



AN OVERVIEW OF IMPAIRMENT

Presentation by:

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The image shows a large, multi-layered wall in a state of severe disrepair. The top portion of the wall is a smooth, light-colored concrete or plaster finish, which is cracked and peeling in several places. Below this, the wall is constructed from red bricks, many of which are missing, crumbling, or exposed in a way that reveals the underlying structure. The bricks are arranged in a traditional running bond pattern. To the left of the main wall, there is a smaller, more fragmented section of brickwork. In the foreground, there are stacks of dark, weathered wooden planks or beams. The ground is covered with dry, brown leaves and some sparse green vegetation. In the background, there are trees with green foliage, suggesting a wooded or park-like setting. The overall scene conveys a sense of neglect and decay.

Impairment looks like this.....

Presentation agenda



- ☐ Introduction
- ☐ Overview of impairment- IAS 36
- ☐ Disclosures
- ☐ Q&A

Introduction



Objectives of the session is to ensure we:

1. Are able to identify evidence of impairment
2. Understand procedures to be followed to ensure that assets are not carried at more than recoverable amount
3. Understand when an impairment loss should be reversed
4. Understand the required disclosures

Introduction



Why impairment in accounting?

Assets should be carried at no more than their recoverable amount, i.e. the amount expected to be recovered through use of the asset, or sale of the asset (its fair value less cost to sell).

Overview of IAS 36- Impairment



Applies to all assets except

- ☐ Inventories
- ☐ Assets arising from construction contracts
- ☐ Deferred tax assets
- ☐ Financial assets
- ☐ Assets arising from employee benefits
- ☐ Investment property measured at fair value
- ☐ Biological assets measured at fair value less estimated point-of-sale costs
- ☐ Assets arising from insurance contracts
- ☐ Non-current assets classified as held for sale

Indicators 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

Steps in impairment testing



1. Determine when to test impairment
2. Determine the sequence of impairment tests
3. Determine the recoverable amount
4. Determine the carrying amount of the CGU
5. Measure and recognise impairment loss

