IND AS 36 : IMPAIRMENT OF ASSETS

WIRC IFRS STUDY GROUP MEETING : 30 APRIL 2016

PRESENTED BY : CA. TEJAS PARIKH
Agenda

- Scope and Objectives
- Important Definitions
- Impairment tests
- Identifying Cash Generating Unit (CGU)
- Fair Value
- Value in Use
- Impairment Process
- Allocation of Goodwill to CGU – Impairment
- Recognition / Reversal of Impairment losses
- Corporate Assets
- Disclosures
- Case Studies
- Differences in Existing AS 28 v/s Ind AS 36
- Transitional Challenges – First Time Adopters
Objectives

1. To ensure that assets are carried at not more than their recoverable amount.

2. To determine when an entity should reverse an impairment loss.
# Impairment – Practical Experience

## Top Impairments: Not So Lucky

<table>
<thead>
<tr>
<th>Company</th>
<th>Asset</th>
<th>Impairment Charge (₹ crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sesa Sterlie</td>
<td>Oil &amp; gas</td>
<td>20,000</td>
</tr>
<tr>
<td>Tata Steel</td>
<td>Corus</td>
<td>8,000</td>
</tr>
<tr>
<td>Hindalco</td>
<td>Novelis</td>
<td>7,780</td>
</tr>
</tbody>
</table>

### MNC Impairments on Indian Assets*

<table>
<thead>
<tr>
<th>Company</th>
<th>Asset</th>
<th>Impairment Charge (₹ crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Daiichi</td>
<td>Ranbaxy</td>
<td>17,508</td>
</tr>
<tr>
<td>Vodafone</td>
<td>India operations</td>
<td>15,157</td>
</tr>
<tr>
<td>BP</td>
<td>D6 fields</td>
<td>5,255</td>
</tr>
</tbody>
</table>

*Rupee-dollar rate according to date of impairments

Source: Company filings

Compiled by BS Research Bureau
The standard shall be applied in accounting for the impairment of all assets, other than:

<table>
<thead>
<tr>
<th>Inventories</th>
<th>Biological Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contracts that are recognised in accordance with Ind AS 115</td>
<td>Deferred acquisition costs</td>
</tr>
<tr>
<td>Deferred Tax Assets</td>
<td>Insurance Contracts under Ind AS 104</td>
</tr>
<tr>
<td>Assets arising from employee benefits (Ind AS 19)</td>
<td>Non- current assets held for sale in accordance with Ind AS 105</td>
</tr>
<tr>
<td>Financial Assets within the scope of Ind AS 109</td>
<td></td>
</tr>
</tbody>
</table>
This Standard applies to financial assets classified as

a) Subsidiaries as defined in Ind As 110, Consolidated Financial Assets
b) Associates as defined in Ind As 28, Investments in Associates
c) Joint Ventures as defined in Ind AS 111, Joint Arrangements
Definitions

- **Cash Generating Unit (CGU):**
  - Smallest identifiable group of assets
  - Generates cash inflows largely independent of cash inflows from other assets or group of assets.

- **Carrying amount:**
  Amount at which an asset is recognised after deducting any accumulated depreciation (Amortisation) and accumulated impairment losses thereon.

- **Impairment Loss:**
  Amount by which the carrying amount of an assets / CGU exceeds its recoverable amount.
Definitions cont.....

- **Recoverable Amount:**
  Higher of -- Fair Value (less) costs of disposal & its value in use

- **Fair Value:**
  Price that would be received on sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

- **Value in use:**
  Present value of the future cash flows expected to be derived from an asset or cash-generating unit.
Costs of Disposal are incremental costs directly attributable to the disposal of asset or cash generating unit, excluding finance costs and income tax.

Corporate assets are assets other than goodwill that contribute to the future cash flows of both cash generating units under review and other cash generating units.
A mining entity owns a private railway to support its mining activities. The railway is used to transport the ore mined and does not generate revenue the way passenger trains do. The private railway could be sold only for scrap value and it does not generate cash inflows that are largely independent of the cash inflows from the other assets of the mine. It is not possible to estimate the recoverable amount of just the private railway by itself because its value in use cannot be determined and is probably different from scrap value. Therefore, the entity estimates the recoverable amount of the cash-generating unit to which the private railway belongs, i.e. the mine as a whole.
When to test for an impairment?

