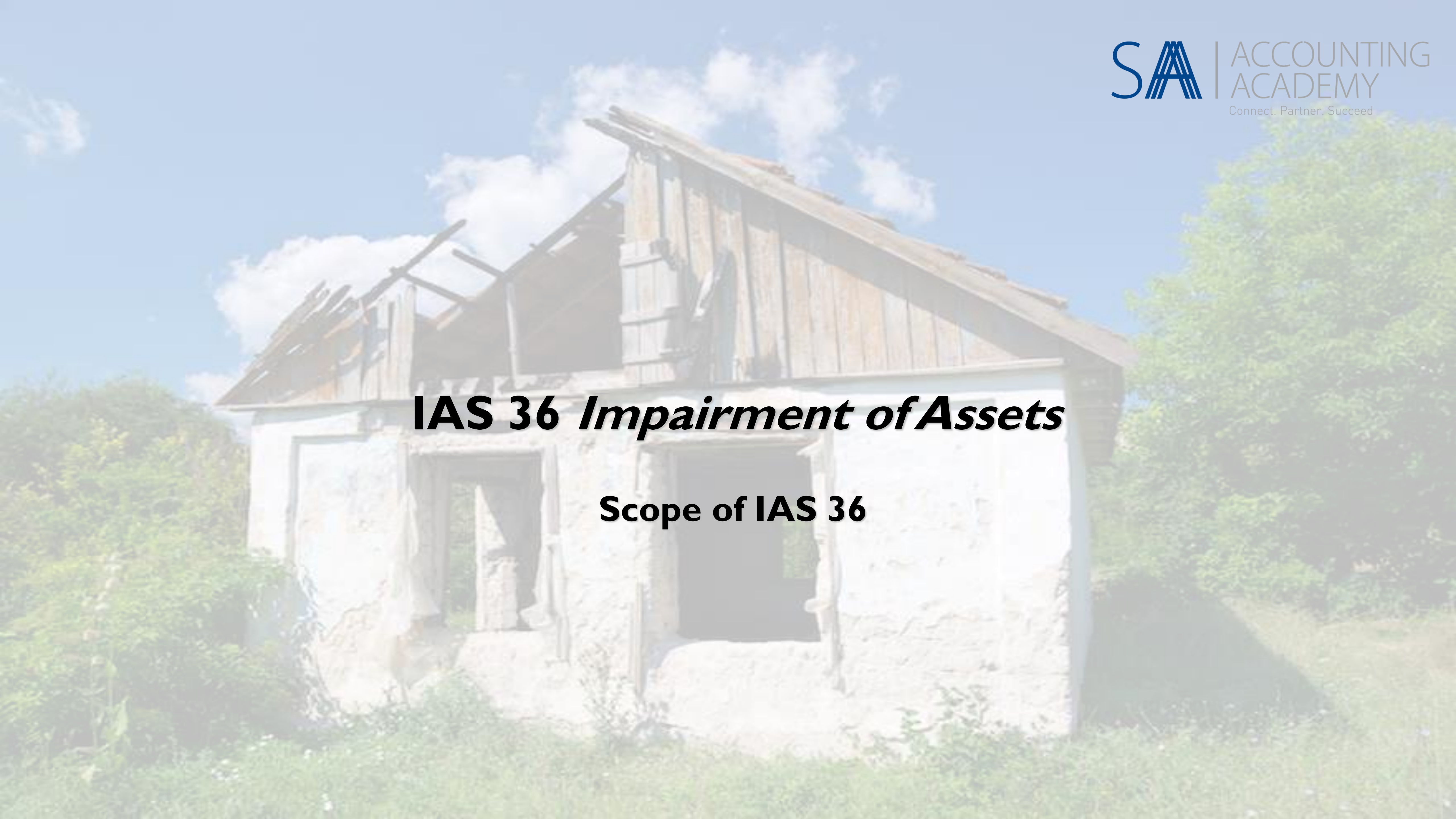
Welcome to this webinar dealing with **IAS 36 *Impairment of Assets*** in **full IFRS**

