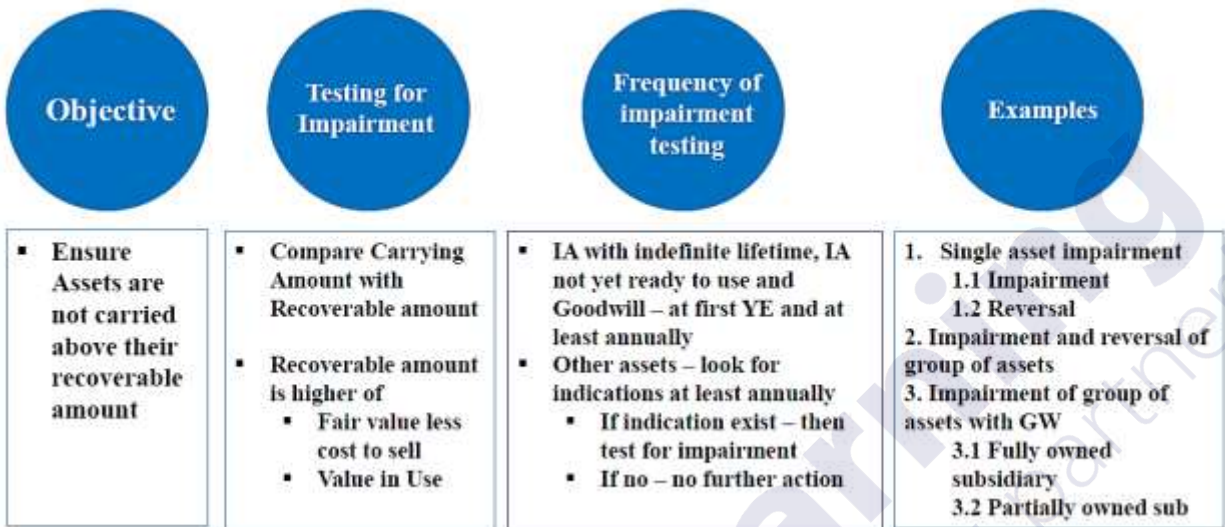


LKAS 36 – Impairment of Assets



1. Core principle

◆ Objective

- Prescribe the procedures to ensure that assets are carried at no more than their recoverable amount, i.e. the amount expected to be recovered through use of the asset, or its fair value less cost to sell.

◆ Purpose

- Specify procedures to be followed to ensure that assets are not carried at more than recoverable amount
- Specify when an impairment loss should be reversed
- Specify required disclosures

2. Scope

◆ Applies to all assets except

- Inventories
- Assets arising from construction contracts
- Deferred tax assets
- Financial assets within the scope of LKAS 39
- Assets arising from employee benefits
- Investment property measured at fair value
- Biological assets measured at fair value less estimated point-of-sale costs

- Deferred acquisition costs and intangible assets arising from insurance contracts
- Non-current assets classified as held for sale

3. Definition

3.1 Cash-generating unit

- ◆ Determine recoverable amount for the individual asset if possible
- ◆ Apply the CGU concept if the asset's recoverable amount cannot be estimated, i.e. if the asset does not generate cash inflows independent from other assets and its value in use cannot be estimated to be close to its fair value less costs to sell
- ◆ A CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent from other (groups of) assets

CGU – Factors to be considered

- ◆ Key factor: ability to generate independent cash inflows
 - If an active market exists for the output of an asset group, then it is a CGU even if the output is only sold to another division with the entity
 - The focus is on cash inflows, not net cash flows
- ◆ Consider how management makes decisions about continuing or disposing of assets / operations
- ◆ Consider how management monitors operations

3.2 Goodwill

- ◆ Future economic benefits arising from assets that are not capable of being individually identified and separately recognised
- ◆ Does not generate independent cash flows

3.2.1 Allocation of goodwill

Basic principle:

Goodwill is allocated to the acquirer's CGU (or group of CGUs) that are expected to benefit from the synergies of the business combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units

- ◆ Initial allocation of goodwill to CGUs:
 - Finalised before the end of the first annual reporting period beginning after the acquisition date

- Completed on provisional basis before the end of the reporting period in which acquisition took place
- ◆ Each unit or group of units shall:
 - Represent the lowest level within the entity at which goodwill is monitored for internal management purposes
 - Not be larger than entity's operating segments as determined by SLFRS 8 before applying the aggregation criteria of para 12 of SLFRS 8.
 - Applicable prospectively for annual periods beginning on or after 1 January 2010
- ◆ Disposal of operations: goodwill allocated to the carrying amount of the operation when calculating gain/loss