On Impairment Indicators:
- Internal Indicators:
  1. Evidence of obsolescence, physical damage
  2. Discontinuance, restructuring plans
- External Indicators:
  1. Significant decline in Market Value
  2. Changes in technological, market, economic or legal environment
  3. Changes in interest rates
  4. Carrying amount more than its market capitalization.

Annual Impairment:
- Test annually for impairment when:
  1. Intangible asset has indefinite life
  2. Intangible asset is not available for use.
External Indicators of impairment

- Observable indications where assets’ value has declined during the period significantly more than would be expected as a result of the passage of time or normal use
- negative changes in technology, markets, economy, or laws
- increases in market interest rates
- net assets of the company higher than market capitalisation

These lists are not intended to be exhaustive.

Further, an indication that an asset may be impaired may indicate that the asset's useful life, depreciation method, or residual value may need to be reviewed and adjusted (para 17).
Internal Indicators of impairment

- obsolescence or physical damage
- asset is idle, part of a restructuring or held for disposal
- worse economic performance than expected for investments in subsidiaries, joint ventures or associates, the carrying amount is higher than the carrying amount of the investee's assets,
- cash flows for acquiring the asset, or subsequent cash needs for operating or maintaining it, that are significantly higher than those originally budgeted;
- actual net cash flows or operating profit or loss flowing from the asset that are significantly worse than those budgeted;
- a significant decline in budgeted net cash flows or operating profit, or a significant increase in budgeted loss, flowing from the asset;
- operating losses or net cash outflows for the asset, when current period amounts are aggregated with budgeted amounts for the future.
Identifying the Cash Generating unit to which the asset belongs

- If there is any indication that an asset may be impaired, recoverable amount shall be estimated for the individual asset. If it is not possible to estimate the recoverable amount of the individual asset, an entity shall determine the recoverable amount of the cash-generating unit to which the asset belongs.

- Cash-generating units shall be identified consistently from period to period for the same asset or types of assets, unless a change is justified.
Basic principles of impairment

BOOK VALUE < RECOVERABLE VALUE = NO IMPAIRMENT

Goodwill
Identifiable Assets

CGU
Recoverable Value
Basic principles of impairment cont...
Basic principles of impairment cont...
Recoverable Amount

Higher of the following

- Fair Value less cost of disposal
- Value in use
Fair Value less cost of disposal

- 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.
- Cost of disposal are deducted in determining fair value less costs of sell. Examples of such costs are:
  - Legal costs
  - Stamp Duty and similar transaction taxes
  - Costs of removing the asset
  - Direct incremental costs to bring an asset into condition for its sale.
- Costs of disposal does not include termination benefits and costs associated with reducing or reorganising a business following the disposal of asset.
Value in use

ESTIMATED FUTURE CASH FLOWS

DISCOUNT RATE
Following elements shall be reflected in the calculation of an asset's value in use:

- an 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.
Future cash flows need to be estimated by considering following factors:

- Reasonable and supportable assumptions that best represent management’s best estimate of the range of economic conditions that will exist over the remaining useful life of the asset.
- Greater weight needs to be given to external evidence
- Past trends / key ratios of 3-5 years, most recent approved financial budgets, forecasts
- Reasonable and supportable assumptions regarding market conditions, asset’s future capacity of performance.
- Cash flows need to be pre-tax and shall exclude financing activities
- Cash flows shall also exclude effect of future cash restructuring or improving or enhancing assets performance.
Estimated Future Cash Flows - contd

Estimates of future cash flows shall include:

- projections of cash inflows from the continuing use of the asset;
- projections of cash outflows that are necessarily incurred to generate the cash inflows from continuing use of the asset (including cash outflows to prepare the asset for use) and can be directly attributed, or allocated on a reasonable and consistent basis, to the asset; and
- net cash flows, if any, to be received (or paid) for the disposal of the asset at the end of its useful life [entity expects to obtain from the disposal of the asset in an arms length transactions]

Foreign Currency Cash Flows: Future cash flows are estimated in the currency in which they will be generated and then discounted using a discount rate appropriate for that currency. An entity translates the present value using the spot exchange rate at the date of the value in use calculation
The discount rate (rates) shall be a pre-tax rate (rates) that reflect(s) current market assessments of:
(a) the time value of money; and
(b) the risks specific to the asset for which the future cash flow estimates have not been adjusted.

Discount rate is determined for arriving at present value of future cash inflows. Following factors need to be considered for determining Discount Rate:
- Country in which operations of the company under review are conducted
- Market Risks involved in that country
- Industry specific risks
- Risk free returns.

