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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

SL-25-1 – Advanced Corporate Reporting

Strategic Level (2025 Curriculum)

- LKAS 36 – Impairment of Assets

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LKAS 36
Impairment of Assets

Introduction

Impairment is determined by comparing the carrying amount of the asset with its recoverable amount. Recoverable amount is the higher of its fair value less costs of disposal and its value in use.

There is an established principle that assets should not be carried at above their recoverable amount. An entity should write down the carrying amount of an asset to its recoverable amount if the carrying amount of an asset is not recoverable in full either through continued use or sale. LKAS 36 Impairment of assets puts in place a detailed methodology for carrying out impairment reviews and related accounting treatments and disclosures.

The main accounting issues to consider are as follows.

(a) How is it possible to **identify when** an impairment loss may have occurred?
(b) How should the **recoverable amount** of the asset be measured?
(c) How should an 'impairment loss' be **recognized in the accounts**?

Scope of LKAS 36

This Standard shall be applied in accounting for the impairment of all assets, other than:

- Inventories
- Assets arising from construction contracts

- Deferred tax assets
- Assets arising under LKAS 19 Employee benefits
- Financial assets within the scope of LKAS 32 Financial instruments: presentation
- Investment property measured at fair value (LKAS 40)
- Biological assets measured at fair value less costs to sell (LKAS 41)
- Non-current assets held for sale, which are dealt with under SLFRS 5 Noncurrent assets held for sale and discontinued operations.

Definitions

Impairment Loss	An impairment loss is the amount by which the carrying amount of an asset or cash-generating unit exceeds its recoverable amount.
Carrying Amount	Carrying amount is the amount at which an asset is recognised after deducting any accumulated depreciation (amortisation) and accumulated impairment losses thereon.
Recoverable Amount	The recoverable amount of an asset or a cash generating unit is the higher of its fair value less costs of disposal and its value in use.
Fair Value	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.
Costs Of Disposal	Costs of disposal are incremental costs directly attributable to the disposal of an asset or cash generating unit, excluding finance costs and income tax expense.
Value In Use	Value in use is the present value of the future cash flows expected to be derived from an asset or cash generating unit

Identifying an asset that may be impaired

An entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset. Standard does not require an entity to make a formal estimate of recoverable amount if no indication of an impairment loss is present unless a compulsory testing is required by the same standard.

For this also the concept of materiality applies, and only material impairment needs to be identified. If there are indications of possible impairment, the entity is required to conduct an impairment test.

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

A. An intangible asset with an indefinite useful life

B. An intangible asset that is not yet available for use
C. Goodwill acquired in a business combination

Impairment testing of intangible assets must take place at the same time every year; however, there is no need for this to be at the reporting date. In the year in which an intangible asset was initially recognized, it must be tested for impairment before the end of that year.

In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a **minimum**, the following **indications**:

External Sources of Information
(a) A fall in the asset's market value that is more significant than would normally be expected from passage of time over normal use.
(b) A significant change in the technological, market, legal or economic environment of the business in which the assets are employed.
(c) An increase in market interest rates or market rates of return on investments likely to affect the discount rate used in calculating value in use.
(d) The carrying amount of the entity's net assets being more than its market capitalization.

Internal Sources of Information
(e) Evidence of obsolescence or physical damage of an asset.
(f) Adverse changes in the use to which the asset is put, eg the asset becoming idle, plans to dispose of an asset early or plans to discontinue the part of a business that uses the asset.
(g) Worse than expected economic performance of the asset.
(h) Evidence from internal reporting such as: • Cash flows for operating/maintaining the asset those are significantly higher than originally budgeted. • Net cash flows or operating profit/loss that is significantly worse than budgeted. • A significant decline in budgeted net cash flows or operating profit flowing from the asset. • Operating losses or net cash outflows when current periods are aggregated with budgeted amounts for the future
(i) for an investment in a subsidiary, joint venture or associate, the investor recognizes a dividend from the investment and evidence is available that:

- the carrying amount of the investment in the separate financial statements exceeds the carrying amounts in the consolidated financial statements of the investee's net assets, including associated goodwill; or

- the dividend exceeds the total comprehensive income of the subsidiary, joint venture or associate in the period the dividend is declared

The Impairment Test

Testing for impairment involves determining an asset's recoverable amount and comparing this with the asset's carrying amount.

Calculation of impairment loss

An impairment loss arises where carrying amount exceeds recoverable amount, which is the higher of value in use and fair value less costs of disposal. In this case, carrying amount is written down to recoverable amount and the write down is recognized as an impairment loss.

