Training Program on Implementation of International Financial Reporting Standards (IFRS) / Ind-AS in CPSEs

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Ind AS 36-Impairment Of Assets

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Scope

Applies to all assets (including current assets) other than:

- Inventories (IND AS 2 – Inventories)
- Assets arising from construction contracts (IND AS 115– Construction Contracts)
- Deferred tax assets (IND AS 12-Income Taxes)
- Assets arising from employee benefits (IND AS 19-Employee Benefits)
- Financial Assets that are within the scope of IND AS 39 – Financial Instruments
- Biological assets (IND AS 41- Agriculture)
- Deferred acquisition costs, and intangible assets arising from Insurance contract (IND AS 104)
- Non – Current asset (or disposal groups) classified as held for sale in accordance with IND AS 105

Reasons – The other standards provide / those are too technical in nature and hence special treatment

Scope

Assets	In Scope	Outside the Scope of Ind AS 36	Relevant Ind AS for asset out of Scope
Inventories		✓	Ind AS 2
Assets arising from construction contracts		✓	~~Ind AS 11~~ 115
Deferred tax assets		✓	Ind AS 12
Assets arising from employee benefits		✓	Ind AS 19
Financial assets that are within the scope of Ind AS 39		✓	Ind AS 39
Biological assets related to agricultural activity that are measured at fair value less costs to sell		✓	Ind AS 41
Subsidiaries (as defined in Ind AS 27), associates (as defined in Ind AS 28) and joint ventures (as defined in Ind AS 31)	✓		
Non-current assets (or disposal groups) classified as held for sale		✓	Ind AS 105
Deferred acquisition costs, and intangible assets, arising from an insurer's contractual rights under insurance contracts		✓	Ind AS 104
Plant, property and equipment, including revalued assets	✓		
Intangible assets, including goodwill and revalued assets	✓		
Investment property (measured at cost)	✓		
Investment property (measured using the fair value model)		✓	Ind AS 40

Other assets not specifically excluded in the above table are within the scope of Ind AS 36

What is impairment Loss -

- Dictionary meaning of the word impairment is *"the state of being diminished, weakened, or damaged"*
- An asset is considered as impaired when its carrying amount exceeds its recoverable amount.
- Carrying amount of asset (or CGU) – Its recoverable amount.
- When you are not vaccinated (Covishield/ Covaxin), you are Impaired

Definitions

- **Impairment loss:** It is the amount by which the carrying amount of an asset or a cash-generating unit exceeds its recoverable amount
- **Carrying amount :**It is the amount at which an asset is recognized after deducting any accumulated depreciation (amortization) and accumulated impairment losses thereon
- **Cash-generating unit:** It is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets
- **Apply CGU concept**
  If asset's fair value less cost of disposal is higher than its carrying value then same asset has to be tested for impairment individually.

Definitions

Example of CGU:

- Samsung has 5 stores including store Connaught Place in Delhi wherein purchase, pricing, marketing & advertising are done from corporate level i.e. HO. Can CP store be CGU?

Indicators of CGU:

- Internal management reporting is organized to measure performance on a store-by-store basis; and
- The business is run on a store-by-store profit basis or on a region/city basis
- But cash flows generated by store X are independent of cash flow from other stores

Definitions

Example of CGU:

- Samsung has 5 stores including store CP wherein purchase, pricing, marketing & advertising are done from corporate level i.e. HO. Can CP store be CGU?

Indicators of CGU:

- Internal management reporting is organized to measure performance on a store-by-store basis; and
- The business is run on a store-by-store profit basis or on a region/city basis
- But cash flows generated by store CP are independent of cash flow from other stores

Ans: Yes

Practical cases – Is this possible – Yes

Definitions

Example of CGU:

- Company Mohan Breweries, Mohan Nagar has two plant MB-A and MB-B. Output of plant A is used by plant B however there is an active market for the output of plant A.

Identify the CGU

Definitions

Example of CGU:

- Company Mohan Breweries has two plant MB-A and MB-B. Output of plant A is used by plant B however there is an active market for the output of plant A.

