

LKAS 36 : Impairment of Assets

AAT Level III FAR - Financial Reporting

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AAT Level 03

Financial Accounting and Reporting

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LKAS 36 Impairment

Question No. 01

Explain the meaning of Impairment of Assets.

Answer No. 01

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What is Impairment of Assets?



The loss arising due to **decline in value** of assets

We know the Carrying Amount of an Asset

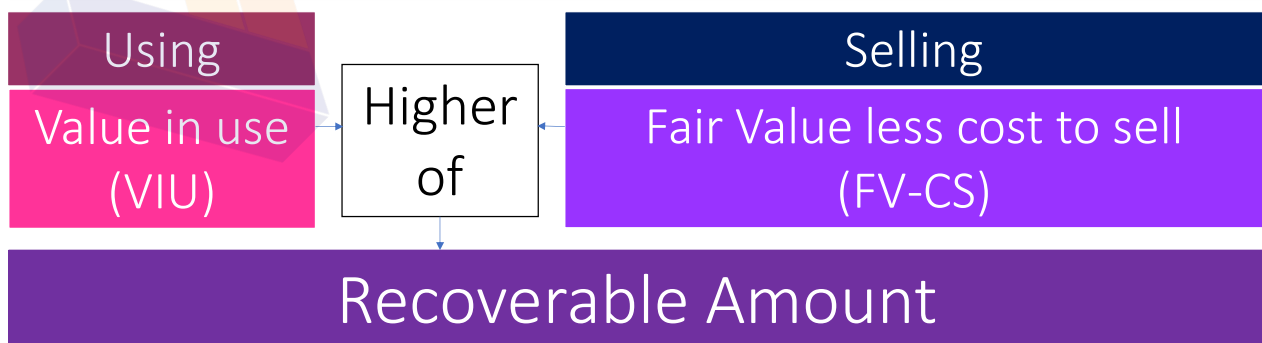
Carrying Amount is the Net Value shown in books

Cost/Revalued Amount	XX
(-) Accumulated Depreciation charged up to now	(X)
(-) Accumulated Impairment Losses charged up to now	(X)
Carrying Amount	XX

Recoverable Amount

Any Asset has a Recoverable Amount.

That is the value that will **recover** the cost either by **Using** or **Selling**.



What is the rationale of taking higher value?

Value in use is,

Present value of future cash flows expected to be derived from an asset



Factors to be considered when computing Value in use

Cash inflows and cash outflows from using the asset

Residual value from disposing the asset at the end of useful life

When forecasting future cash flows consider following

- Reasonable and Supportable assumptions
- Maximum period of 5 years
- Exclude
 - Income tax receipts or payments
 - Interest payments
 - Future restructuring to which an entity is not yet committed

For discounting, risk adjusted pre-tax interest rate should be used.

Fair Value less cost to sell is



The Value arrived at after deducting costs of disposal from the market value (SLFRS 13) of the asset

Costs to sell includes:

Legal costs



Stamp duty



Costs of removing the asset



Costs of Disposal does not include:

Costs associated with reorganizing a business after disposal of an asset

Generally, the Recoverable Amount is higher than the Carrying Amount. However, due to certain reasons, the Recoverable Amount may be lower than the Carrying Amount

We call these reasons as **Impairment Indicators**
They can be categorized as follows:

Internal Indicators

External Indicators

Internal Impairment Indicators

Physical damages to an asset

Obsolescence

Assets becoming idle

Decrease in usage due to change in business plans

Lower economic performance than expected



External Impairment Indicators

Significant decline in Market Value

Increase in market interest rates

Adverse changes in macro economic factors

- Tax impositions
- Technological obsolescence
- Change in consumer appetite
- Adverse legal changes

Market Capitalisation being lower than the entity's net asset value



2020 July Question No. 04

(a) As per LKAS 36 - Impairment of Assets, there are indications that an asset may be impaired.

You are required to:

State two (02) indications to identify that an asset may be impaired as per LKAS 36.

