

Week 6 – Impairment of Assets

- entities required to conduct impairment tests to ensure assets not overstated
- impairment exclusions: inventories, deferred tax assets, non-current assets held for sale (specific requirements for these assets are covered in AASBs that deal with these balances)
- impairment is an **unexpected** decline in the service utility of an asset (e.g. damage from the Qld floods)
- impairment also includes obsolescence due to technical innovation or changes to legislation
- impairment is different from depreciation which is a planned reduction in the CA of an asset

When to undertake an Impairment Test

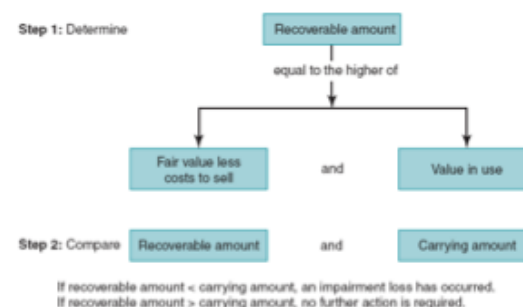
- for most assets, not necessary to conduct an impairment test every year
- assets must be tested for impairment when there's an indication/evidence of impairment (if no evidence, entity can assume impairment hasn't occurred)
- following assets must be tested annually for impairment because the CA of these assets is more uncertain than that of other assets:
 - o intangibles with indefinite useful lives
 - o intangibles not yet available for use
 - o goodwill acquired in a business combination

Collecting Evidence of Impairment

- External sources of information include:
 - o Decline in market value of asset (e.g. technological advancements)
 - o Adverse changes in enviro/markets (e.g. competitor patented new product, causing permanent fall in market share of entity)
 - o Increases in interest rates (affects present value of future CFs)
 - o Market capitalisation (CA of net assets is greater than market capitalisation of the entity)
- Internal sources of info include:
 - o Obsolescence or physical damage of individual asset
 - o Change in asset use (e.g. asset became idle)
 - o Asset's eco performance being worse than expected

Impairment Test for an Individual Asset

- 2 possible amounts (for recoverable amount) against which the CA can be tested for impairment: fair value less costs to sell, and value in use →
- not always necessary to measure both amounts when testing for impairment:
 - o if either 1 of the 2 amounts is higher than the CA, asset is not impaired



Fair Value Less Costs to Sell

- Fair value less costs to sell: amount obtainable from sale of asset in an arm's length transaction, less costs of disposal (Fair Value & cost of disposal)
- Fair value is determined using the following 'value hierarchy':
 - o Price in a binding sale agreement

- Market price (current bid price)
- Appropriate estimation (e.g. using NPV calculations)
- costs of disposal include: legal fees, stamp duty, costs of removing the asset (finance costs and income tax are not considered as costs of disposal)

Value in Use (do not need to calculate this in exam)

- Value in use: present value of future cash flows expected to be derived from an asset or cash-generating unit
- 5 elements when calculating value in use:
 - estimate future cash flows
 - expectations about possible variations in amount or timing of future cash flows
 - time value of money
 - price of bearing uncertainty (risks) inherent in asset
 - other factors such as illiquidity
- object overall is to: estimate future CFs and apply a discount rate
- Estimating future cash flows:
 - Projections should be based on management's best estimates (external evidence should be given greater weight than reliance on management's expectations)
 - Projections should be based on most recent forecasts and should cover a max. period of 5 years
 - For years subsequent to 5 years, reliance should be placed on steady or declining growth rates
 - Cash inflows should include those from continuing use of the asset and those expected on the disposal of the asset (cash outflows must also be taken into account → net cash flow)
 - Projected CFs must be estimated for the asset in its current condition
 - Financing and tax related CFs are excluded from calculations
 - Disposal price should take into account any expected future price increase/decrease
 - Appendix A of AASB 136 shows 2 possible approaches to compute present value: 'traditional' approach which uses a singlet set of estimated CFs and 'expected CF' approach which uses all expectations about possible CFs an weighs them based on their probabilities
- Determining the discount rate:
 - Discount rate should reflect: time value of money and risks specific to the asset for which future CFs have not been adjusted
 - Discount rates are commonly based on: entity's weighted average cost of capital (WACC) (determined using Capital Asset Pricing Model), entity's incremental borrowing rate, or other appropriate marketing borrowing rates
 - Rate must reflect specific risks relating to: country, currency, price risk

