

# IAS 36

## Impairment of assets

### 1. Objective

The objective of IAS 36 is to prescribe the procedures that an entity applies to assess possible impairment of its assets at the end of each reporting period, except for certain assets where impairment is covered in another specific standard.

### 2. Scope

#### 2.1 Scope of application

IAS 36 applies to all assets except:

- inventories (IAS 2);
- contract assets and assets arising from costs to obtain or fulfil a contract that are recognised in accordance with IFRS 15
- deferred tax assets (IAS 12);
- assets arising from employee benefits (IAS 19);
- financial assets that are within the scope of IFRS 9;
- investment property measured at fair value (IAS 40);
- biological assets biological assets related to agricultural activity within the scope of IAS 41 - Agriculture that are measured at fair value less costs to sell;
- deferred acquisition costs and intangible assets arising from an insurer's contractual rights (IFRS 17);
- non-current assets held for sale (IFRS 5).

At the end of each reporting period, an entity must assess whether there is any indication from external or internal sources that an asset may be **impaired**. If such an indication exists, the entity must estimate the net recoverable amount of the asset.

#### 2.2 Annual impairment test

In addition to requirement above, an annual impairment test must be performed for:

- intangible assets with an indefinite useful life or not yet available for use;
- goodwill acquired in a business combination.

## 2.3 Procedure to assess impairment

This Standard requires an entity to recognize an impairment loss whenever the **carrying amount** of an asset exceeds its **recoverable amount**. Where possible, this should be done for each individual asset. However, if it is not possible to estimate the recoverable amount of an individual asset, an entity must determine the recoverable amount of the relevant **Cash-Generating Unit (CGU)**.

A CGU is the smallest group of assets that generates **cash inflows that are largely independent** of the cash flows from other assets or groups of assets.

A CGU to which goodwill has been allocated cannot be larger than an operating segment (as defined by IFRS 8) that existed before the business combination.

Example 1: Company X operates maritime shipping lines between various European and African ports, with a fleet of between 3 and 10 ships on each line. Each maritime line may be considered as a CGU since each of them has its own resources and generates its own cash flows.

However, if Company X has entered into a specific contract with each of its ships, then in this case the CGU may be regarded as each individual ship.

CGUs must be identified in a consistent and similar manner each year unless there has been a change in the composition of a CGU.

The procedure used to assess whether an asset or a CGU should be identified as impaired includes three steps.

### **1° Identification of impairment**

The following factors must be taken into consideration:

- **external factors:** decline in market value, changes in interest rates or foreign currency translation rates, regulatory changes, introduction of quotas, changes in an entity's environment, technological obsolescence of the asset;

Example 2: Company Z builds diesel powered automobiles without having any know-how on hybrid or electric technology in-house. With the phasing out of diesel and gas powered cars by the government, traffic restrictions on these automobiles will apply. The government's decision is an impairment factor for company Z unless it can show that the company can still maintain its cash flows (markets in foreign countries unaffected by these policies).

- **internal factors:** physical deterioration, technical performance lower than expected, decrease in budgeted cash flows.

## **2° Measuring an impairment loss (impairment test)**

An impairment loss is the difference between an asset's (or group of assets) net carrying amount and the recoverable amount.

The **recoverable amount** of an asset is the higher of its fair value less costs of disposal (effectively its **net disposal value**) and its **value in use**. The value in use of an asset is the present value of the cash flows expected to be derived from continuing use of an asset and its disposal at the end of its useful life.

IAS 36 prescribes that:

- cash flow projections must be based on reasonable and supportable assumptions in line with management's budgets over a maximum period of five years (unless a longer period can be justified);
- the asset must be considered in its current condition, i.e. without taking future investment into consideration;
- cash flows should not include interest expenses and taxes;
- the discount rate should be applied:
  - ✓ before tax,
  - ✓ in line with current market rates,
  - ✓ taking into consideration the risks specific to the asset (unless this factor is already used in computing cash flows).

It should be noted that the impairment test process stops whenever either the fair value less costs of disposal or the value in use is higher than the carrying amount.

## **3° Recognizing an impairment loss**

If the recoverable amount of an asset or CGU is less than its carrying amount, the carrying amount of the asset or CGU must be reduced to its recoverable amount.

# **3. Accounting impacts**

## **3.1 Recognizing an impairment loss**

An impairment loss must be recognized immediately. However, an impairment loss of a **previously revalued asset** must be treated as a **revaluation decrease** and allocated directly and proportionately to the revaluation reserve (see IAS 16).

The depreciation schedule for an asset or CGU must be adjusted in future periods whenever the carrying amount of the asset or CGU changes as a result of an impairment loss.

An impairment loss on a CGU must be allocated to all the assets of the unit in the following order:

- first, to the carrying amount of any goodwill allocated to the CGU;
- then, to the other assets of the unit, pro rata to the carrying amount of each asset in the CGU.