(02 marks)

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Answers



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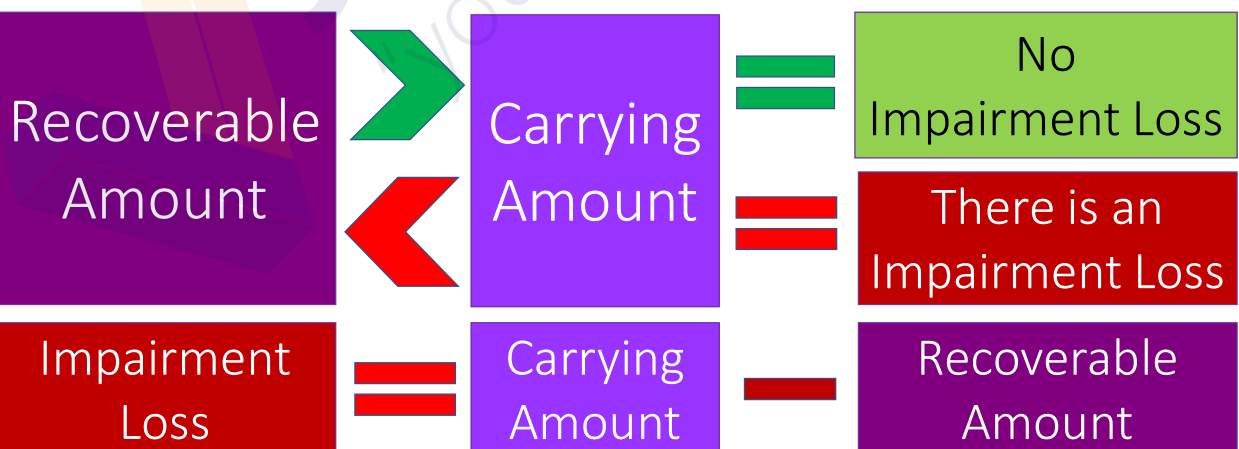
Question No. 02

Decide whether following are Impairment Indicators or not.

1. Decrease in the future usage of an asset due to technological advancement.
2. Government decision to grant subsidies to the industry
3. Rise in interest rates
4. Market capitalization being more than the entity's net assets
5. Damages to inventories due to floods
6. Motor vehicle accident
7. Impact on an Export entity due to depreciation of foreign exchange rates
8. Management deciding to carry out administrative functions online

When there's an Impairment Indicator,
an Impairment Test should be conducted

In an Impairment Test, the Recoverable Amount is estimated
and compared with the Carrying Amount!



2020 July Question No. 04

(b) Cost of the machinery of a company is Rs. 6 million and carrying value of this machinery as at 31st March 2020 was Rs.3.5 million. The company carried out an impairment test on 31st March 2020 and it was revealed that the fair value less cost of disposal and value in use of the machinery are Rs.2 million and Rs. 2.5 million respectively.

You are required to:

Calculate the impairment loss of the machinery for the year ended 31st March 2020. (03 marks)

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Answers



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2023 January Question No. 06 (b)

(B) Carrying value of a motor vehicle as at 31st March 2022 of Sam Ltd was Rs.3,600,000/- and this motor vehicle was purchased for Rs.4,800,000/- on 1st April 2019. The company carried out an impairment test on 31st March 2022 and it was found that the fair value less cost of disposal of the motor vehicle was Rs.2.8 million and the value in use was Rs.3 million.

You are required to:

Calculate the impairment loss of the motor vehicle as per LKAS 36. (04 marks)

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Answers



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Even if there are no indications of an impairment, following assets must be tested for impairment annually.

Intangible
Assets with an
Indefinite
useful life

Intangible
Assets that are
not yet available
for use

Goodwill
acquired in a
Business
Combination

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Accounting for Impairment Loss

Does the Asset have any Revaluation Reserve?

No

Yes

Impairment Loss Dr
Accumulated Impairment Losses Cr

Up to the
amount of the
Reserve

Balance

Revaluation Reserve Dr
Accumulated Impairment Losses Cr

Question No. 03

Sasindu Ltd. purchased a Computer System. The technology of that computer system became obsolete. The impairment loss is Rs. 2 Mn. This computer system has a revaluation reserve of Rs. 1 Mn. How to account for the Impairment Loss?

Answer 03

Subsequent Accounting of an Impaired Asset

The net book value after deducting impairment losses should be depreciated over the remaining useful life.

Question No. 04

Hiran PLC produces biscuits. One of its competitors introduced a new product to the market and therefore, the demand for the biscuits of Hiran PLC has decreased. Its machinery remains idling as a result.