Therefore, testing for impairment involves establishing recoverable amount. As recoverable amount is the higher of value in use and fair value less costs of disposal, if either of these amounts exceeds an asset's carrying amount, the asset is not impaired and there is no need to determine the other amount.

Question 01

In each of the following situations, **identify** whether the asset is impaired.

(1) The carrying amount of a machine is Rs. 69,500. Its value in use is Rs. 68,500 and its fair value is Rs. 70,000. Costs of disposal are Rs. 600.

(2) The carrying amount of a property is Rs. 4.5m. The property could be sold on the open market for an estimated Rs. 5m subject to 10% agency fees. The value in use has been estimated at Rs. 4.4m.

Measuring fair value less costs of disposal

Fair value is established in accordance with the requirements of SLFRS 13 Fair value measurement. It 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.

LKAS 36 provides no guidance on establishing fair value;

However; It does clarify that costs of disposal may include 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.

They do not, however, include termination benefits, nor costs associated with reducing or reorganizing a business following the disposal of an asset.

Measuring Value in Use

Value in use is the present value of the future cash flows expected to be generated by an asset. It must reflect:

(a) An estimate of the future cash flows the entity expects to derive from the asset.
(b) Expectations about variations in the amount and timing of future cash flows
(c) The time value of money
(d) The price for bearing the uncertainty inherent in the asset
(e) Other factors that would be reflected in pricing future cash flows from the asset Estimating value in use involves estimating cash flows to be derived from use (and disposal) of the asset and applying an appropriate discount rate.

Estimate of Cash Flows

The standard requires that:

(a) Cash flow projections are based on 'reasonable and supportable' assumptions.
(b) Projections of cash flows, normally up to a maximum period of five years, are based on the most recent budgets or financial forecasts.
(c) A steady or declining growth rate for each subsequent year (unless a rising growth rate can be justified) is used in extrapolating short-term projections of cash flows beyond this period. Unless a higher growth rate can be justified, the long-term growth rate employed should not be higher than the average long-term growth rate for the product, market, industry or country.

Cash flows should include:

- Projected cash inflows from continuing use of the asset
- Projected cash outflows necessary to generate these cash inflows
- Net cash flows from the disposal of the asset at the end of its life

They should not include:

- Cash flows associated with a future restructuring to which an entity is not committed.
- Cash flows associated with improving the asset's performance.
- Cash flows from financing activities
- Income tax receipts or payments

Discount rate

The discount rate should be a current pre-tax rate (or rates) that reflect:

- The current assessment of the time value of money
- The risks specific to the asset

Impairment testing of an intangible asset with an indefinite useful life

An intangible asset with an indefinite useful life must be tested for impairment **annually**, regardless of whether there are indications of impairment.

As this requirement can be onerous to apply, LKAS 36 allows an entity to use the most recent detailed calculation of recoverable amount in a preceding period for the current period where:

(a) If the asset is tested for impairment as part of a cash-generating unit, the assets and liabilities making up that unit have not changed significantly since the most recent recoverable amount calculation.

(b) The most recently calculated recoverable amount exceeded the asset's carrying amount by a substantial margin.

(c) Events and circumstances that have occurred since the most recent recoverable amount calculation have been analyzed and there is only a remote likelihood that recoverable amount, if determined now, would be less than the asset's carrying amount.

Accounting for Impairment

An impairment loss is recognized in **profit or loss** in the period when it arises.

Recognition of Impairment Loss

If the recoverable amount of an asset is less than its carrying amount, the asset is impaired and an impairment loss should be recognized. Impairment losses are normally recognized in profit or loss as they arise; however, where an impairment loss arises on a revalued asset, the impairment is treated as a revaluation decrease and first charged to the revaluation surplus.

Question 02

Fernando Property (Pvt) Ltd acquired a property on 1 January 20X4 at a cost of Rs. 8m and commenced depreciation over a 50-year useful life from this date. The company applied the LKAS 16 revaluation model for the subsequent accounting of the property, and revalued it for the first time to Rs. 8,544,000 at 31 December 20X5, continuing to depreciate it over the original term. During 20X6 there was a commercial property crash, and as a result the recoverable amount of the property fell to Rs. 7.4m at 31 December 20X6. Fernando Property do not make an annual reserves transfer in respect of revalued property.

Required:

Demonstrate how the impairment at 31 December 20X6 is accounted for.

Question 03

A company that extracts natural gas and oil has a drilling platform in the Caspian Sea. It is required by legislation of the country concerned to remove and dismantle the platform at the end of its useful life. Accordingly, the company has included an amount in its accounts for removal and dismantling costs, and is depreciating this amount over the platform's expected life.