## **AGENDA POINTS TO COVER:**

1. Scope of IAS 36?
2. When is an asset impaired?
3. How is the recoverable amount measured?
4. How are impairment losses recognised and measured for assets/CGUs?
5. What are the requirements to *reverse* impairment losses for assets/CGUs?
6. Disclosures (notes to AFS)

# ***IAS 36 Impairment of Assets***

## **Scope of IAS 36**



# Scope exclusions

- **Impairment loss = CA of asset > Recoverable amount of asset**
- Impairment of ALL assets dealt with by IAS 36, except for:
  - Inventories (IAS 2)
  - Contract assets i.t.o. IFRS 15 (Revenue)
  - Deferred tax assets (IAS 12)
  - Employee benefit assets (IAS 19)
  - Financial assets (IFRS 9)
  - Investment property measured at FVTPL (IAS 40)
  - Biological assets measured at FV – CTS (IAS 41)
  - Insurance contract assets (IFRS 17)
  - Non-current assets held for sale (IFRS 5)



# ***IAS 36 Impairment of Assets***

**When is an asset impaired?**

# Impairment assets in the scope of IAS 36

- EACH REPORTING DATE: Assess whether indicators exist of possible impairment
- ONLY if indicators exist, then RECOVERABLE AMOUNT is calculated
- THREE assets are tested annually for impairment, with/without indicators of possible impairment:
  - Intangible assets *not yet available for use* (e.g. development cost) (IAS 38)
  - Intangible assets with *indefinite useful life* (IAS 38)
  - Goodwill from a *business combination* transaction (IFRS 3)
- Assessing indicators of (possible) impairment:
  - Should assess at each reporting date whether **indicators** of possible impairment exist. If not, no recoverable amount needs to be calculated!
  - *Remember: selling assets before original intended date = indicator of possible impairment!*
  - Indicators of possible impairment of an asset also trigger the review of the depreciation method, useful life and residual value (NB!)
  - **If impossible to calculate the recoverable amount for an individual asset, the entity estimates the recoverable amount of the *cash-generating unit (CGU)* to which the asset belongs**

# Minimum info assessed annually (I)

- **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

**The above must be considered on an annual basis**



# Minimum info assessed annually (2)

- **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)
- A dividend is received from an investment in a subsidiary, associate or JV and there is evidence that either:
  - CA of investment in separate AFS of parent/investor > CA of investment in consolidated AFS
  - Dividend received > total comprehensive income of subsidiary, associate or JV

**The above must be considered on an annual basis**

# So what if an indicator exists?

- Is an impairment test immediately performed?
  - Impairment tests are costly!
- Firstly, the list of external and internal indicators is **not exhaustive**
- Secondly, consider **materiality** when assessing indicators
  - Previous years' calculations indicate CA significant > than recoverable amount AND no change in circumstances, despite an indicator arising = then no impairment test
  - Previous analyses indicate that asset's CA is not sensitive to the indicator that has arisen = then no impairment test

**Be realistic, have evidence, consider materiality!**

# Intangible assets with indefinite useful life?

- Tested **annually** for impairment with/without indicators of possible impairment, as mentioned
- Previous detailed calculation of RA, not indicating impairment, may be used for the CY's impairment test, if ALL the following requirements satisfied:
  - If IA is part of CGU and tested for impairment part of CGU, the composition of the CGU has not changed significantly since the previous calculation of RA; and
  - The most recent calculation of RA exceeded the CA of the asset by a substantial margin; and
  - Analysing events and circumstances SINCE the most recent calculation of the RA, indicate that likelihood of a recalculated  $RA < CA$  of asset = remote

**Think carefully as there could be relief!**

## ***IAS 36 Impairment of Assets***

**How is the recoverable amount measured?**

# Measuring the recoverable amount

- **Recoverable amount (RA)** is the **HIGHER** of:
  - SALE: i.e. fair value less costs of disposal (“FV – CoD”) of 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 – CoD, RA = FV – CoD
  - Thus: try to prove that FV – CoD exceeds CA = easiest