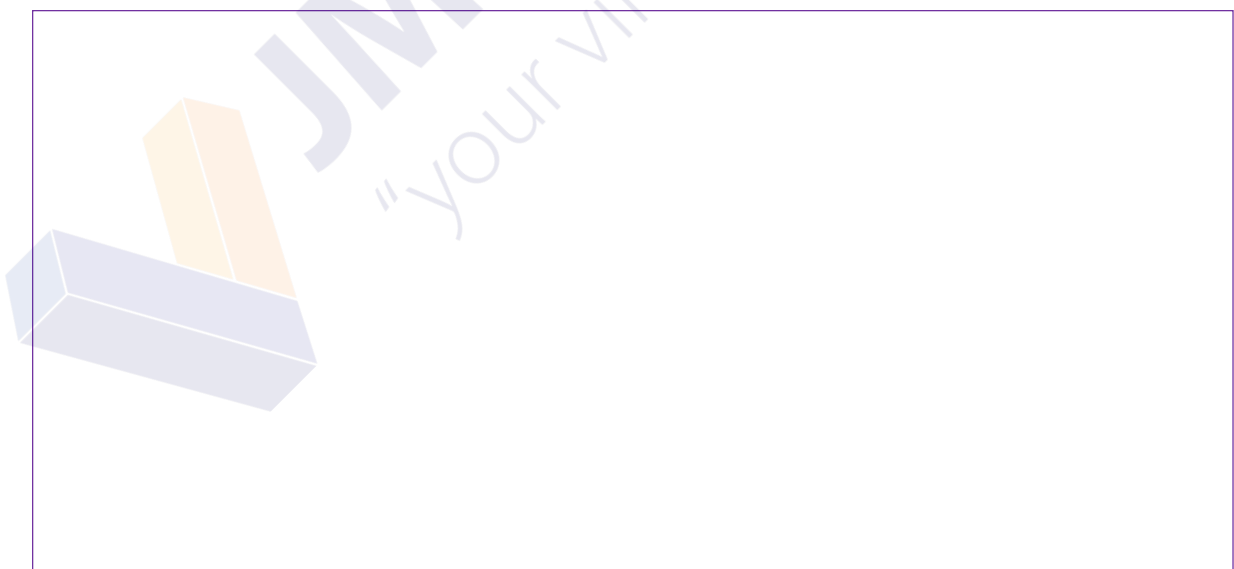
The Carrying Amount of these machinery is Rs. 100 Mn.

Its Fair Value less costs to sell is Rs. 90 Mn.

Value in use is Rs. 98 Mn.

1. Calculate the Impairment Loss
2. If the remaining useful life of machinery is 4 years, calculate the Depreciation charge for the next year.

Answer 04



Answer 04

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Question No. 05

The lorry of Kasun Ltd. met with an accident.

The Fair Value less costs to sell on that date was Rs. 5 Mn.

The lorry can be used for another 3 years.

It is expected to receive,

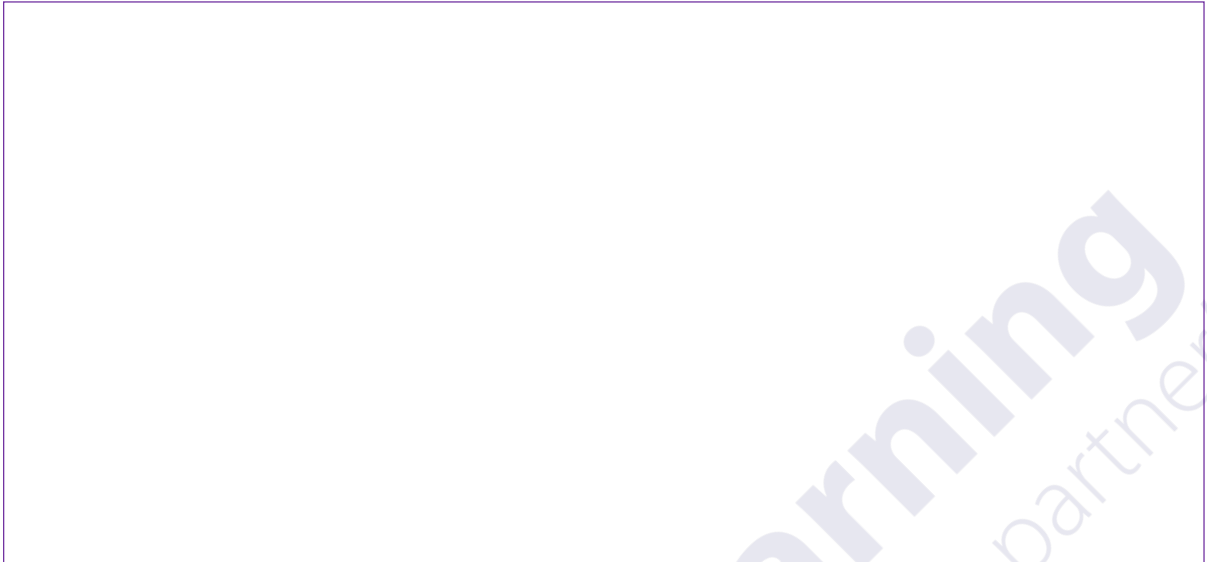
- Rs. 2 Mn within the first year
- Rs. 3 Mn within the second year
- Rs. 1 Mn within the third year