Ans: Both A and B are CGU

Definitions

Example of CGU:

- An entity has a company office building which is used for the internal purpose, but the entity gives on the rent half of the office building to third party.

Identify the CGU

Definitions

Example of CGU:

- An entity has a company office building which is used for the internal purpose, but the entity gives on the rent half of the office building to third party. Identify the CGU

  Ans: Building in its entirety is CGU

Definitions

- **Recoverable Amount**: Recoverable amount of an asset or cash generating unit is the higher of its fair value less costs of disposal and its value in 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.
- **Value in use:** It is the present value of the future cash flows expected to be derived from an asset or cash-generating unit.

What is impairment ?

- The recoverable amount of an asset is less than its carrying amount (may be carried at cost or revalued amount)

  - The asset is impaired

  - The asset's carrying amount should be reduced to its recoverable amount

Asset i.e. Individual asset or Cash Generating Unit (CGU)

Identifying assets for impairment testing

- All assets in its scope shall be required for impairment testing where there is an impairment indicator at each reporting period

- However, in the case of goodwill acquired in a business combination, (indefinite life) and intangible assets that are not yet ready for use must also be tested for impairment annually irrespective of whether there any indication of impairment

- A) An entity shall assess at the end of each reporting period whether there is any indication that an asset (or CGU) has been impaired.

Identifying assets for impairment testing

External Indications	Internal Indications
•An asset's market value has declined significantly •Significant changes with an adverse effect on the entity have taken place or will take place. •Market interest rates or other market rates of return on investments have increased (yours are at low) •carrying amount of the net assets of the entity is more than its market capitalisation.	•Obsolescence or physical damage of an asset. •Restructuring plans •Idle Assets •Economic performance of the asset is worst than expected

Ind AS 36 on Impairment of Assets specifies when an entity is required to perform an impairment test and outlines the major steps as per below:

- Determining the scope and structure of the impairment testing
- Determining scenarios when impairment test is necessary
- Estimation and recognition of impairment loss or reverse any impairment loss, if necessary
- Disclosure requirement

The recent uncertainty in the economy at global level has thrown a spotlight on impairment. Due to economic and financial instability, many entities reassess their impairment testing processes, models and assumptions.

Step 2: Impairment Testing

1. To confirm that the asset is within the scope of Ind AS 36,

2. The next step is to determine whether the asset will be reviewed for impairment individually or as part of a larger group of assets.

3. Recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets.

4. If this is the case, recoverable amount is determined for the cash-generating unit to which the asset belongs, unless either:

   a)the asset's fair value less costs to sell is higher than its carrying amount; or

   b) the asset's value in use can be estimated to be close to its fair value less costs to sell and fair value less costs to sell can be determined.

The following steps determine the scope of the quantified impairment testing:

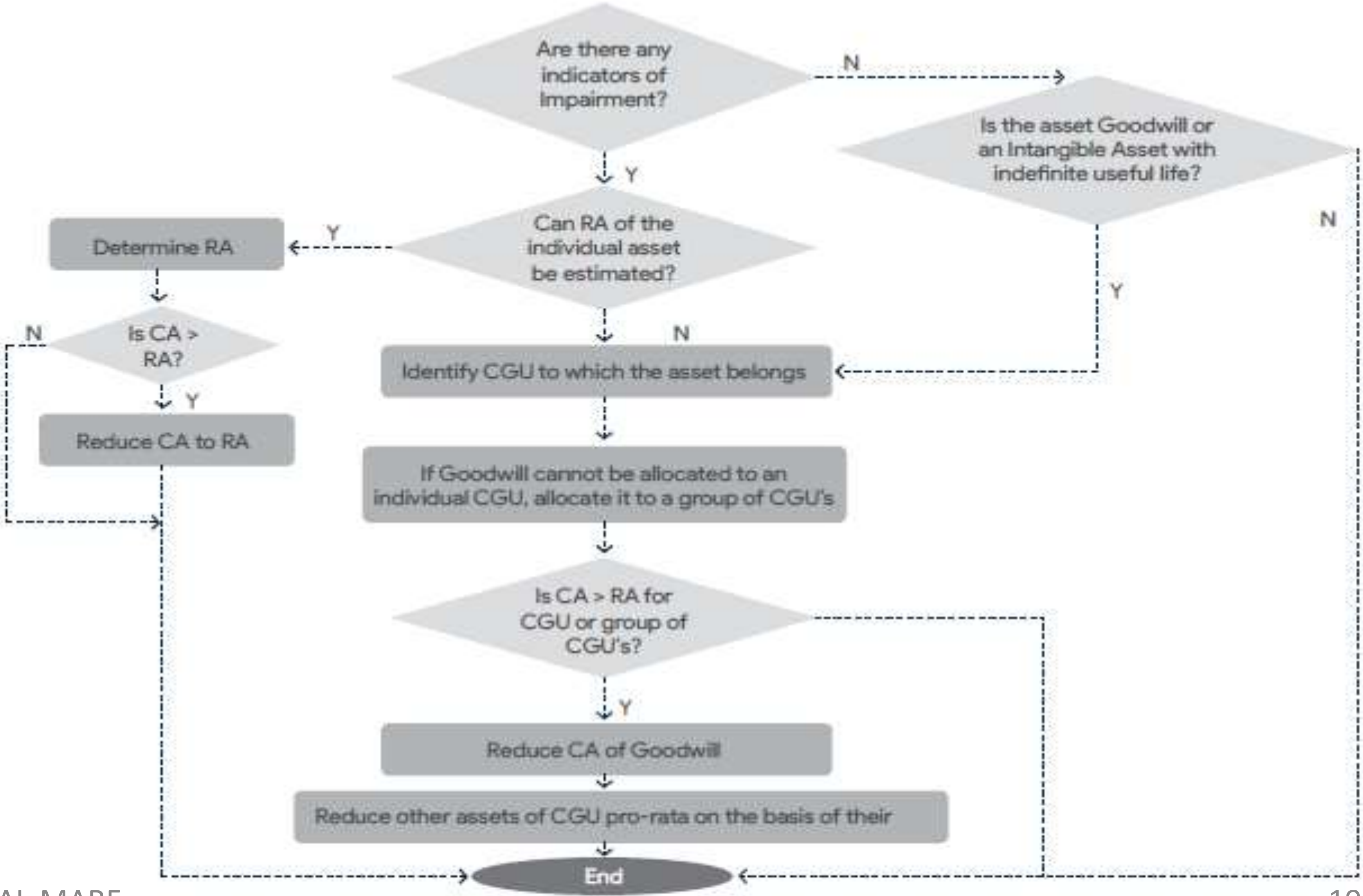
1. Estimation of the recoverable amount for the assets and CGUs as required