# What is a CGU?

- 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



# FV – CoD => the easier one...

- ***Fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (IFRS 13)**
  - The IFRS 13 considerations must be taken into account, and are not dealt with anymore in IAS 36
- What are costs of disposal (CoD)?
  - legal costs,
  - stamp duty and similar transaction taxes,
  - costs of removing the asset, and
  - direct incremental costs to bring an asset into condition for its sale.
- *Termination benefits (as defined in IAS 19) and costs associated with reducing or reorganising a business following the disposal of an asset are not direct incremental costs to dispose of the asset*

# VIU => the more complicated one...

- 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
- What must be determined (key enabling elements)?
  - 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



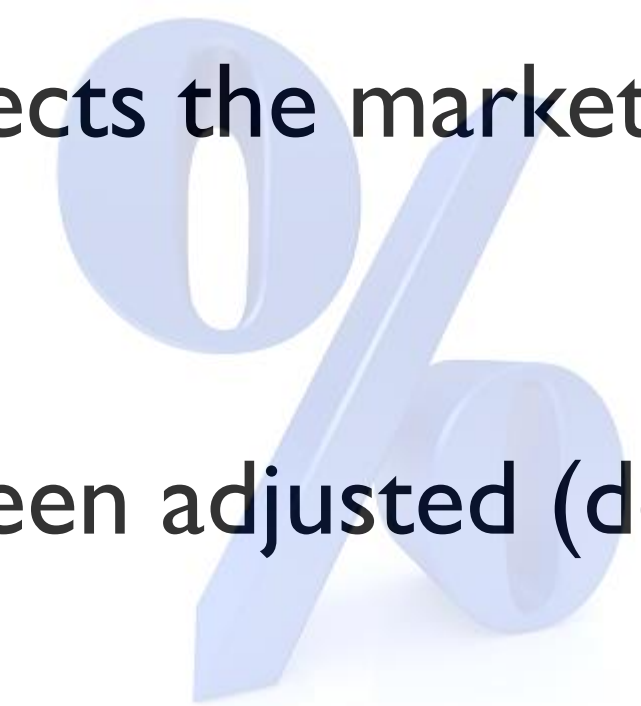
# VIU (continued)

- **What is INCLUDED in future cash flows?**
- The following elements shall be reflected in the calculation of an asset's VIU:
  - an estimate of the future cash flows the entity expects to derive from the asset;
  - expectations about possible variations in the amount or timing of those future cash flows;
  - the time value of money, represented by the current market risk-free rate of interest;
  - the price for bearing the uncertainty inherent in the asset; and
  - other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset.
- 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)

- 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)