4. Indications of impairment

- ◆ **External sources**
 - Significant decline in market value
 - Technological, market, economic, legal environment
 - Increases in interest rates or rates of return
 - Lower market capitalisation than equity book value
- ◆ **Internal sources**
 - Evidence of obsolescence or physical damage
 - Discontinuance, disposal, restructuring plans
 - Asset performance declining or expected to decline
 - Receipt of a dividend of a subsidiary, jointly controlled entity or associate when the carrying amount of the investment exceeds the share of underlying net assets (including goodwill) in the consolidated accounts or when the dividend exceeds total comprehensive income of the investee

5. Frequency and timing of testing

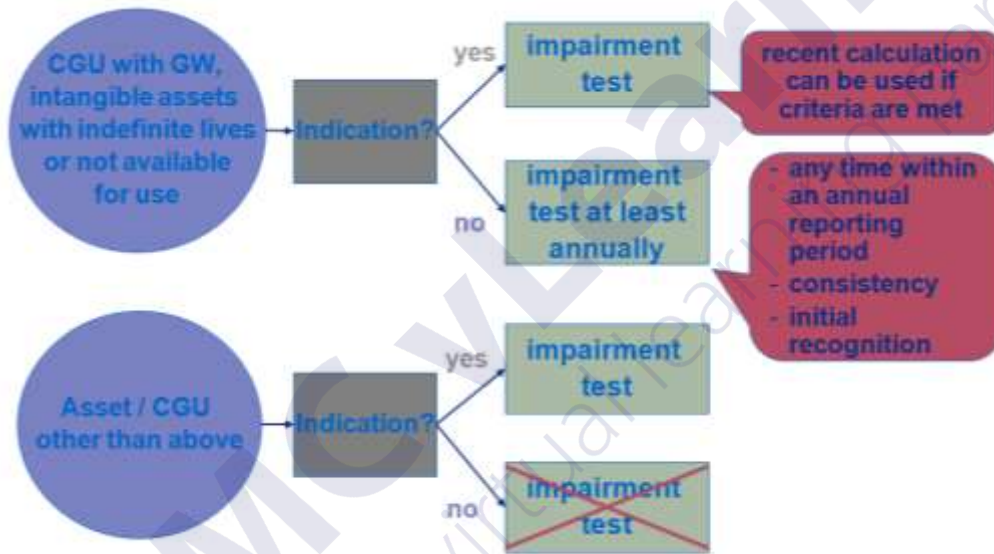
- ◆ CGU to which goodwill has been allocated
- ◆ Intangible assets with an indefinite useful life
- ◆ Intangible assets not yet available for use
 - Impairment test Annually; - Any time within an annual reporting period Needs to be consistent (same time every year)

and

- At each reporting date, if there is an impairment indicator;
 - Before the end of the period of initial recognition
- ◆ Recent calculation can be used if the following criteria are met:
- CGU did not change substantially
 - Most recent recoverable amount was significantly greater than carrying amount
 - Analysis of events and circumstances – no elimination of the difference

Note: A recent calculation can only be used in the case of intangible assets with an indefinite useful life and cash-generating units to which goodwill has been allocated

Frequency – Summary



6. Recoverable amount

- ◆ **Recoverable amount is the greater of:**
- Value in use (VIU): present value of estimated future cash flows to be derived from an asset/CGU (continuing use and ultimate disposal)
 - Fair value less costs to sell (FVLCS): amount obtainable from a sale of asset/CGU in an arm's length transaction less costs of disposal
- ◆ **If FVLCS is determinable, then not required to measure VIU or test at CGU level when:**
- an asset's FVLCS is higher than the carrying amount; or
 - an asset's FVLCS can be estimated to be close to VIU (e.g. asset held for disposal)

6.1 Fair value less costs to sell

- ◆ Fair value is based on best available evidence, which is (from most reliable to least):
 - Binding sale agreement
 - Active market (current bid price)
 - Best information available
- ◆ Less costs of disposal, excluding
 - Costs already recognised as liabilities
- ◆ Observable market: **not required to determine FVLCS** (other valuation techniques may be used in its absence)
- ◆ Valuation techniques: **any reasonable and reliable method can be used to estimate FVLCS**
- ◆ Newly acquired unit
- ◆ Arm's length price paid to acquire the unit: best evidence of fair value
- ◆ Needs to be adjusted: disposal costs and any changes in economic circumstances
- ◆ Reflects market's assessment of costs and benefits of future restructuring and capital expenditure
- ◆ Entity specific synergies are not included in fair value

