

Impairment of Assets

IAS 36

Presented by
CPA Peter Njuguna
+254 722 608 618



Insight

- An entity obtained licence to install a wind power plant at a cost of Ksh 150 million.
- Immediately after construction, the community around was against the project and has obtained a court injunction terminating the operation of the company.



Fraudulent reporting

- Failing to recognize that an asset has experienced an impairment.
- The strategy employed when an entity intentionally fails to recognize an impairment loss is to conceal the fact that a loss has been incurred, either by concealing pertinent facts that would indicate a loss or by mischaracterizing or improperly describing the nature of the asset.
- This is called fraudulent reporting (not creative accounting)
- The reporter is hoping that the reader of the financial statements fails to see the warning signs that an impairment loss has occurred.



Impairment of assets

- Impairment loss is the excess of carrying amount of an asset or a cash-generating unit over its recoverable amount.

Impairment loss

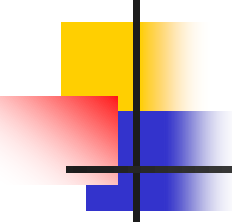
- Carrying amount xxx
- Less recoverable amount (xxx)
xxx

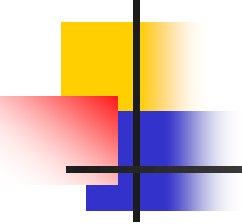
No impairment if carrying amount is less than recoverable amount



Impairment principle

- Test for an impairment loss whenever circumstances indicate that an asset's carrying amount may not be recoverable either through use or sale.
- If no indications of a potential impairment loss are present there is no need to make a formal estimate of recoverable amount, except for intangible assets with indefinite useful lives.

- 
-
- Examples of such instances are:
 - Significant decrease in the asset's market price
 - Significant adverse change in the asset's manner of use
 - Significant adverse change in legal factors or the business climate that could affect the asset's value
 - Excessive costs incurred to acquire or construct the asset

- 
-
- Historical and projected operating or cash flow losses associated with the asset
 - The asset is more than 50% likely to be sold or otherwise disposed of significantly before the end of its previously estimated useful life



Example

- A company constructed green houses at a cost of Ksh 450 millions on 1st July 2016.
- Due to environmental impact of the project the company was denied licence of the specific crop.
- The management is considering selling the construction material as scrap which is estimated to bring in Ksh 350 million before paying Ksh 15 million to dismantle the structure and 5 million to the auctioneer
- Alternative is to plant an alternative crop which will not be very productive as the earlier anticipated crop.
- Alternative use is expected to generate cash flows in future which are discounted to present value at Ksh 360 millions

- Required
- Compute the recoverable amount
- Compute the impairment to be recognised



Carrying amount

- Carrying amount is the amount at which an asset is recognised after deducting any accumulated depreciation (amortisation) and accumulated impairment losses thereon.
- Determined by the accounting policy of the entity



Recoverable amount

- Recoverable amount of an asset or a cash-generating unit is the higher of its fair value less costs to sell and its value in use.
- Assets must have attributable future economic value
- The value is realised through continued use or through use



Fair value less costs to sell

- The amount obtainable from the sale of an asset or cash-generating unit in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal.
- Costs of disposal – are incremental costs directly attributable to the disposal of an asset, excluding finance costs, income tax expense and any cost which has already been included as a liability.

Examples include:

- Legal costs
- Stamp duty
- Costs of removing the asset
- Other direct incremental costs to bring an asset into condition for its sale.



Value in use

- How much will the asset generate
- Uncertainty surrounding future cash flows
- Assets are used to generate money
- Priority are set based on the asset ability to generate cash
- Although there are uncertainty estimate should be made based on high probability



Value in use

reflect

- 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.
- cash flow projections based on reasonable and supportable assumptions that represent management's best estimate



Indicators of impairment

- Objective evidence of impairment
- Certain factors that may tell you that an asset is impaired
- assess at the end of each reporting period whether there is any indication that an asset may be impaired



Consider the following

- A current expectation that, “more likely than not,” a long-lived asset (asset group) will be sold or otherwise disposed of significantly before the end of its previously estimated useful life
- (The term more likely than not refers to a level of likelihood that is more than 50 percent).



Indicators of impairment

External sources of information

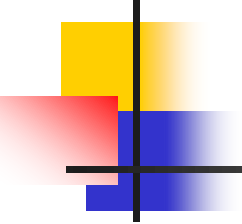
- market value has declined significantly
- significant changes in the technological, market, economic or legal environment
- market interest rates increased
- carrying amount is more than its market capitalisation.

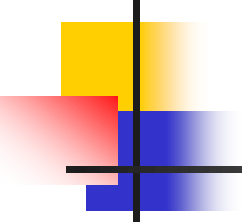


Evidence of impairment

Internal factors

- obsolescence or physical damage
- significant changes in the extent to which, or manner in which, an asset is used the asset becoming idle, plans to discontinue or restructure
- economic performance is worse than expected
- actual net cash flows or operating profit or loss flowing from the asset that are significantly worse than those budgeted;

- 
-
- Buord is an entity involved in the manufacture of steel. It owns a steel production facility constructed in 2013. The facility has ten blast furnaces each of which is being written off over 30 years from the date of construction.
 - Recent technological innovations have resulted in a new type of furnace coming onto the market. This furnace offers efficiency improvements which the manufacturers claim will reduce the unit cost of a tonne of steel by 15-20%.
 - The company that supplied the furnaces for Buord has recently introduced a series of price cutting measures to try to preserve its own market share. The market for the grade of steel that Buord produces is very price sensitive and price is often used as a basis of competition in this market. A major competitor has announced that it is constructing a new plant that will utilise the new technology.