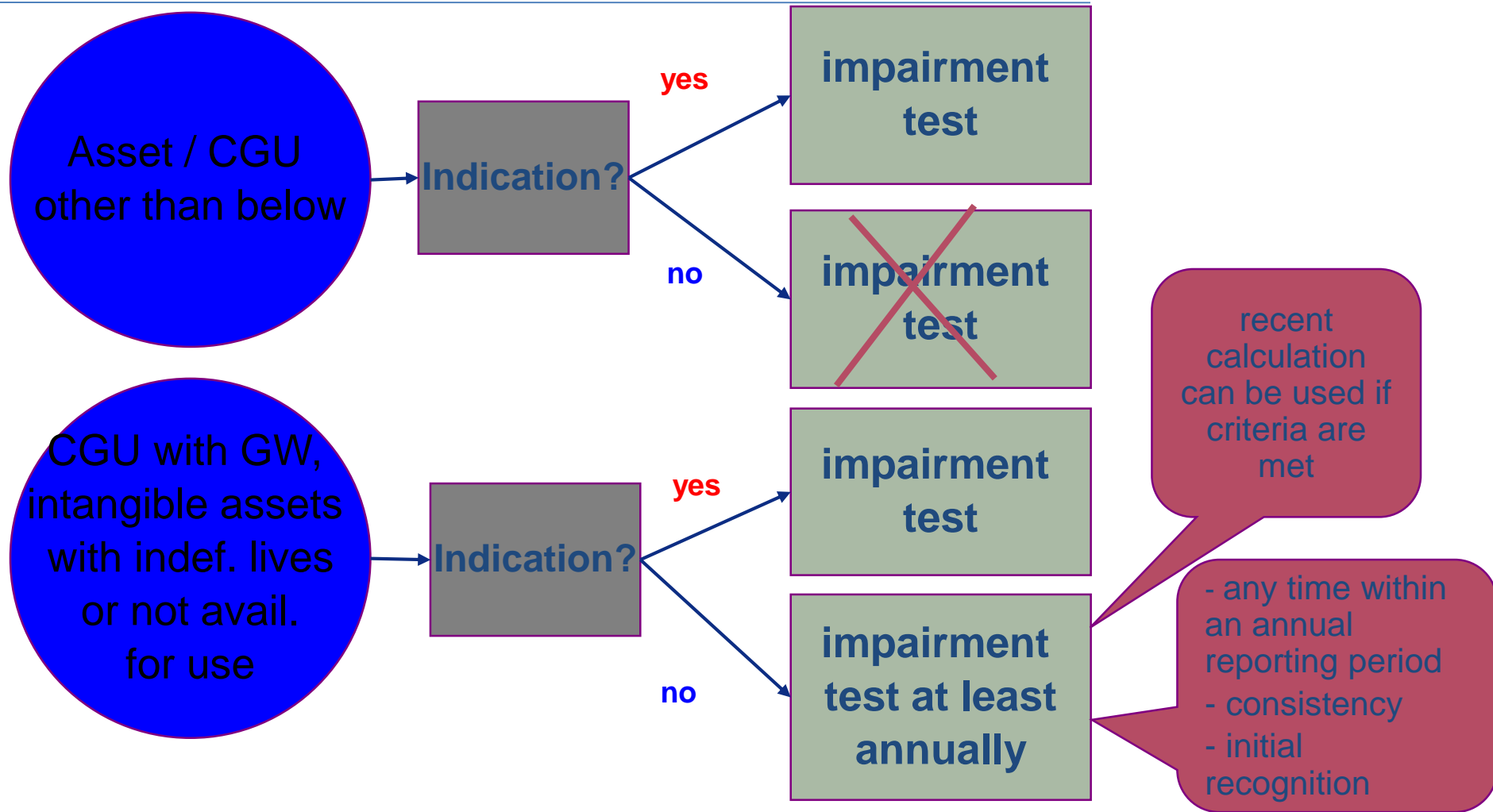
Determine when to test impairment



Impairment testing is required:

1. At each reporting date of an asset or CGU when an indication or trigger event exist; and
2. Annually for the following assets regardless of a triggering event:
 - a) Intangible assets with indefinite useful life;
 - b) Intangible assets not yet available for use; and
 - c) CGU's to which goodwill has been allocated

Frequency and testing of impairment



Recoverable amount



- ❑ Recoverable amount is the greater of:
 - ✓ **Fair value less costs to sell (FVLCS):** amount obtainable from the sale of asset/CGU in an arm's length transaction less costs of disposal
 - ✓ **Value in use (VIU):** present value of estimated future cash flows to be derived from an asset/CGU (continuing use and ultimate 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)

Fair value less costs to sell



Fair value is based on best available evidence, which is (from most reliable to least):

- Binding sale agreement, or

- Active market (current bid price), or

- Best information available

Less costs of disposal, excluding

- Finance costs and income tax expense

- Costs already recognised as liabilities

Fair value less costs to sell – best information available



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 benefits of future restructuring and capital expenditure

Entity specific synergies are not included in fair value

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. illiquidity)

Value in use- measurement



- ❑ Reasonable and supportable assumptions that reflect management's best estimate
- ❑ Most recent financial budgets/forecasts (exclude future restructuring and capital expenditure)
- ❑ 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

Value in use- composition



- ❑ Cash inflows from the continuing use of the asset, including disposal
- ❑ Cash flows in foreign currency are estimated in FC and discounted using a discount rate appropriate for that currency.
- ❑ From the asset in its current condition: ignore cost savings relating to uncommitted expenditure (future restructuring) or future capital expenditure
 - ✓ Ignore financing and tax cash flows
 - ✓ Avoid double counting costs already recognised as liabilities

Discount rate



- ☐ Pre-tax rate
- ☐ Current market assessments of time value of money and risks specific to the asset/CGU- WACC of a listed entity that has a single asset (or portfolio of assets) similar to the asset/CGU under review
- ☐ Where not available, start from other discount rates and adjust:
 - ✓ Entity's WACC (using CAPM)
 - ✓ Entity's incremental borrowing rate
 - ✓ Other market borrowing rates (for similar companies)
- ☐ Should not reflect risks for which cash flow estimates have been adjusted