6.2 Value in use

- ◆ Elements to be considered:
 - Cash inflows and outflows specific to the asset/CGU
 - Time value of money (market risk-free rate)
 - Uncertainty inherent to the asset
 - Expectations about possible variations in the amount or timing of those future cash flows
 - Other factors (e.g. forecasting risk)
- ◆ Reasonable and supportable assumptions that reflect management's best estimate
- ◆ Most recent financial budgets/forecasts approved by management (excluding future restructurings and capital expenditure to enhance performance)
- ◆ Short term projections: 5 years (unless a longer period can be justified)

- ◆ Projection beyond the period covered by the most recent financial budgets/forecasts approved by management
 - Extrapolation based on steady or declining growth rate
 - Growth rates shall not exceed long term average rates for the product/industry/country
- ◆ Projection period based on the asset essential to CGU with the longest useful life; replacement of assets with shorter lives reflected in projected servicing costs

6.2.1 Value in use – Composition

- ◆ Cash inflows from the continuing use of the asset, including disposal
- ◆ From the asset in its current condition: ignore cost savings relating to uncommitted expenditure (future restructuring) or future capital expenditure that would enhance the performance of the asset
 - Ignore financing and tax cash flows
 - Avoid double counting costs already recognised as liabilities

6.2.2 Discount rates

- ◆ Pre-tax rate
- ◆ Current market assessments of time value of money and risks specific to the asset/CGU
- ◆ Where not available, start from other discount rates and adjust
- ◆ Should not reflect risks for which cash flow estimates have been adjusted
- ◆ Current market assessments of time value of money and risks specific to the asset
 - WACC of a listed entity that has a single asset (or portfolio of assets) similar to the asset/CGU under review
- ◆ If not available, then use as a starting point:
 - Entity’s WACC (using CAPM)
 - Entity’s incremental borrowing rate
 - Other market borrowing rates (for similar companies and/or assets)
- ◆ However, these rates must be adjusted to reflect specific risks associated with the projected cash flows

6.2.3 Value in use – Consistency

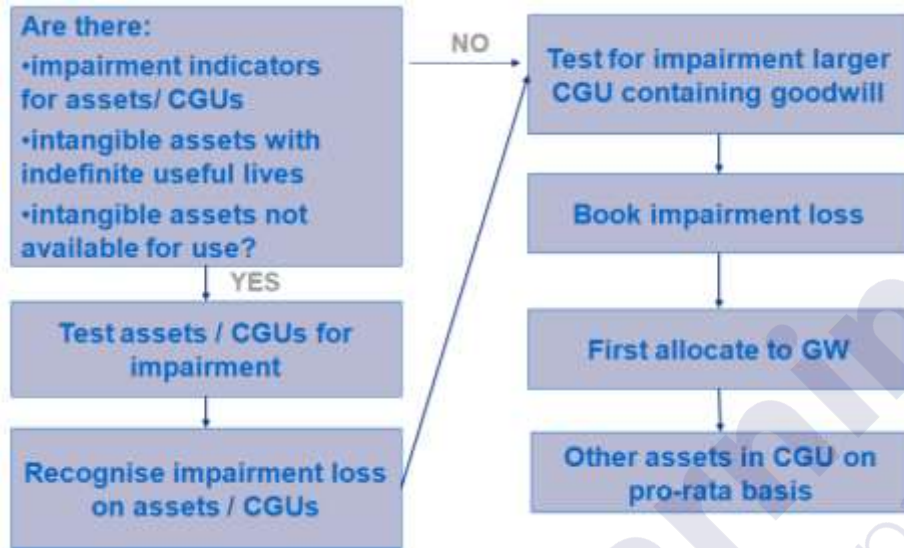
Cash flows (CF)	Discount rate (DR)
CF should not include inflows and outflows from financing activities	Financing is accounted for by discounting
If CF are adjusted for certain risks...	...DR should not reflect these risks
CF estimated in currency in which CF will be generated	DR appropriate for that currency
If <u>pre-tax</u> CF is used...	... <u>Pre-tax</u> DR is applied
If <u>post-tax</u> CF is used...	... <u>Post-tax</u> DR is applied
If nominal CF is used (i.e. including expected inflation)...	...DR including expected inflation
If real CF is used (i.e. excluding inflation expectations)...	...DR excluding expected inflation