The residual value is Rs. 1 Mn. Discount rate is 10%. If the Carrying Amount is Rs. 7 Mn, calculate the Impairment Loss.

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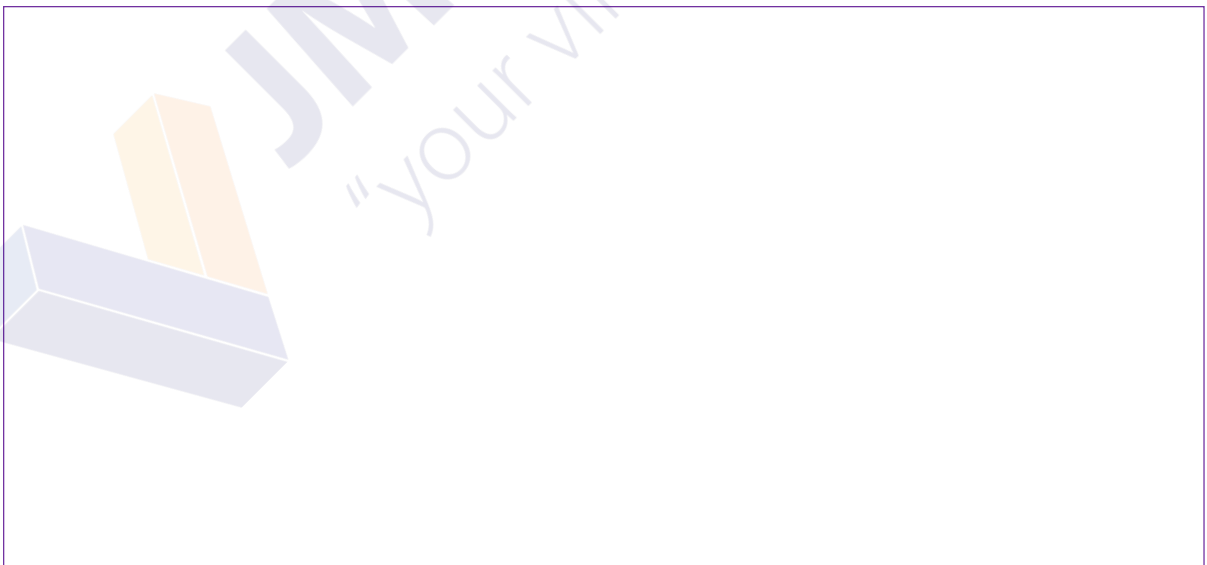
Answer 05



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Answer 05



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Question No. 06

The Carrying Amount of the beverage production machine of Nimal Ltd. is Rs. 25 Mn.

The useful life is 5 years.

It was determined that the machine has been impaired due to lower economic performance than expected.

It can produce 100,000 units annually.