The entity might take into account the following rates:
- the entity’s weighted average cost of capital determined using techniques such as the Capital Asset Pricing Model
- the entity’s incremental borrowing rate;
- other market borrowing rates
Allocating Goodwill to CGU

- Goodwill shall, from the acquisition date, be allocated to each of the acquirer’s CGU, or group of CGU, that is expected to benefit from the synergies of the combination. Each unit or the group of units to which goodwill is so allocated shall:
  - Represent the lowest level within the entity at which the goodwill is monitored for internal management purposes; and
  - Not be larger than an operating segment.

- If the initial allocation of goodwill acquired in a business combination cannot be completed before the end of the annual period in which the business combination is effected, that initial allocation shall be completed before the end of the first annual period beginning after the acquisition date.
The annual impairment test for a cash-generating unit to which goodwill has been allocated may be performed at any time during an annual period, provided the test is performed at the same time every year. Different cash generating units may be tested for impairment at different times. However, if some or all of the goodwill allocated to a cash-generating unit was acquired in a business combination during the current annual period, that unit shall be tested for impairment before the end of the current annual period.
Impairment Process

1. Are there any impairment indicators
2. If yes whether recoverable amount of individual asset be determined.
3. If yes, determine recoverable amount for that asset and consider impairment loss to the extent carrying amount is more than recoverable amount.
4. If answer to step 2 is NO, then identify CGU to which that asset belongs, if goodwill cannot be allocated to an individual CGU, allocate it to group of CGUs, if carrying amount is more than recoverable amount, then first reduce carrying amount of goodwill and then reduce other assets of CGU on pro rata basis.
Recognition of Impairment loss cont...

- An impairment loss shall be recognised immediately in profit or loss, unless the asset is carried at revalued amount in accordance with another Standard (for example, in accordance with the revaluation model in Ind AS 16). Any impairment loss of a revalued asset shall be treated as a revaluation decrease in accordance with that other Standard.

- An impairment loss on a non-revalued asset is recognised in profit or loss. However, an 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. Such an impairment loss on a revalued asset reduces the revaluation surplus for that asset.

- After the recognition of an impairment loss, the depreciation (amortisation) charge for the asset shall be adjusted in future periods to allocate the asset’s revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.
An impairment loss shall be recognised for a cash-generating unit if, and only if, the recoverable amount of the unit is less than the carrying amount of the unit. The impairment loss shall be allocated to reduce the carrying amount of the assets of the unit in the following order:

(a) first, to reduce the carrying amount of any goodwill allocated to the cash-generating unit (group of units); and

(b) then, to the other assets of the unit (group of units) pro rata on the basis of the carrying amount of each asset in the unit (group of units).

These reductions in carrying amounts shall be treated as impairment losses on individual assets.

In allocating an impairment loss, an entity shall not reduce the carrying amount of an asset below the highest of:

(a) its fair value less costs of disposal (if measurable);

(b) its value in use (if determinable); and

(c) zero.

The amount of the impairment loss that would otherwise have been allocated to the asset shall be allocated pro rata to the other assets of the unit (group of units).
Reversal of impairment loss

- An entity shall 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 or may have decreased. If any such indication exists, the entity shall estimate the recoverable amount of that asset.

- In assessing whether there is any indication that an impairment loss recognised in prior periods for an asset other than goodwill may no longer exist or may have decreased, an entity shall consider external and internal sources of information.

- An impairment loss recognised in prior periods for an asset other than goodwill shall be 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 recognised. If this is the case, the carrying amount of the asset shall be increased to its recoverable amount. That increase is a reversal of an impairment loss.
Reversal of impairment loss...treatment

- An asset’s value in use may become greater than the asset’s carrying amount simply because the present value of future cash inflows increases as they become closer. However, the service potential of the asset has not increased. Therefore, an impairment loss is not reversed just because of the passage of time even if the recoverable amount of the asset becomes higher than its carrying amount.

- The increased carrying amount of an asset other than goodwill attributable to a reversal of an impairment loss shall not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years.

- A reversal of an impairment loss for an asset other than goodwill shall be recognised immediately in profit or loss, unless the asset is carried at revalued amount. Any reversal of an impairment loss of a revalued asset shall be treated as a revaluation increase in accordance with that other Indian Accounting Standard.
A 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. These increases in carrying amounts shall be treated as reversals of impairment losses for individual assets.