6.2.4 WACC – Definition

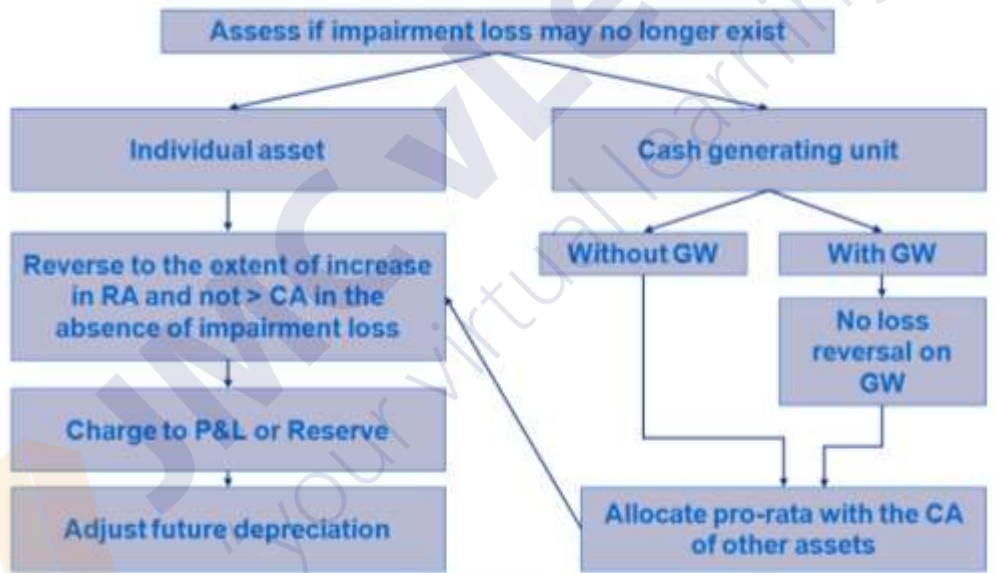
- ◆ Average representing the expected return on a company's capital structure
- ◆ Capital structure must reflect market values and long term financing policies of an “average market participant”
- ◆ A rate of return is assigned to each source of capital and weighted in accordance with the proportion that each source of capital contributes to the long run optimal CGU capital structure
- ◆ Used for evaluating capital projects and/or investments



7. Allocating impairment loss – Step by step



8. Reversal of impairment loss



9. Non-wholly-owned CGUs

- ◆ Entity X acquires 80% ownership interest in Entity Y for 1,600 on 1 January 2010. At that date, Y's identifiable net assets have a fair value of 1,500.
- ◆ Recognised in X consolidated financial statements:
 - goodwill of 400, being the difference between the cost of the business combination of 1,600 and X's 80 % in Y's identifiable net assets
 - Y's identifiable net assets at their fair value of 1,500

- a non-controlling interest of 300, being the 20% interest in Y's identifiable net assets held by parties outside X (as elected by entity X)

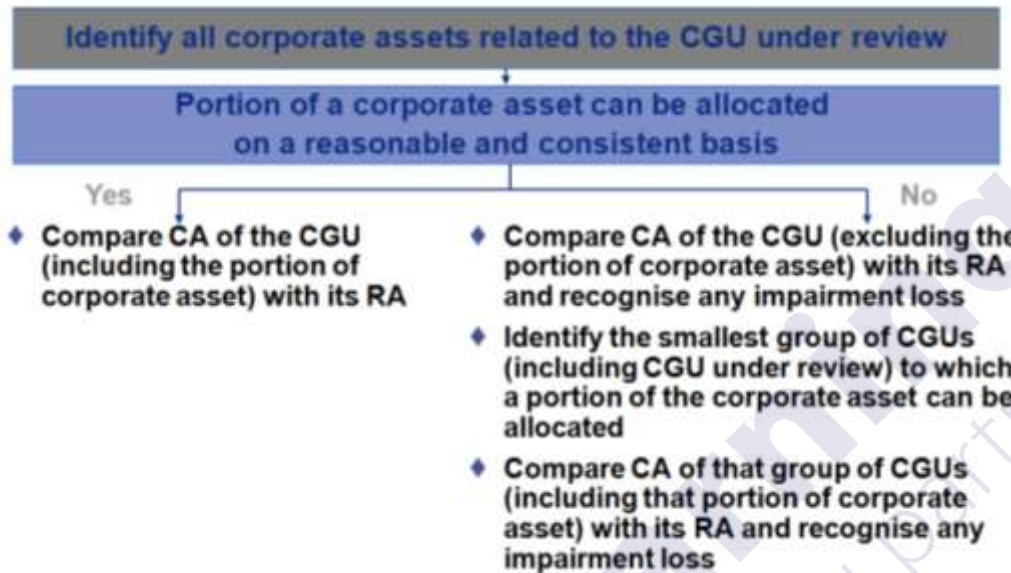
◆ **At the end of 2010, X determines that the recoverable amount of cash generating unit Y is 1,000.**