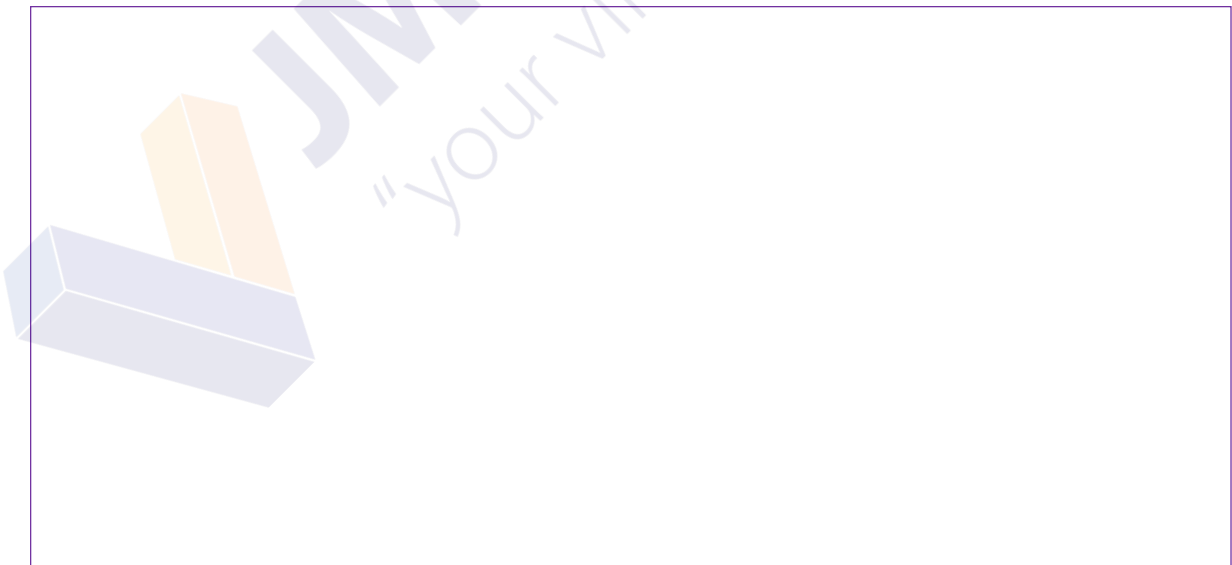
Unit price is Rs. 150/- and the unit cost is Rs. 100/-.

Discount rate is 10%.

Calculate the Recoverable Amount.

Calculate the Impairment Loss (if any).

Answer 06



Answer 06

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Cash-generating Units (CGU)

Impairment losses should be calculated for individual assets as far as possible.

If it is difficult to identify an individual asset from other assets, then Impairment loss can be considered for the cash generating unit (CGU) to which the asset belongs to.

What is a Cash-generating Unit?

A cash-generating unit (CGU) is the smallest identifiable group of assets that generates cash inflows, that are largely independent from other assets.

Examples

- Departments
- Subsidiary companies
- Divisions
- Branches

Examples for Cash-generating Units

- Tables and chairs in a restaurant do not generate cash independently. Therefore, all assets in the restaurant can be considered as a CGU.



- There is a railway service designed to transport minerals in a mine. This railway service operates independently. It can be considered as a CGU.



Impairment Losses of a CGU

Impairment
Loss



Carrying Amount
of the CGU



Recoverable Amount
of the CGU

How to adjust Impairment Losses of a CGU

Firstly, adjust to assets that are specifically impaired.

Next, adjust to the Goodwill if any, in CGU.

Then, the remaining loss, adjust to all other assets on a pro-rata basis.

Question 07

Harini PLC considers its Badulla Branch as a CGU. The Carrying Amount of its assets is as follows.