In allocating a reversal of an impairment loss for a cash-generating unit, the carrying amount of an asset shall not be increased above the lower of:

- its recoverable amount (if determinable); and
- the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior periods.

An impairment loss recognised for goodwill shall not be reversed in a subsequent period.
Corporate Asset

- Corporate assets are assets other than goodwill that contribute to the future cash flows of both the cash-generating unit under review and other cash generating units.

Can be allocated to CGU

- Compare the carrying amount of the unit, including the portion of the carrying amount of the corporate asset to be allocated to the unit, with its recoverable amount for impairment loss.

Can not be allocated to CGU

- Compare the carrying amount of the unit excluding the corporate asset, with its recoverable amount for impairment loss.
- Identify the smallest group of CGU to which the corporate asset can be allocated and then compare its carrying value including corporate asset’s carrying value with its recoverable amount.
- Compare the carrying amount of the entire group including the portion of carrying amount of corporate asset with recoverable amount of group of assets.
An entity shall disclose the following for each class of assets:

a) the amount of impairment losses recognised in profit or loss during the period and the line item(s) of the statement of profit and loss in which those impairment losses are included.

b) the amount of reversals of impairment losses recognised in profit or loss during the period and the line item(s) of the statement of profit and loss in which those impairment losses are reversed.

c) the amount of impairment losses on revalued assets recognised in other comprehensive income during the period.

d) the amount of reversals of impairment losses on revalued assets recognised in other comprehensive income during the period.
Disclosures — Contd

- Events leading to recognition of impairment or reversal
- Nature of asset and the reportable segment to which it belongs
- Description of cash generating unit
- Key assumptions used in the determination of recoverable amount of asset.
- Changes in aggregation of assets for identifying cash generating unit than previous estimates.
- If the recoverable amount is value in use, the discount rate used in current estimate and previous estimate of value in use
- If recoverable amount is fair value less cost of disposal, then detailed disclosures of level of fair value hierarchy (para 130(f))
- Detailed disclosure to goodwill or intangible asset with indefinite use lives are allocated to cash generating units.
- Disclosure when recent calculation of recoverable amount of previous period is used in impairment testing of current period (para 24, 99, 136)
## Differences – Ind AS 36 v/s AS -28

<table>
<thead>
<tr>
<th>IND AS 36</th>
<th>AS -28</th>
</tr>
</thead>
<tbody>
<tr>
<td>It applies to financial assets which include subsidiaries, joint ventures and associates</td>
<td>It does not apply to subsidiaries, joint ventures and associates</td>
</tr>
<tr>
<td>It requires annual impairment testing for an intangible asset with an indefinite useful life or net available for use and goodwill acquired in business combination</td>
<td>It does not require the annual impairment testing for goodwill unless there is an indication of impairment</td>
</tr>
<tr>
<td>Goodwill is allocated to CGUs or group of CGUs that are expected to benefits from synergies of the business to which it arose. There is no bottom up or top down approach for allocation of goodwill</td>
<td>Goodwill is allocated to CGUs only when the allocation can be done on a reasonable and consistent basis. If that requirement is not met for a specific CGU under review, the smallest CGU to which the carrying amount of goodwill can be allocated on a reasonable and consistent basis. When it cannot be allocated two levels of impairment tests are carried out bottom up test and top down test</td>
</tr>
</tbody>
</table>
## Differences – Ind AS 36 v/s AS -28

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</thead>
<tbody>
<tr>
<td>It prohibits the reversal of impairment loss of goodwill</td>
<td>It requires that the impairment loss recognised for goodwill should be reversed in a subsequent period when it is caused by a specific external event of an exceptional nature that is not expected to recur and subsequent external events that have occurred that the reverses effect of that event.</td>
</tr>
<tr>
<td>It specifically excludes biological assets related to agricultural activity</td>
<td>It does not specifically exclude biological assets.</td>
</tr>
</tbody>
</table>

Ind AS 36 provides additional guidance on estimating value in use, for managements to assess the reasonableness of the assumptions on which cash flows are based, using present value techniques in measuring an asset’s value in use.
Transitional Challenges

- First time adopters of Ind AS are required to test goodwill carried in the balance sheet at the date of transition for impairment when business combination occurring prior to date of transition have not been retrospectively restated, regardless of whether there are any indications of impairment.

- For other assets, first time adopters should perform an impairment test when there are indications

- Impairment tests are based on conditions at the transition date.

- Estimates made should be consistent with the estimates under previous GAAP (except change in accounting policies and earlier estimates were in error.)
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