Recording an Impairment Loss for an Individual Asset

- **impairment loss = CA > RA**
- where the asset is accounted for under cost model, impairment loss is recognised immediately in P/L

- where asset is accounted for under revaluation model, impairment loss is treated as a revaluation decrement
- any subsequent depreciation/amortisation is based on the new recoverable amount

Example under Cost Model: Asset has a CA of \$100 (cost of \$160 – accum. Depr. of \$60) and a RA of \$90. The journal entry to record this impairment loss would be:

Dr Impairment Loss (P/L)	10	
		Cr Accum. Depr. & Impairment Losses 10

Example under Revaluation Model: Asset has a CA of \$100 (FV of \$120 – accum. Depr. of \$20) and a RA of \$70. This asset was previously revalued upwards by \$20 (ARS balance = \$14; DTL balance = \$6). The journal entry to record impairment loss:

Dr Acc. Depr.	20	
		Cr Asset 40
Dr Loss on revaluation – impairment (OCI)	20	
Dr Loss on revaluation (P&L) – impairment	10	
		Cr Asset 30

Dr DTL	6	
		Cr Income Tax Expense (OCI) 6

Dr Asset Revaluation Surplus	14	
Dr Income Tax Expense	6	
		Cr Loss on revaluation – impairment (OCI) 20

Cash-Generating Units (CGUs)

- where fair value less costs to sell < CA, it's necessary to calculate the value in use of an asset to determine whether or not it has been impaired
- may not be possible to identify an individual asset's value in use when asset only has a value due to its relationship with other assets (e.g. machine in a factory works in conjunction with the rest of the assets in the factory)
- in such cases, value in use of asset must be determined in the context of asset's cash-generating unit (CGU)
- CGU: smallest identifiable group of assets that generates CIFs that are largely independent of the cash inflows from other assets or group of assets

Identifying CGUs

- identification of CGUs requires consideration of:
 - o how management monitors entity's operations
 - o how management makes decisions about continuing or disposing of assets and operations
- if an active market exists for the output of a group of assets (even if some of the output of the group of assets is used internally), this group of assets is classified as a CGU
- CGUs must be identified consistently from period to period
- AASB 136 allows a segment to be used as a CGU where the segment equates to the smallest group of assets generating independent CFs

Impairment Loss for CGUs – excluding Goodwill

- where an impairment loss arises in a CGU with no goodwill, the loss is allocated across all of the assets in the CGU on a pro-rata basis based on the CA of each asset relative to the total CA amount of the CGU
- losses are accounted for in the same way as for individual assets
- CA of an individual asset cannot be reduced below the highest of:
 - o Fair value less costs to sell (if determinable);
 - o Value in use (if determinable); or
 - o Zero
- corporate assets – if possible to be allocated across CGUs on a reasonable and consistent basis

Example of Impairment losses and CGUs – no goodwill: A Ltd has identified an impairment loss of \$12,000 on one of its CGUs. CGU consists of these assets (stated at current CA): Buildings 500 000, equipment 300 000, land 250 000, fittings 150 000. The fair value less costs to sell of the building is \$497,000. Calculate the allocation of impairment loss against all assets in the CGU.

	CA	Pro-rata	Impairment Loss Allocated	Adjusted CA (Net CA)
Buildings	500,000	5/12	\$5,000	\$495,000
Equipment	300,000	3/12	3,000	297,000
Land	250,000	2.5/12	2,500	247,500
Fittings	150,000	1.5/12	1,500	148,500
	\$1,200,000		\$12,000	

As the fair value less costs to sell of building is \$497,000, the max. impairment loss that can be allocated to the building is \$3,000. The remaining \$2,000 must be allocated across the other assets in the CGU. (because of the rule shown above)

	CA	Pro-rata	Impairment Loss Allocated	Adjusted CA (Net CA)
Buildings				\$497,000
Equipment	297,000	297/693	\$ 857	296,143
Land	247,500	247.5/693	714	246,786
Fittings	148,500	148.5/693	429	148,071
	\$693,000		\$2,000	