WACC – formula



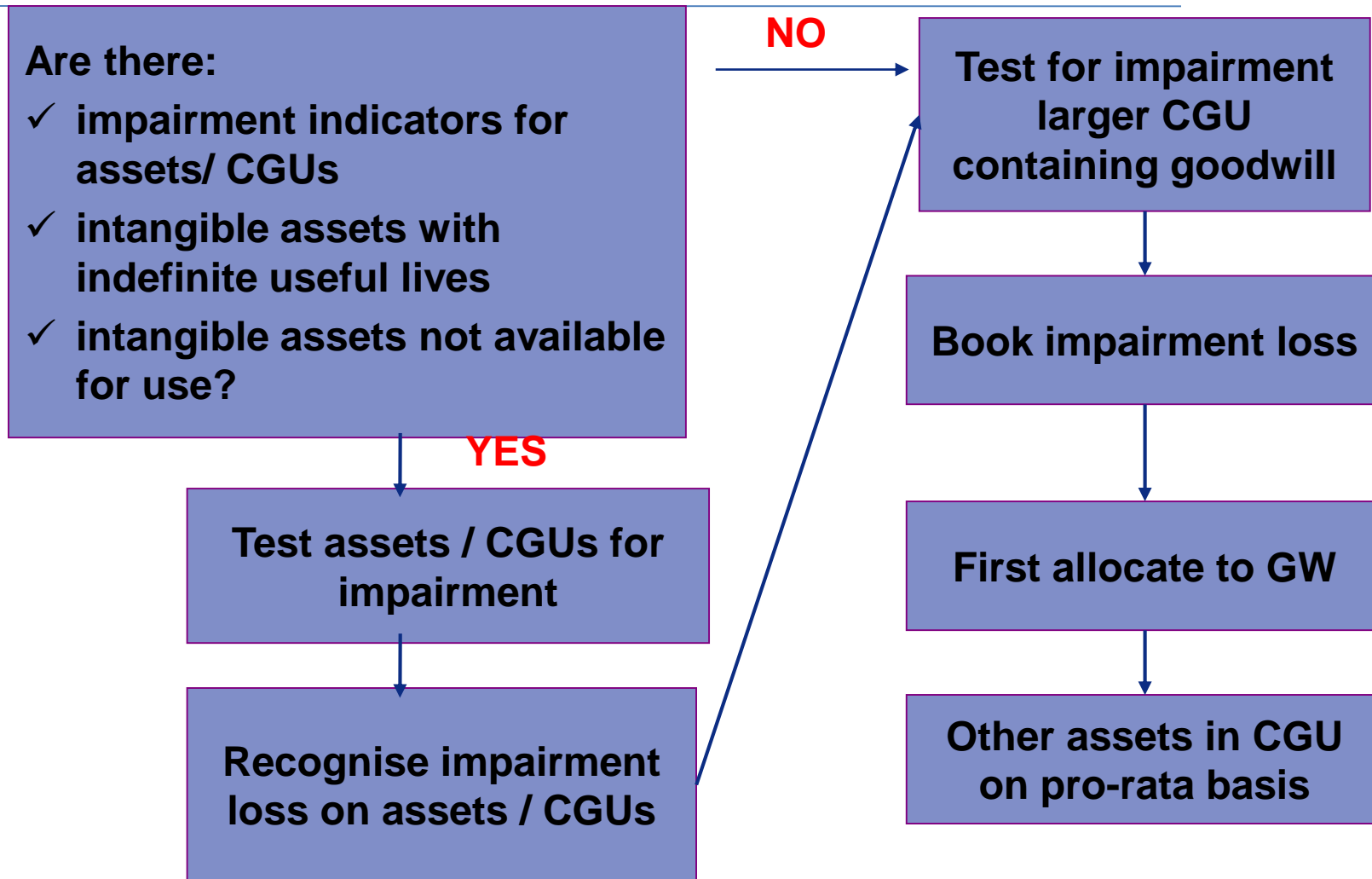
- ❑ A rate of return is assigned to each source of capital and weighted in accordance with the proportion that each source of capital contributes to the company's capital structure.
- ❑ $WACC = (D/V \times R_d) + (E/V \times R_e)$, where:
 - D = Debt
 - E = Equity
 - V = E + D
 - R_d = borrowing rate or return on debt
 - R_e = return on equity