End of 2010	Goodwill	Net assets	Total
Gross carrying amount	400	1 500	1 900
Accumulated depreciation	-	(150)	(150)
<i>Carrying amount</i>	<i>400</i>	<i>1 350</i>	<i>1 750</i>
Unrecognised non-controlling interest	100	-	100
<i>Notionally adjusted carrying amount</i>	<i>500</i>	<i>1 350</i>	<i>1 850</i>
Recoverable amount			1 000
Impairment loss			850

End of 2010	Goodwill	Net assets	Total
Gross carrying amount	400	1 500	1 900
Accumulated depreciation	-	(150)	(150)
<i>Carrying amount</i>	<i>400</i>	<i>1 350</i>	<i>1 750</i>
Impairment loss	(400)	(350)	(750)
<i>Carrying amount after impairment loss</i>	<i>-</i>	<i>1 000</i>	<i>1 000</i>

What if the Non-controlling interest was valued at fair value (at 350) on the acquisition date?

10. Corporate assets – Step by step



11. Key disclosures

- ◆ **By category of asset**
 - Amount of impairment losses recognised / reversed during the period in
 - Profit or loss or
 - Other comprehensive income
 - If recognised in profit or loss, disclosure of where items are included
 - Segment reporting information
- ◆ **By category of asset**
 - Disclosures for an individual asset when impairment losses are material
 - Information on basis used for determining recoverable amount
 - Discount rate used
- ◆ **For each CGU (or group of units)**
 - Key assumptions used to measure the recoverable amounts
 - Other specified information when a reasonably possible change in a key assumption would cause the CGU's (or group of units') carrying amount to exceed the recoverable amount
- ◆ **Aggregated carrying amount of goodwill/intangible assets with indefinite useful lives allocated to those units (or groups of units)**
- ◆ **Additional disclosures**

- If the recoverable amounts of any of those units (or group of units) are based on the same key assumptions and the aggregate carrying amount of allocated goodwill/intangible assets with indefinite useful lives is significant
- Other specified information when a reasonably possible change in a key assumption would cause the CGU's (or group of units') carrying amount to exceed the recoverable amount

Practice questions – Example 1

(i) Telepath acquired an item of plant at a cost of Rs.800,000 on 1 April 2010 that is used to produce and package pharmaceutical pills. The plant had an estimated residual value of Rs.50,000 and an estimated life of five years, neither of which has changed. Telepath uses straight-line depreciation. On 31 March 2012.

Telepath was informed by a major customer (who buys products produced by the plant) that it would no longer be placing orders with Telepath. Even before this information was known, Telepath had been having difficulty finding work for this plant. It now estimates that net cash inflows earned from the plant for the next three years will be:

		Rs.'000
year ended:	31 March 2013	220
	31 March 2014	180
	31 March 2015	170

On 31 March 2015, the plant is still expected to be sold for its estimated realisable value. Telepath has confirmed that there is no market in which to sell the plant at 31 March 2012.

Telepath's cost of capital is 10%

(ii) Telepath owned a 100% subsidiary, Tilda, that is treated as a cash generating unit. On 31 March 2012, there was an industrial accident (a gas explosion) that caused damage to some of Tilda's plant. The assets of Tilda immediately before the accident were:

	Rs.'000
Goodwill	1,800
Patent	1,200
Factory building	4,000
Plant	3,500
Receivables and cash	1,500
	12,000

As a result of the accident, the recoverable amount of Tilda is Rs.6.7 million.

The explosion destroyed (to the point of no further use) an item of plant that had a carrying amount of Rs. 500,000.

Tilda has an open offer from a competitor of Rs.1 million for its patent. The receivables and cash are already stated at their fair values less costs to sell (net realisable values).

Required:

Calculate the carrying amounts of the assets in (i) and (ii) above at 31 March 2012 after applying any impairment losses.

Example 2

Given below are the statements of financial position of the Traveler and its two subsidiaries Data and Captive. (In Rs ‘Mn)

	Traveler	Data	Captive
Assets:			
Non-current assets			
Property, plant and equipment	439	810	620
Investments in subsidiaries			
Data	820		
Captive	541		
Financial assets	108	10	20
	<u>1,908</u>	<u>820</u>	<u>640</u>
Defined benefit asset	72		
Current assets	995	781	350
	<u>2,975</u>	<u>1,601</u>	<u>990</u>
Equity and liabilities:			
Share capital			
Share capital	1,120	600	390
Retained earnings	1,066	442	169
Other components of equity	60	37	45
	<u>2,246</u>	<u>1,079</u>	<u>604</u>
Non-current liabilities			
Non-current liabilities	455	323	73
Current liabilities			
Current liabilities	274	199	313
	<u>729</u>	<u>522</u>	<u>386</u>
Total equity and liabilities	<u>2,975</u>	<u>1,601</u>	<u>990</u>

Traveler acquired equity interest of 70% in Data and 80% in Captive several years ago.