Assets	Rs. Mn
Building	10
Machinery	5
Software	2
Goodwill	2
Carrying Value	19

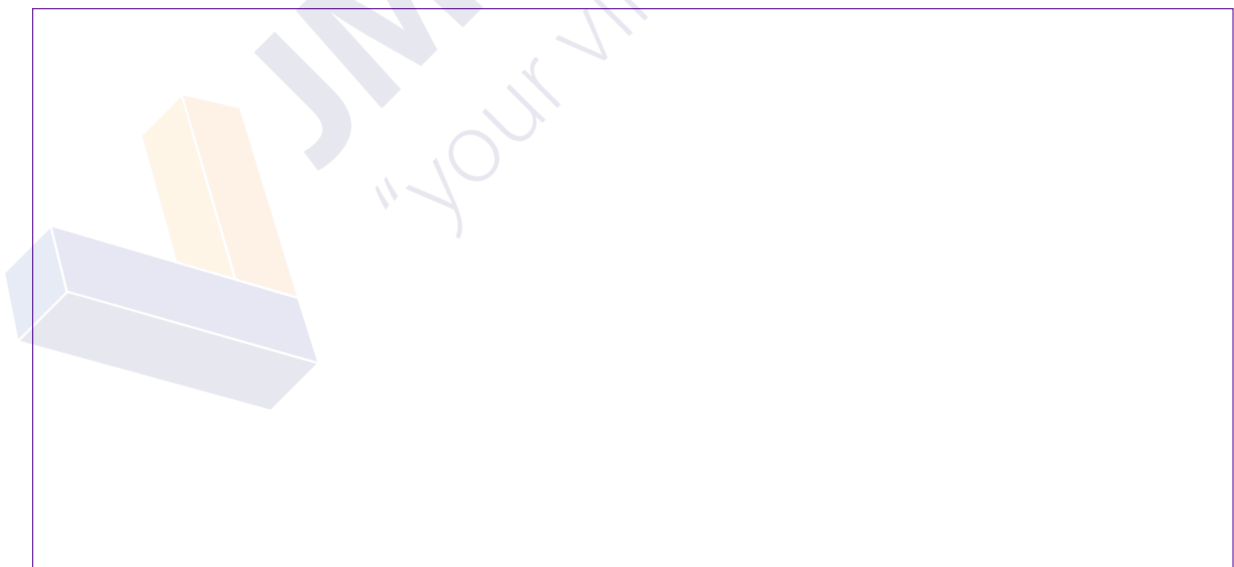
Question No. 07

This CGU has been impaired.
Its Value in use is Rs. 10 Mn.
Fair Value less costs of disposal is Rs. 9 Mn.
Software included in this unit has been fully impaired.
Show how impairment losses should be adjusted to the assets.

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Answer 07



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Answer 07

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Reversal of Impairment Losses

When the Recoverable Amount of a previously impaired asset exceeds the Carrying amount, the previously recognized impairment loss shall be reversed.

Accumulated Impairment Losses	Dr
Other Expenses account	Cr

The new carrying amount of the asset after the reversal shall not exceed the carrying amount of the asset before impairment losses (after deducting subsequent depreciation).

When impairment loss of a CGU is reversed, except for Goodwill, the reversal shall be allocated to other assets on a pro-rata basis.

Question No. 08

The Carrying Amount of the machine of Pathum Ltd. is Rs. 10 Mn as at 31/3/20X1.

It's recoverable value was Rs.8 Mn due to a decline in market demand.

Its remaining useful life is 5 years.

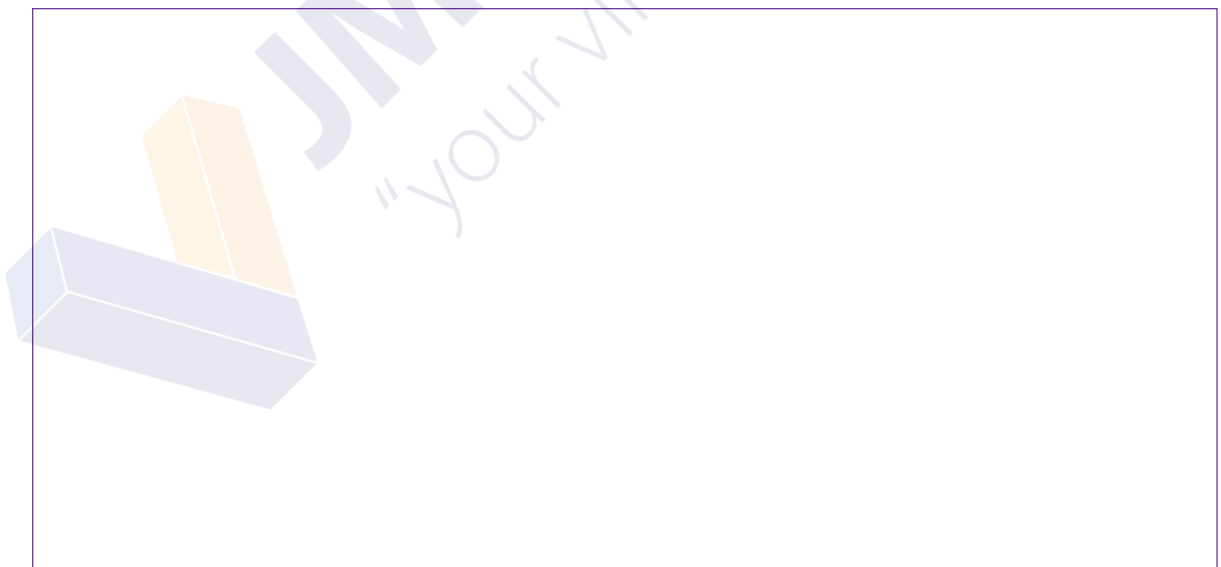
One year later, the market demand increased, and its Recoverable Amount has increased to Rs. 12 Mn.

1. Calculate the Impairment Loss and show the double entry.
2. Show the Reversal of Impairment Loss with calculations.

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Answer 08



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Answer 08



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