- 
-
- Chloride Ltd is a quoted entity with 5 million ordinary shares listed in the NSE. The carrying value of its identifiable net assets is Ksh 100m. The market price per share is Ksh 20 (capitalisation Ksh 80m).
 - The value of the entity as compared to the carrying value of its net assets indicates that its assets might be impaired. Sickles should make a formal estimate of the recoverable amount of its assets.



Impairment of financial assets

- Assess whether there is objective evidence of impairment of any financial assets that are measured at cost or amortized cost.
- Objective evidence includes observable data about the following loss events:
 - significant financial difficulty of the issuer or obligor.
 - a breach of contract, such as a default or delinquency in interest or principal payments.
 - the creditor, for economic or legal reasons relating to the debtor's financial difficulty, granting to the debtor a concession that the creditor would not otherwise consider.
 - it has become probable that the debtor will enter bankruptcy or other financial re-organisation.
 - observable data indicating that there has been a measurable decrease in the estimated future cash flows



Frequency of impairment testing

- Whenever there is an indication that the asset may be impaired except
- Intangible asset with an indefinite useful
- Intangible asset not yet available for use
- Goodwill acquired in a business combination



Effect of impairment loss

- Reduce carrying amount of the asset to its recoverable amount.
- Recognise impairment loss immediately in profit or loss, unless the asset is carried at revalued amount
- Any impairment loss of a revalued asset is treated as a revaluation decrease
- impairment loss on a revalued asset is recognised in other comprehensive income to the extent that the impairment loss does not exceed the amount in the revaluation surplus for that same asset



Effect of impairment

- If impairment loss is greater than the carrying amount of the asset to which it relates, recognise a liability if onerous contract
- Depreciation (amortisation) charge for the asset is adjusted in future periods to allocate the asset's revised carrying amount, less its residual value, on a systematic basis over its remaining useful life.



Cash-generating unit

- Cash-generating unit is the smallest group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.
- Recoverable amount should be estimated for the individual asset.
- If it is not possible determine the recoverable amount of the cash-generating unit to which the asset belongs.



Cash generating unit

- Group of asset that generate a single stream of cash flows
- If an active market exists for the output produced by an asset or group of assets, that asset or group of assets shall be identified as a cash-generating unit
- carrying amount of a cash-generating unit includes the carrying amount of only those assets that can be attributed directly, or allocated on a reasonable and consistent basis



Cash generating unit

- Cash-generating unit to which goodwill has been allocated tested for impairment annually
- Corporate assets include group or divisional assets such as the building of a headquarters or a division of the entity, EDP equipment or a research centre.
- identify all the corporate assets that relate to the cash-generating unit



Goodwill on a business combination

- to be tested for impairment as part of the cash-generating unit to which it related.
- Employ a 'bottom-up/top-down' approach to allocate its carrying amount on a reasonable and consistent basis.
- To all cash-generating units, that are expected to benefit from the synergies of the business combination.
- lowest level within the entity at which the goodwill is monitored for internal management purposes; and
- not be larger than an operating segment determined
- prohibits the recognition of reversals of impairment losses for goodwill.



Impairment loss in CGU

- allocated to reduce the carrying amount of the assets of the unit in the following order:
 - first, to reduce the carrying amount of any goodwill allocated to the cash-generating unit and
 - then, to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit
- carrying amount of an asset below the highest of:
 - its fair value less costs to sell;
 - its value in use; and
 - zero.



Reversal of impairment loss

- assess at the end of each reporting period whether there is any indication that an impairment loss recognised in prior periods for an asset other than goodwill may no longer exist
- reversed if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised
- reversal of an impairment loss not to exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years.



Reversal of impairment loss

- Reversal of an impairment loss for an asset other than goodwill recognised immediately in profit or loss, unless the asset is carried at revalued amount
- Any reversal of an impairment loss of a revalued asset is treated as a revaluation increase
- Depreciation (amortisation) charge for the asset shall be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value , on a systematic basis over its remaining useful life.



Reversal of impairment loss

- Reversal of an impairment loss for a cash-generating unit shall be allocated to the assets of the unit, except for goodwill, pro rata with the carrying amounts of those assets



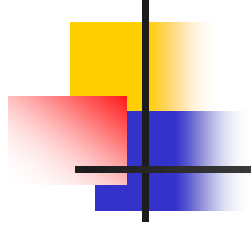
Disclosures

- Impairment losses recognised in profit or loss and statement of comprehensive income
- Reversals of impairment losses recognised in profit or loss and the statement of comprehensive income



Asset evaluated for impairment

- Biological assets accounted for at cost
- Property plant and equipment
- Intangible assets
- Leasehold improvement
- Inventories
- Financial assets accounted for at cost / amortised cost



Thank you

Interactive session