The goodwill on the acquisition of Data amounted to Rs. 60mn (NCI at fair value – full goodwill method) and Captive amounted to Rs. 120mn. (NCI at proportion of net assets – partial goodwill method)

Data could be considered as a single cash generating unit (CGU) and its recoverable amount was determined at Rs. 1,050mn.

Captive had two business lines and was considered as two independent CGU’s. The assets of the 2 CGU’s constituted 80% and 20% of the whole company. This same proportion was used as the basis for the purpose of allocating the goodwill as well. The recoverable amount of Captive was determined at Rs. 700mn of which CGU 2 had a value of Rs. 160mn

The financial assets and the current assets of the companies are stated at their recoverable amounts.

Calculate the impairment loss, if any, and show how it will be allocated and present the extracts of the consolidated statement of financial position showing the PPE, goodwill, financial assets and current assets of the group. (5 Marks)

Example 3

On 1 December 2006, Blackcutt opened a school at a cost of \$5 million. The estimated useful life of the school was 25 years. On 30 November 2012, the school was closed because numbers using the school declined unexpectedly due to a population shift caused by the closure of a major employer in the area. The school is to be converted for use as a library, and there is no expectation that numbers using the school will increase in the future and thus the building will not be reopened for use as a school. The current replacement cost for a library of equivalent size to the school is \$2.1 million. Because of the nature of the non-current asset, value-in-use and net selling price are unrealistic estimates of the value of the school. The change in use would have no effect on the estimated life of the building.

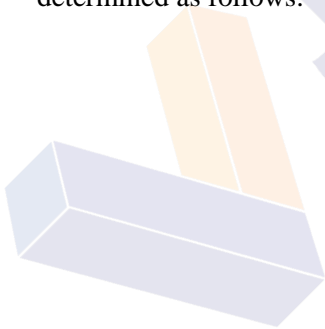
Required:

Discuss how the above events should be accounted for in the financial statements of Blackcutt (06 marks)

Answer

An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and IAS 36 Impairment of Assets requires the recognition of an impairment loss. At the end of each reporting period, an assessment should take place as to whether there is any indication that an asset may be impaired. If any indication exists, the recoverable amount should be estimated taking into account the concept of materiality in identifying whether the recoverable amount of an asset needs to be estimated. If no indication of an impairment loss is present, IAS 36 does not require a formal estimate of the recoverable amount, with the exception of intangible assets.

Impairment in this case is indicated because the purpose for which the building is used has changed significantly from a place for educating students to a library and this is not anticipated to change for the foreseeable future. There is insufficient information to determine value in use and net selling price (fair value less selling costs); as such, depreciated replacement cost should be used as an approximation of the recoverable amount. An impairment loss using a depreciated replacement cost approach would be determined as follows:



Asset	Cost/replacement cost \$000	Accumulated depreciation \$000 – 6/25	Carrying amount/ replacement cost \$000
			30 November 2012
School	5,000	(1,200)	3,800
Library	2,100	(504)	(1,596)
			—————
Impairment loss			2,204
			—————

Thus Blackcutt would record the impairment loss of \$2.204m.

Example 4

- (a) At 30 November 2011, 65% of Scramble’s total assets were mainly represented by internally developed intangible assets comprising the capitalised costs of the development and production of online computer games. These games generate all of Scramble’s revenue. The costs incurred in relation to maintaining the games at the same standard of performance are expensed to the statement of comprehensive income. The accounting policy note states that intangible assets are valued at historical cost. Scramble considers the games to have an indefinite useful life, which is reconsidered annually when the intangible assets are tested for impairment. Scramble determines value in use using the estimated future cash flows which include maintenance expenses, capital expenses incurred in developing different versions of the games and the expected increase in turnover resulting from the above mentioned cash outflows. Scramble does not conduct an analysis or investigation of differences between expected and actual cash flows. Tax effects were also taken into account. (07 marks)

Required:

Discuss the validity of the accounting treatments proposed by Scramble in its financial statements for the year ended 30 November 2011.

Answer

The internally generated intangibles are capitalised in accordance with IAS 38, Intangible Assets. It appears that Scramble is correctly expensing the maintenance costs as these do not enhance the asset over and above original benefits. The decision to keep intangibles at historical cost is a matter of choice and therefore policy. Scramble's accounting policy in this regard is acceptable.

An intangible asset can have a finite or indefinite life and IAS 38 states that an intangible asset shall be regarded by the entity as having an indefinite useful life when, based on an analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.

An indefinite life does not mean infinite and IAS 38 comments that given the history of rapid changes in technology, computer software and many other intangible assets are susceptible to technological obsolescence and the useful life may be short.