Value in use -consistency

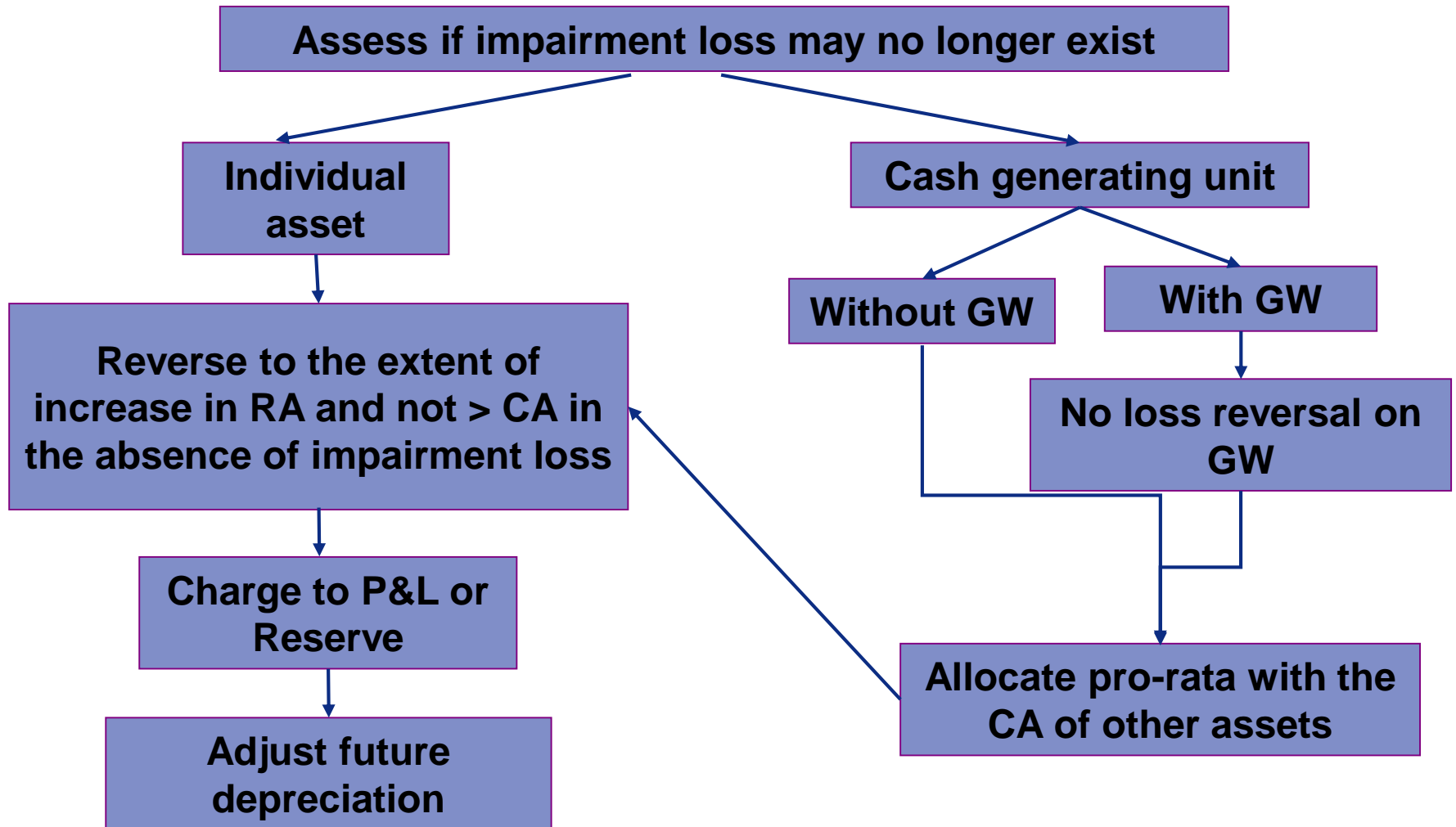


| Cash flows (CF) | Discount rate (DR) |
|---|---|
| CF should not include inflows and out flows from financing activities | Financing is accounted for by discounting |
| If CF are adjusted for certain risks... | ...DR should not reflect these risks |
| CF estimated in currency in which CF will be generated | 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)... | ...Nominal DR is applied |
| If real CF is used (i.e. excluding inflation expectations)... | ...Real DR is applied |

Allocating impairment loss – step by step



Reversal of impairment loss



Key disclosures



By category of asset

- ☐ Amount of impairment losses recognised / reversed during the period in
 - ✓ Income statement and
 - ✓ Directly to equity
- ☐ If recognised in income statement disclosure of where items are included
- ☐ Segment reporting information
- ☐ Disclosures when impairment losses are material for an individual asset
- ☐ Information on basis used for determining recoverable amount
- ☐ Discount rate used

Central points



- ❑ IAS 36 covers impairment of PPE, goodwill, intangible assets and investments in subsidiaries, joint ventures and associates
- ❑ Detailed impairment testing generally is required only when there is an indication of impairment
- ❑ Annual impairment testing:
 - ✓ Intangible assets not yet available for use
 - ✓ Intangible assets with indefinite useful life
 - ✓ Goodwill
- ❑ Recognise impairment loss if
 - ❑ Asset (CGU) carrying amount > FVLCS or Value in use

Interactive Session



Contacts



Thank you

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