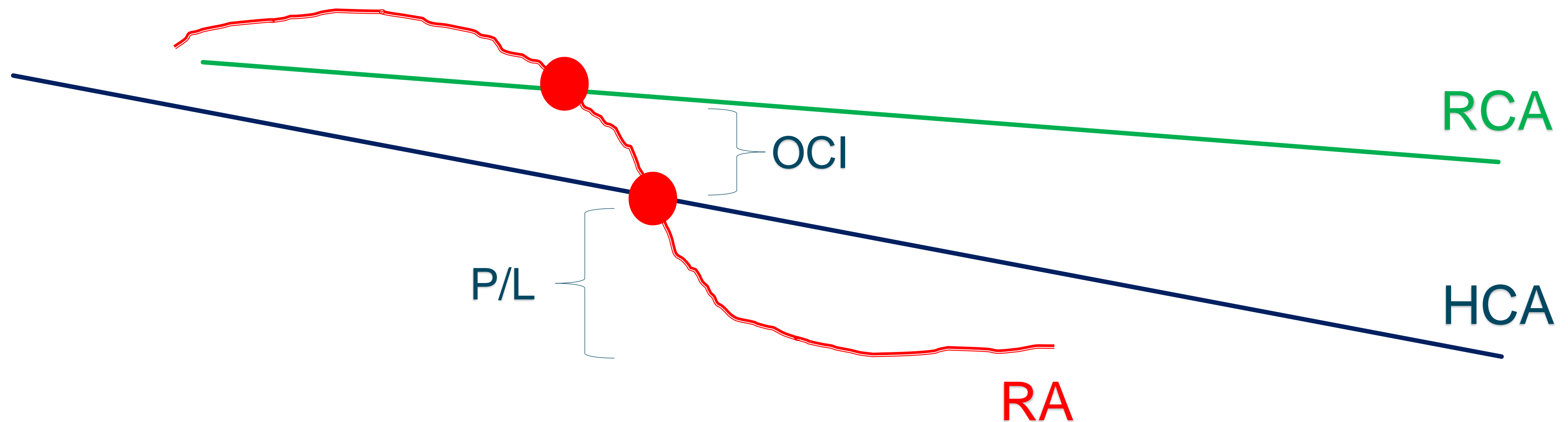


## ***IAS 36 Impairment of Assets***

**How are impairment losses recognised and measured for assets/CGU's?**

# Impairment losses

- $CA > RA = \text{impairment loss}$
- Impairment loss is recognised in profit or loss
  - Impairment losses on revalued assets = recognised in OCI, excess in P/L



# Allocation of i/loss to CGU

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

	<u>CA</u>	<u>RA</u>
• Goodwill	R100 000	
• Machine A	R200 000	R180 000
• Machine B	R300 000	
• Machine C	<u>R250 000</u>	
Total CA	<u>R850 000</u>	R600 000

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