Dr Impairment Loss 12,000
 Cr Acc. Depr. & Impairment Losses – Buildings 3,000
 Cr Acc. Depr. & Impairment Losses – Equipment 3,857
 Cr Acc. Depr. & Impairment Losses – Land 3,214
 Cr Acc. Depr. & Impairment Losses – Fittings 1,929

Impairment Losses and CGUs – with goodwill

- where a CGU includes goodwill, AASB136 contains specific requirements for accg for the allocation of impairment losses arising in relation to the CGU
- goodwill is a residual balance consisting of assets that cannot be individually identified or separately recognised ∴ not possible to determine a fair value less costs to sell for goodwill, or to identify CFs relating to goodwill
- goodwill can only be tested for impairment at the CGU level
- AASB136 requires goodwill to be allocated to the lowest level at which management monitors the goodwill (tested for impairment annually)
- Where an impairment loss arises in a CGU with goodwill, the following allocation rules apply:
 - o Reduce the CA of the CGU's goodwill to zero;

- Allocate the remaining loss to the other assets of the CGU on a pro-rata basis

Example of Impairment losses and CGUs with goodwill: A Ltd identified an impairment loss of \$300,000 on 1 of the CGUs. The CGU consists of the assets (stated at current CA): buildings 500 000, equipment 300 000, land 250 000, goodwill 150 000. Calculate the allocation of impairment loss against all assets in the CGU.

	CA	Pro-rata	Impairment Loss Allocated	Adjusted CA (Net CA)
Goodwill	150,000		150,000	
Buildings	500,000	0.5/1.05 * 150,000	71,429	428,571
Equipment	300,000	0.3/1.05	42,857	257,143
Land	250,000	0.25/1.05	35,714	214,286
	1,050,000		300,000	

Dr Impairment Loss 300,000

Cr Goodwill	150,000
Cr Acc. Depr. & Impairment loss – buildings	71,429
Cr Acc. Depr. & Impairment loss – equipment	42,857
Cr Acc. Depr. & Impairment loss – Land	35,714

Reversal of an Impairment Loss

- recognised losses are reassessed annually
- indicators for reversals of impairment losses are the same as those used for initially recognising a loss
- ability to recognise a reversal of an impairment loss and the accg for that reversal is dependent on whether the reversal related to an individual asset, a CGU or goodwill
- previously recognised impairment losses in relation to individual assets are able to be reversed
- the new CA cannot be higher than the CA that would've been determined had no impairment loss been previously recognised (for depreciable assets, the impact of depreciation needs to be considered)

Example of Reversal of an impairment loss – individual assets under Cost Model:

Dr Accum. Depr. & Impairment Losses	xxx
Cr Income – Impairment Loss reversal	xxx

Example of Reversal of an impairment loss – individual assets under Revaluation Model:

Dr Asset	xxx
Cr Gain on Revaluation – impairment reversal (P/L)	xxx

- where the impairment loss was taken through OCI (decreasing existing ARS), the journal entry to record the reversal of the impairment loss would be:

Dr Asset	xxx
Dr Income tax expense (OCI)	xxx
Cr Gain on revaluation – impairment reversal (OCI)	xxx
Cr Deferred tax liability	xxx

Dr Gain on revaluation – impairment reversal (OCI)	xxx
Cr Income tax expense (OCI)	xxx
Cr Asset Revaluation Surplus	xxx

Reversal of an Impairment Loss – CGUs

- impairment losses relating to goodwill cannot be reversed
- reversal of any impairment loss relating to a CGU is allocated across the assets of the CGU (excluding goodwill) on a pro-rata basis
- reversals for specific assets will be accounted for the same way as outlined above for individual assets
- CA for an individual asset within the CGU cannot be increased above the lower of: its RA, and the CA that would have been determined had no impairment loss been recognised in prior periods
- Any excess from the above situation is allocated across the remaining assets in the CGU on a pro-rata basis

Key Disclosure Requirements for Impairment

- amount of impairment losses recognised in P/L during the period and the respective line items on the statement of comprehensive income
- amount of reversals of impairment losses recognised in P/L during the period and the respective line items on the statement of comprehensive income
- amount of impairment losses on revalued assets recognised in other comprehensive income during the period

amount of reversals of impairment losses on revalued assets recognised in other comprehensive income during the period