### 3.2 Reversing an impairment loss

If an entity has to reverse an impairment loss for assets other than goodwill recognized in prior periods (for example, as a result of an increase in market prices leading to a higher net disposal value), the asset must be carried at its new recoverable amount by reversing the impairment loss. Such reversal is recognized in profit or loss unless the asset is carried at revalued amount. In this case, the reversal shall be treated as a **revaluation increase** and recognized directly in equity. An impairment loss recognized for goodwill must not be reversed in a subsequent period.

**The depreciation expense schedule** for the asset must be adjusted to reflect the revised carrying amount.

A reversal of an impairment loss reflects an observable increase of the recoverable value of the asset or CGU and should not be linked only to variations in discount rates.

The increased carrying amount of an asset attributable to a reversal of impairment must not exceed the carrying amount of the asset that would have been determined, after deducting amortization and depreciation, had no impairment loss been recognized in prior years. A reversal of impairment is allocated only to the assets of a CGU, pro rata to the carrying amounts of these assets). An impairment loss recognized for goodwill may not be reversed as this would be considered an internally-generated increase in goodwill (which is not permitted under IAS 38).

## 4. Disclosure

### 4.1 Information to be disclosed for each class of assets

An entity must disclose:

- the amount of impairment losses recognized during the period in profit or loss and the line items in which they are included;
- the amounts of impairment losses on revalued assets recognized during the period in other comprehensive income;
- the amount of reversals of impairment losses recognized during the period in profit or loss;
- the amount of reversals of impairment losses on revalued recognized during

- the period in other comprehensive income;
- a breakdown of the above items for each reportable segment as reported under IFRS 8 (see p. 152).

## 4.2 Specific rules for recognition and reversal of significant impairment loss

For recognition or reversal of significant impairment loss an entity must disclose:

- the circumstances that led to the recognition or reversal of the impairment loss, the nature of the asset or CGU, the reportable segment to which the asset belongs;
- the basis on which the impairment is recognized (market value/value in use with an indication of the data used when the discounted future cash flow method is used to determine the fair value, less the cost of disposal);
- the discount rate used to determine the value in use;
- the method used to determine fair value less costs to sell;
- any change in the composition of a CGU.

**Example 3:** On 1 January N, company X purchased a truck for 100. The consumption of future economic benefits is expected to be linear over a period of 4 years. The expected annual turnover to be generated by the truck is 150 and the expected operating margin is 30%.

The discount rate used is 6%.

The various data are summarized in the table below.

Items	N	N+1	N+2	N+3
Turnover	150	150	150	150
Margin	45	45	45	45
Future cash flows	120.28	82.50	37.78	
Depreciation	25		25	25 25
Net carrying amount	75	50	25	0
Fair value (assumed)	70	50	30	10
Impairment	0	0	0	0

Future cash flows on December 31 of year N would be calculated as follows:  
 $45 \times (1.06) + 45 \times (1.06)^{-2} + 45 \times (1.06)^{-3} = 120.28$

On 31 December N, no impairment is recognized because although the market value (70) is less than the carrying amount (75), the useful value (120.28) is higher than the market value.

At the end of each of the following years, future cash flows remain higher than the carrying value and there is no need therefore to recognize an impairment loss. Furthermore, the market value must always be at least equal to the carrying amount.

**Example 4:** On 1 January N, company Y purchased a machine for 100. The consumption of future economic benefits is directly related to the turnover. The discount rate used is 6%. The various data are summarized in the table below.

Items	N	N+1	N+2	N+3
Turnover	70	80	80	60
Margin	20	35	30	20
Future cash flows	76.51	46.10	18.87	
Depreciation	24.14	27.59	27.59	20.68
Net carrying amount	75.86	48.27	20.68	0
Fair value (assumed)	70	45	20	0
Impairment (cumulative)	0	2.17	0.68	0

Depreciation is equal to 70/290 in year N, 80/290 in years N+1 and N+2, and 60/290 in year N+3.

At the end of year N, the discounted amount of future cash flows is higher than the net carrying amount: there is no impairment to account for even though the market value (70) is lower than the net carrying value (75.86).

At the end of year N+1, the discounted amount of future cash flows (46.10) and the market value (45) are lower than the net carrying amount (48.27 i.e.  $100 - 24.14 - 27.59$ ). The higher of these two values is used to determine impairment, i.e. the discounted amount of future cash flows. The impairment loss is then equal to:  $48.27 - 46.10 = 2.17$ . At the end of year N+1, given the negligible amount of impairment loss, the depreciation expense schedule is not adjusted for future years N+2 and N+3.

At the end of year N+2, the situation is the same except that the market value is the higher of the two values used to determine an impairment loss. The impairment loss is therefore equal to:  $20.68 - 20 = 0.68$ . This results in a reversal of provision of:  $2.17 - 0.68 = 1.49$  in year N + 2.

➤ *For the purposes of simplification, the impact of deferred tax is not taken into account in the example above.*