The company is carrying out an exercise to establish whether there has been an impairment of the platform.

(a) Its carrying amount in the statement of financial position is Rs. 3m.
(b) The company has received an offer of Rs. 2.8m for the platform from another oil company. The bidder would take over the responsibility (and costs) for dismantling and removing the platform at the end of its life.
(c) The present value of the estimated cash flows from the platform's continued use is Rs. 3.3m (before adjusting for dismantling costs).
(d) The carrying amount in the statement of financial position for the provision for dismantling and removal is currently Rs. 0.6m.

Required:

Calculate the carrying amount of the drilling platform in the statement of financial position, and demonstrate how the impairment loss, if any, is accounted for.

Subsequent Accounting for an Impaired Asset

Subsequent to impairment, an asset continues to be depreciated, with the recoverable amount written off over the remaining useful life. The impairment testing rules of LKAS 36 are applied to all assets including those previously impaired and therefore further impairment tests are carried out at any later date where there are indications of impairment.

Cash-Generating Units (CGU)

Where the recoverable amount of an individual asset cannot be determined, it should be tested for impairment as part of the cash-generating unit to which it belongs.

Recoverable amount is determined for an individual asset as far as possible; however, where an asset does not generate cash flows that are independent of other assets, then recoverable amount must be determined for the cash-generating unit (CGU) to which the asset belongs.

A CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. They should be identified consistently from period to period for the same asset, unless a change is justified.

When **identifying CGUs**, management may consider:

- How the entity's operations are managed eg by product line, business or location
- How decisions are made about continuing or disposing of the entity's operations and assets.

A group of assets is identified as a CGU when an active market exists for the output produced by the group; this is the case even where some of the output is used internally.

Example: Cash-Generating Unit

A mining company owns a private railway to support its mining activities. The railway could only be sold for scrap value and does not generate cash flows that are largely independent of the cash inflows from the other assets of the mine. In this case, it is not possible to estimate the recoverable amount of the private railway because its value in use cannot be determined and is unlikely to be similar to scrap value. Therefore the entity estimates the recoverable amount of the CGU to which the private railway belongs (the mine) as a whole.

Question 04

Lanka Bus Company provides services under contract with a municipality that requires a minimum service on each of five routes. Assets devoted to each bus route and cash flows arising from each route can be identified separately; one of the routes operates at a significant loss.

The management of the Lanka Bus Company has designated each of the five outlets as a separate CGU for the purposes of impairment testing.

Required: Comment on the management decision to designate each route as a CGU.

Question 05

Minimart belongs to a retail store chain Maximart. Minimart makes all its retail purchases through Maximart's purchasing centre. Pricing, marketing, advertising and human resources policies (except for hiring Minimart's cashiers and salesmen) are decided by Maximart. Maximart also owns five other stores in the same city as Minimart (although in different neighbourhoods) and 20 other stores in other cities. All stores are managed in the same way as Minimart. Minimart and four other stores were purchased five years ago, and goodwill was recognised.

Required:

What is the cash-generating unit for Minimart?

Instances in which determining a CGU is unnecessary

There are two instances where the CGU of an asset does not have to be considered in order to determine whether that asset is impaired.

1. Where the asset's fair value less costs of disposal exceeds its carrying amount (ie there is no impairment), or

2. Where the asset's value in use can be estimated to be close to its fair value less costs of disposal and fair value less costs of disposal can be measured

Allocating assets to a CGU

An impairment loss in a CGU arises where its carrying amount exceeds its recoverable amount. The recoverable amount of a CGU is determined in the same way as the recoverable amount of an individual asset.

The carrying amount of a CGU is determined on a basis consistent with the way in which the recoverable amount of the CGU is determined, ie it includes those assets that will generate cash flows that are used in determining the CGU's value in use.

Corporate Assets

A portion of corporate assets should be allocated to the CGUs on a reasonable and consistent basis when determining the CGU's carrying amount eg on the basis of the carrying amounts of the other non-current assets of each CGU.

Where corporate assets **can be allocated** on a reasonable and consistent basis, an impairment test is conducted by comparing the carrying amount of a CGU (including its allocation of corporate asset) with its recoverable amount.

Where corporate assets cannot be allocated on a reasonable and consistent basis, an impairment test is conducted by:

1. Comparing the carrying amount of the CGU excluding the corporate asset with its recoverable amount.
2. Allocating a portion of the asset's carrying amount on a reasonable and consistent basis by identifying the smallest group of CGUs that includes the CGU to which the asset belongs.
3. Comparing the carrying amount of that group of CGUs (including the portion of allocated asset) with the recoverable amount of the group of units.