If the life of an intangible is indefinite then, in accordance with IAS 36, an entity is required to test for impairment by comparing its recoverable amount with its carrying amount.

- (a) annually, and
- (b) whenever there is an indication that the intangible asset may be impaired.

The useful life of an intangible asset that is not being amortised shall be reviewed each period to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. To determine whether the asset is impaired, IAS 36 must be applied and the intangible asset's recoverable amount should be compared to its carrying amount.

The way in which Scramble determines its value in use cash flows for impairment testing purposes does not comply with IAS 36 Impairment of Assets. Cash flow projections should be based on reasonable and supportable assumptions, the most recent budgets and forecasts, and extrapolation for periods beyond budgeted projections. Management should assess the reasonableness of its assumptions by examining the causes of differences between past cash flow projections and actual cash flows. This process does not seem to have been carried out by Scramble. Additionally, cash flow projections should relate to the asset in its current condition and future restructurings to which the entity is not committed and expenditures to improve or enhance the asset's performance should not be anticipated. The cash flows utilised to determine the value in use were not estimated for the asset in its current condition, as they included those which were expected to be incurred in improving the games and cash inflows expected as a result of those improvements. Further estimates of future cash flows should not include cash inflows or outflows from financing activities, or income tax receipts or payments. Scramble has taken into account the tax effects of future cash flows.

(b) Scramble has two cash generating units (CGU) which hold 90% of the internally developed intangible assets. Scramble reported a consolidated net loss for the period and an impairment charge in respect of the two CGUs representing 63% of the consolidated profit before tax and 29% of the total costs in the period. The recoverable amount of the CGUs is defined, in this case, as value in use. Specific discount rates are not directly available from the market, and Scramble estimates the discount rates, using its weighted average cost of capital. In calculating the cost of debt as an input to the determination of the discount rate, Scramble used the risk-free rate adjusted by the company specific average credit spread of its outstanding debt, which had been raised two years previously. As Scramble did not have any need for additional financing and did not need to repay any of the existing loans before 2014, Scramble did not see any reason for using a different discount rate. Scramble did not disclose either the events and circumstances that led to the recognition of the impairment loss or the amount of the loss recognised in respect of each cash-generating unit. Scramble felt that the events and circumstances that led to the recognition of a loss in respect of the first CGU were common knowledge in the market and the events and the circumstances that led to the recognition loss of the second CGU were not needed to be disclosed.

(07 marks)

Required:

Discuss the validity of the accounting treatments proposed by Scramble in its financial statements for the year ended 30 November 2011.

Answer

The calculation of the discount rate is not wholly in accordance with the requirements of IAS 36 because the discount rate applied did not reflect the market assessment of the contributing factors. According to IAS 36, the discount rate to be applied in these circumstances is a pre-tax rate that reflects the current market assessment of the time value of money and the risks specific to the assets for which the future cash flow estimated have not been adjusted. IAS 36 specifies that a rate that reflects the current market assessment of the time value of the money and the risks specific to the assets is the return that the investors would require if they chose an investment that would generate cash flows of amounts, timing and risk profile equivalent to those that the entity expects to derive from the assets.

If a market-determined asset-specific rate is not available, a surrogate must be used that reflects the time value of money over the asset's life as well as country risk, currency risk, price risk, and cash flow risk. This would include considering the entity's own weighted average cost of capital, the entity's incremental borrowing rate and other market borrowing rates. Therefore, the inputs to the determination of the discount rates should be based on current credit spread levels in order to reflect the current market assessment of the time value of the money and asset specific risks. The credit spread input applied should reflect the current market assessment of the credit spread at the moment of impairment testing, irrespective of the fact that Scramble did not intend taking any additional financing.

Scramble has not complied with the disclosure requirements of IAS 36, in that neither the events and circumstances that led to the impairment loss nor the amounts attributable to the two CGUs were

separately disclosed. IAS 36 requires disclosure of the amount of the loss and as regards the cash-generating unit, a description of the amount of impairment loss by class of assets. The fact that the circumstances were common knowledge in the market is not a substitution for the disclosure of the events and circumstances.

Question

At 31 May 2010 Cate held an investment in and had a significant influence over Bates, a public limited company.

Cate had carried out an impairment test in respect of its investment in accordance with the procedures prescribed in IAS 36, Impairment of assets. Cate argued that fair value was the only measure applicable in this case as value-in-use was not determinable as cash flow estimates had not been produced. Cate stated that there were no plans to dispose of the shareholding and hence there was no binding sale agreement. Cate also stated that the quoted share price was not an appropriate measure when considering the fair value of Cate’s significant influence on Bates. Therefore, Cate estimated the fair value of its interest in Bates through application of two measurement techniques; one based on earnings multiples and the other based on an option–pricing model. Neither of these methods supported the existence of an impairment loss as of 31 May 2010.