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

- Goodwill
- Machine A  $(R200 / (R200 + R300 + R250)) \times R150k$
- Machine B  $(R300 / (R200 + R300 + R250)) \times R150k$
- Machine C  $(R250 / (R200 + R300 + R250)) \times R150k$
- **Total impairment allocated**

## Impairment

R100 000 (in full)
R40 000
R60 000
<u>R50 000</u>
<b><u>R250 000</u></b>

## New CA

R-
<b>R160 000</b>
R240 000
<u>R200 000</u>
<b><u>R600 000</u></b>

# Allocation of i/loss to CGU (2)

- Problem: Machine A is over-impaired**

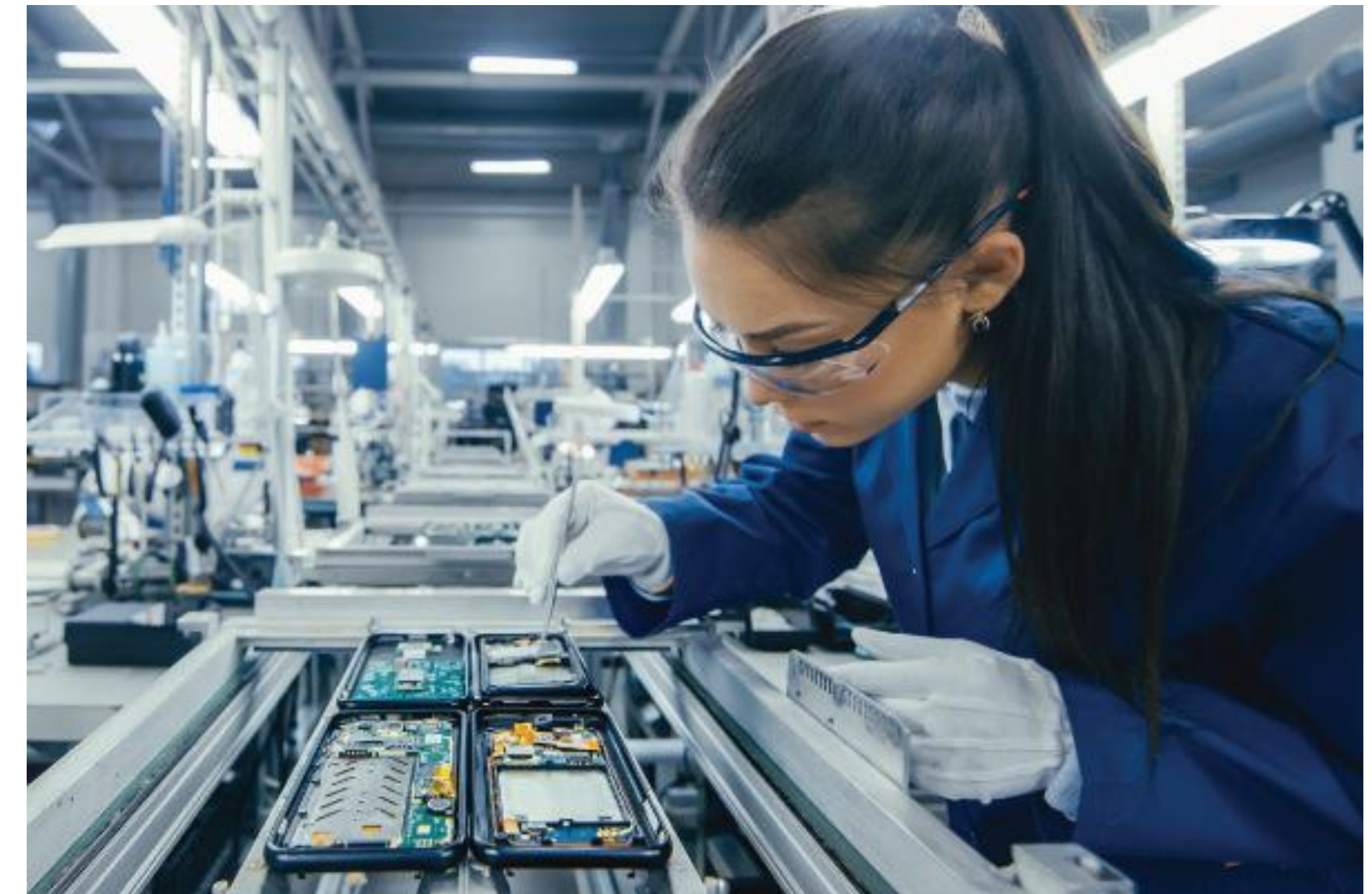
- CA (after impairment) = R200 000 – R40 000 = R160 000
- FV – CTS = R180 000
- R20 000 re-allocated to machines B and C, as follows:

- 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!**

# Notes on impairment of goodwill

- 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**

# Impairment test: goodwill

## Example

	<b>Total</b>	<b>Parent (80%)</b>	<b>NCI (20%)</b>
At acquisition date equity	R10 000 000	R8 000 000	R2 000 000
Investment in subsidiary		<u>R9 000 000</u>	<u>R2 300 000</u> (fair value)
Goodwill		R1 000 000	R300 000

Assume in consolidated AFS, at acquisition date, NCI is measured at fairly stated NAV, i.e. R2 000 000. Fair value of the NAV at acquisition date, is R2 300 000.

## Cash-generating unit (CGU)

Goodwill

PP&E

Intangible assets

Total NAV

RA of CGU

Impairment loss

## Partial GW method

R1 000 000 (parent only)

R8 000 000

R4 000 000

R13 000 000

R12 500 000

R500 000

## Full GW method

R1 300 000

R8 000 000

R4 000 000

R13 300 000

R12 500 000

R800 000

***How allocated? R640 000 allocated to parent (in relation to ownership, not contribution to GW!)***

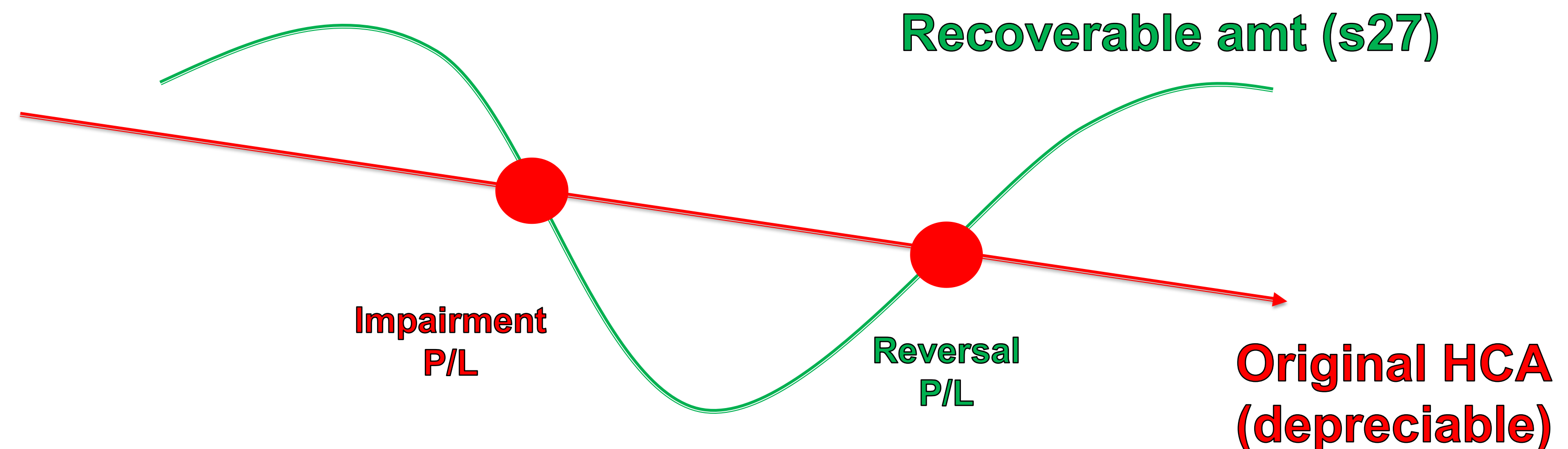


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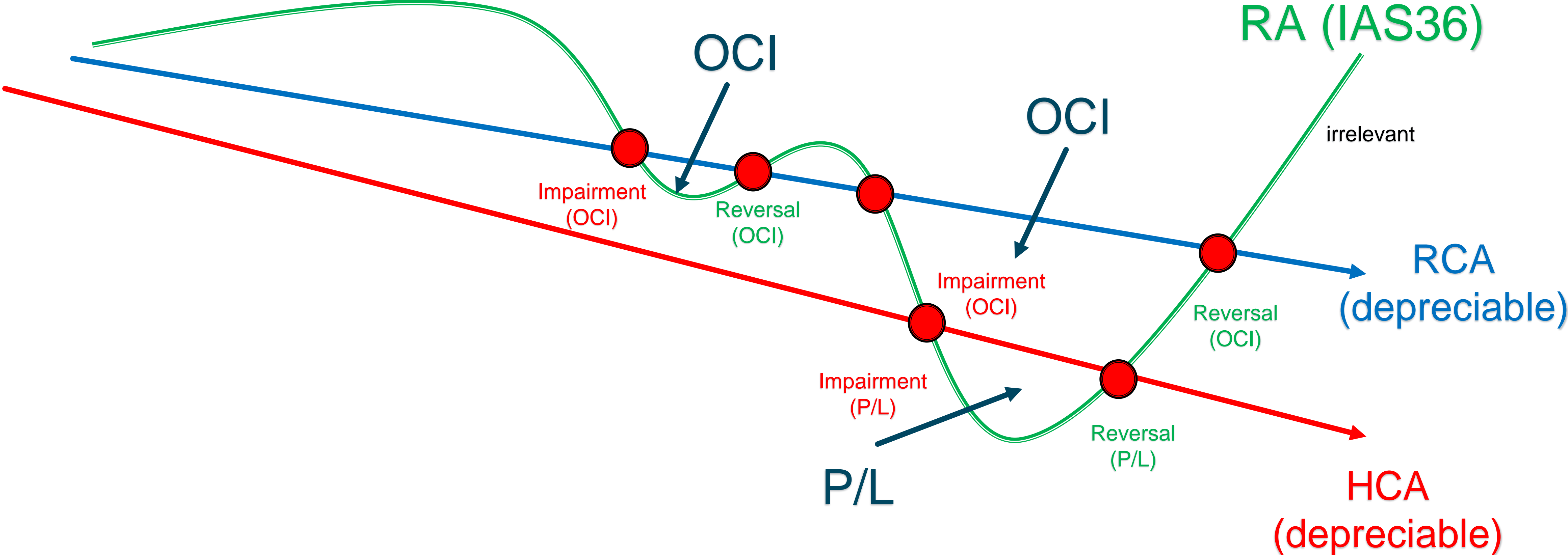
**What are the requirements  
to *reverse* impairment losses on assets/**CGU's**?**

# 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



# ***IAS 36 Impairment of Assets***

**Disclosures (notes to AFS)**

# Disclosure requirements

- Onerous disclosure requirements in IAS 36
- Refer summary of disclosure requirements (PDF document attached)

**Thank you for your  
participation**

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