Goodwill

Goodwill acquired in a business combination does not generate cash flows independently of other assets. It must be allocated to each of the acquirer's cash-generating units (or groups of cash-generating units) that is expected to benefit from the synergies of the combination. Each unit to which the goodwill is so allocated should:

1. Represent the lowest level within the entity at which the goodwill is monitored for internal management purposes.

2. Not be larger than a reporting segment determined in accordance with SLFRS 8 operating segments.

It may be impracticable to complete the allocation of goodwill before the first reporting date after a business combination, particularly if the acquirer is accounting for the combination for the first time using provisional values. The initial allocation of goodwill must be completed before the end of the first reporting period after the acquisition date.

Impairment testing where goodwill allocated to a single CGU

In this case an impairment test is conducted by comparing the carrying amount of the CGU including goodwill with its recoverable amount.

Impairment testing where goodwill allocated to a group of CGUs

In this case an impairment test is conducted for each CGU by comparing the carrying amount of the CGU excluding goodwill with its recoverable amount. Goodwill is tested for impairment by comparing the carrying amount of all CGUs in the group (including goodwill) with their recoverable amount.

Where there is a **non-controlling interest** in a CGU to which goodwill is allocated, and the non-controlling interest is measured as a proportion of the net assets of the acquiree, adjustment is required to the carrying amount of goodwill before the impairment test is carried out. This ensures that full goodwill is included in the carrying amount of the CGU before it is compared with recoverable amount.

Question 06

P acquired an 80% interest in a subsidiary for Rs. 16 million in 20X5 when the identifiable net assets of the subsidiary amounted to Rs. 18 million. The non-controlling interest is measured as a proportion of net assets and the subsidiary is a CGU.

At 31 December 20X5, P's year end, the recoverable amount of the subsidiary is Rs. 19.1 million and the carrying amount of its identifiable net assets is Rs. 18.4 million.

Required: Calculate the impairment loss at 31 December 20X5.

Accounting for an Impairment Loss in a CGU

An impairment loss should be recognized for a CGU if (and only if) the recoverable amount of the CGU is less than the carrying amount in the statement of financial position. When an impairment loss is recognized for a cash-generating unit, the loss should be allocated between the assets in the unit in the following order.

(a) First, to any assets that are obviously damaged or destroyed.
(b) Next, to the goodwill allocated to the cash generating unit.
(c) Then, to all other assets in the cash-generating unit, on a pro-rata basis

In allocating an impairment loss, the carrying amount of an asset **should not be reduced below the highest** of:

(a) Its fair value less costs of disposal
(b) Its value in use (if determinable)
(c) Zero

Question 07

A cash-generating unit comprises the following (All are in Rs.Mn)

- Building 30
- Plant and equipment 6
- Goodwill 10
- Current assets 20

Following a recession, an impairment review has estimated the value in use of the cash-generating unit to be Rs. 50m and the fair value less costs of disposal to be Rs. 48m.

Required:

Demonstrate how the impairment loss is allocated.

Question 08

The Dias Company is testing for impairment two subsidiaries, which have been identified as separate cash-generating units.

Some years ago, Dias acquired 80% of The Horas Company for Rs. 600,000 when the fair value of Horas' identifiable assets was Rs. 400,000. As Horas' policy is to distribute all profits by way of dividend, the fair value of its identifiable net assets remained at Rs. 400,000 on 31 December 20X7. The impairment review indicated Horas' recoverable amount at 31 December 20X7 to be Rs. 520,000.

Some years ago, Dias acquired 85% of The Meses Company for Rs. 800,000 when the fair value of Meses' identifiable net assets was Rs. 700,000. Goodwill of Rs. 205,000 (Rs. 800,000 – (Rs. 700,000 * 85%)) was recognised. As Meses' policy is to distribute all profits by way of dividend, the fair value of its identifiable net assets remained at Rs. 700,000 on 31 December 20X7. The impairment review indicated Meses' recoverable amount at 31 December 20X7 to be Rs. 660,000.

It is Dias group policy to measure the non-controlling interest using the proportion of net assets method.

Required:

Determine the following amounts in respect of Dias' consolidated financial statements at 31 December 20X7 according to LKAS 36 Impairment of assets.