Discuss the appropriateness of the conclusion reached by Cate. (05 marks)

Answer

Cate’s position for an investment where the investor has significant influence and its method of calculating fair value can be challenged.

An asset’s recoverable amount represents its greatest value to the business in terms of its cash flows that it can generate i.e. the higher of fair value less costs to sell (which is what the asset can be sold for less direct selling expenses) and value in use (the cash flows that are expected to be generated from its continued use including those from its ultimate disposal). The asset’s recoverable amount is compared with its carrying value to indicate any impairment. Both net selling price (NSP) and value in use can be difficult to determine. However it is not always necessary to calculate both measures, as if the NSP or value in use is greater than the carrying amount, there is no need to estimate the other amount.

It should be possible in this case to calculate a figure for the recoverable amount. Cate’s view that market price cannot reflect the fair value of significant holdings of equity such as an investment in an associate is incorrect as IAS 36 prescribes the method of conducting the impairment test in such circumstances by stating that if there is no binding sale agreement but an 16 asset is traded in an active market, fair value less costs to sell is the asset’s market price less the costs of disposal. Further, the appropriate market price is usually the current bid price.

Additionally the compliance with IAS 28, Investments in associates is in doubt in terms of the non-applicability of value in use when considering impairment. IAS 28 explains that in determining the value in use of the investments, an entity estimates:

- (i) *its share of the present value of the estimated future cash flows expected to be generated by the associate, including the cash flows from the operations of the associate and the proceeds on the ultimate disposal of the investment; or*

(ii) *the present value of the estimated future cash flows expected to arise from dividends to be received from the investment and from its ultimate disposal.*

Estimates of future cash flows should be produced. These cash flows are then discounted to present value hence giving value in use.

It seems as though Cate wishes to avoid an impairment charge on the investment.

June 2017 CA Corporate Level

Question No. 2 (b)

Plaza Ltd is a diversified company. The Plaza Homes division is one of its main business divisions, engaged in renting out apartments for residential purposes. It only has one property, which consists of 50 apartments, situated in the heart of Colombo. The company’s year-end is 31 March. In December 2016, the government asked Plaza Ltd to relocate its above property to another area as the said area was identified as only to be used for commercial purposes. As an alternative to relocation, the Plaza Homes division could use this property for commercial purposes. As at 31 March 2017, the carrying value of the combined net assets of the division is Rs. 890 million and the details are shown below

	Rs. million
Property	650
Equipment	205
Allocated goodwill	30
Receivables	70
Cash and cash equivalents	15
Total assets	970
Payables	80
Net assets	890

Plaza Ltd has obtained a valuation for the Plaza Homes division from an independent professional valuer as at 31 March 2017. The valuer estimated that the division could be sold for Rs. 760 million. An estimated cost of Rs. 5 million would have to be incurred to make this sale. Termination benefits that will be required to pay for the employees whose services are terminated (before their retirement) due to the disposal are estimated to be Rs. 10 million.

If the property is used for commercial purposes, the Plaza Homes division could generate a present value of estimated future cash flows of Rs. 646 million. This amount includes the following costs as well.

- Rs. 70 million (present value) that would be incurred to restructure the property in order for it to be suitable for commercial purpose. The management of Plaza Ltd has not yet committed to incur this restructuring cost.

- Present value of the finance cost of Rs. 7 million. Plaza Ltd has decided to test the Plaza Homes division for impairment. This division is identified as a cash generating unit (CGU).

Required:

Advise the management whether any impairment adjustment is necessary to the above mentioned CGU, and on the accounting treatment to be applied. (13 marks)

June 2018 CA Corporate Level

Question No. 1 (b)

POP PLC has an investment in RED (Pvt) Ltd which has been accounted as an investment in associate. Due to the adverse market conditions over the past few years, the management carried out an impairment test as at 31 March 2018 to see whether the investment was impaired. This impairment test revealed that the investment was not impaired since the value in use was higher than the carrying value (value in use is higher than the fair value less cost to sell). In computing value in use, the following has been considered among other things.

- Future cash flows have been projected for 10 years. Revenue is expected to grow by 5% in the next 5 years based on the most recent budget approved by the management. Thereafter, revenue is expected to grow by 10% as a result of future restructuring.
- Proceeds to be received from a loan already approved by the bank.
- Discount rate used was the long-term Treasury bond rate.

Required:

Advise the management on the accuracy of the value in use computation based on the information provided above. (09 marks)