(a) The carrying amount of Horas' assets to be compared with its recoverable amount for impairment testing purposes

(b) The carrying amount of goodwill in respect of Horas after the recognition of any impairment loss

(c) The carrying amount of the non-controlling interest in Meses after recognition of any impairment loss

Question 09

Assume that the facts relating to the acquisition of Horas are the same as above, except that The Dias Group chooses to measure the non-controlling interest on the acquisition of Horas at fair value. The fair value of the non-controlling interest in Horas at acquisition was Rs. 100,000.

Required:

Determine the following amounts in respect of The Dias Group's consolidated financial statements at 31 December 20X7 according to LKAS 36 Impairment of assets.

(a) The carrying amount of Horas' assets to be compared with its recoverable amount for impairment testing purposes

(b) The carrying amount of goodwill in respect of Horas after the recognition of any impairment loss

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Reversals of Impairment

In some circumstances, a previously recognized impairment loss may be reversed.

Individual Assets

Where impairment testing is carried out on a previously impaired asset, the recoverable amount may be higher than the asset's carrying amount. In this case, the previously recognized impairment loss is reversed if, and only if, there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized.

The new carrying amount after the reversal cannot be higher than the carrying amount would have been (after the relevant depreciation) if the original impairment had not occurred. Subsequent depreciation is based on the new carrying amount, estimated residual value and estimated useful life.

Cash-generating Units

An impairment loss for goodwill is not reversed subsequent to recognition.

Question 10

A cash-generating unit comprising assets and associated purchased goodwill becomes impaired because the product it makes is overtaken by a technologically more advanced model produced by a competitor. The recoverable amount of the cash-generating unit falls to Rs. 80m, resulting in an impairment loss of Rs. 60m, allocated as follows.

	Carrying amount before depreciation (Rs.Mn)	**Carrying amount after depreciation (Rs.Mn)**
Goodwill	40	-
Current assets	20	20
Tangible non-current assets (market value Rs. 60m)	80	60
	140	**80**

After two years, the entity makes a technological breakthrough of its own. At this time the carrying amount of the tangible non-current assets of the CGU is Rs. 48m and the carrying amount of current assets is Rs. 25m and the recoverable amount of the cash-generating unit increases to Rs. 90m. The carrying amount of the tangible non-current assets had the impairment not occurred would have been Rs. 64m.

Required:

Calculate the reversal of the impairment loss.

Disclosure

LKAS 36 has extensive disclosure requirements. LKAS 36 requires that the following is disclosed in respect of impairments.

(a) The amount of impairment losses and reversals recognized in profit or loss in the period and the line item where they are recognized.

(b) The amount of impairment losses and reversals recognized in other comprehensive income in the period.

In addition, the following is disclosed for individual assets or CGUs for which a material impairment loss is recognized or reversed in the period:

(a) Events and circumstances leading to recognition of the loss or reversal
(b) The amount of loss or reversal recognized
(c) Details of the individual asset or CGU
(d) The recoverable amount and whether that is value in use or fair value less costs of disposal
(e) Details of how fair value is determined (where that is recoverable amount)
(f) Details of the discount rate used in value in use (where that is recoverable amount)

For the aggregate impairment losses and the aggregate reversals of impairment losses recognized during the period that are not material:

(a) The main classes of assets affected by impairment losses and reversals
(b) The main events and circumstances that led to the recognition of these impairment losses and reversals

In addition, detailed disclosure is required in respect of estimated used to measure recoverable amounts of CGUs containing goodwill or intangible assets with indefinite useful lives.

Question 11

Canto acquired a cash-generating unit (CGU) several years ago but, at 28 February 2017, the directors of Canto were concerned that the value of the CGU had declined because of a reduction in sales due to new competitors entering the market. At 28 February 2017, the carrying amounts of the assets in the CGU before any impairment testing were (USD Mn):

Goodwill	3
Property, plant and equipment	10
Other assets	19
Total	**32**

The fair values of the property, plant and equipment and the other assets at 28 February 2017 were $10 million and $17 million respectively and their costs to sell were $100,000 and $300,000 respectively.

The CGU's cash flow forecasts for the next five years are as follows:

Date year ended	Pre-tax cash flow (USD Mn)	Post-tax cash flow (USD Mn)
28 February 2018	8	5
28 February 2019	7	5
28 February 2020	5	3
28 February 2021	3	1.5
28 February 2022	13	10

The pre-tax discount rate for the CGU is 8% and the post-tax discount rate is 6%. Canto has no plans to expand the capacity of the CGU and believes that a reorganization would bring cost savings but, as yet, no plan has been approved.

The directors of Canto need advice as to whether the CGU's value is impaired.

Required:

Advise the directors of Canto on how the above transactions should be dealt with in its financial statements with reference to relevant International Financial Reporting Standards.