2. Comparison of the recoverable amount to the carrying amount

3. Accounting of (or reversal, if applicable) any impairment loss, to the individual assets, or

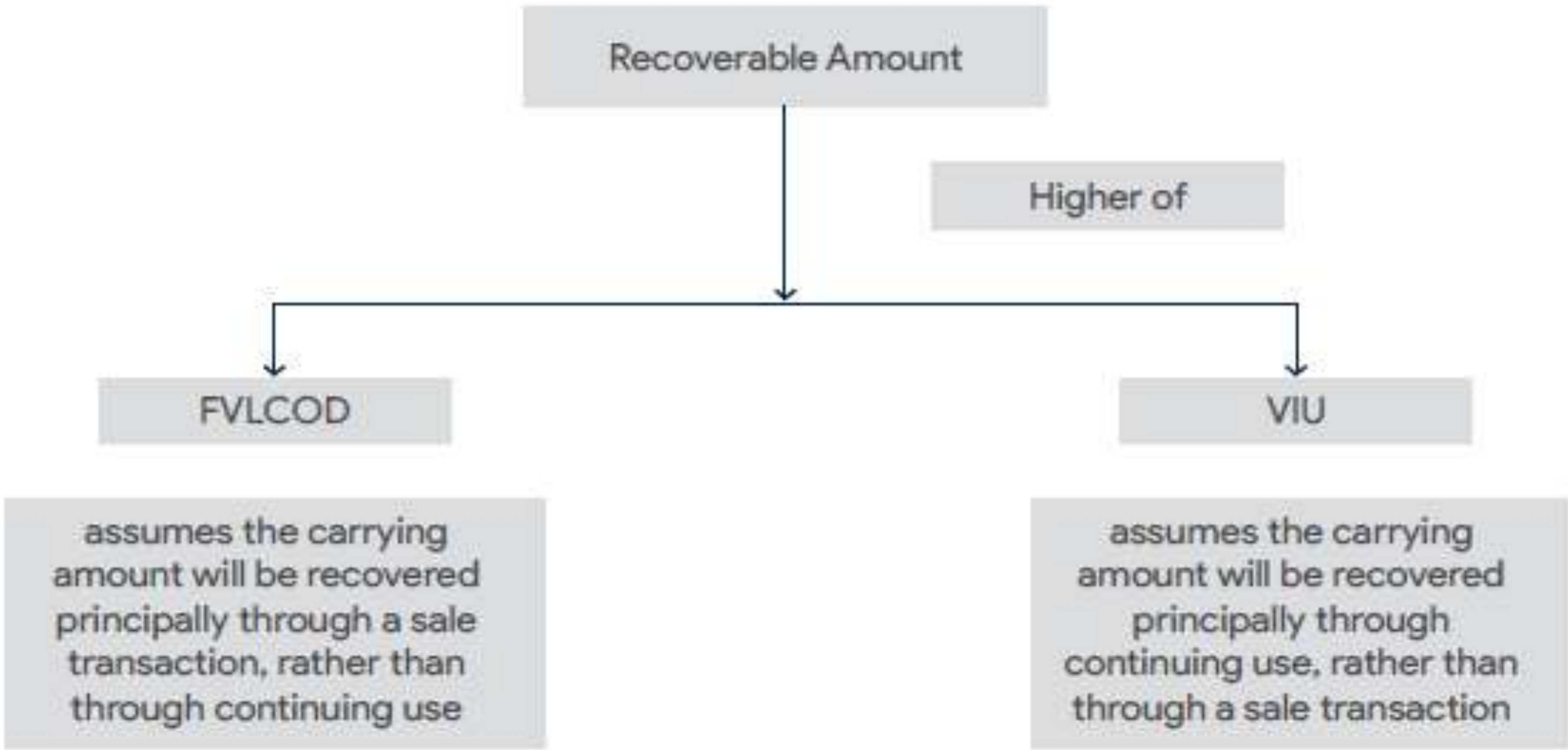
4. Allocated among the assets in impaired CGUs in accordance with Ind AS 36

Determining the Structure of Impairment:



Estimation of RA (recoverable Amount)

As defined earlier, recoverable amount of an asset or a CGU is the higher of its fair value less costs of disposal (FVLCOD) and its value in use (VIU).



Value in use test

The future cash flows the entity expects to derive from the asset

Expectation about possible variations in the amount or timing of the cash flow

The time value of money, being the current market risk-free rate of interest

The price for bearing the uncertainty inherent in the asset

Other factors (such as liquidity) that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset

Elements of value in use calculation

- **Cash flow projections**:
  - Cash inflows from the continuing use of the asset
  - Cash outflows that are necessarily incurred to prepare the asset for continuing use and/or ready to use
  - Net cash in / out flows, if any, from its disposal Factors to consider
  - Short term – maximum 5 years, unless longer can be justified (steady or declining growth)
  - Based on recent financial budgets/forecasts approved by management
  - Estimation for the asset in its current condition (i.e. Restructuring, reorganization and capital expenditure on the assets ignored)

Elements of value in use calculation

- **Discount rate should be:**

  - Pre-tax rate that reflects current market assessment of the time value of money and
  - The risks specific to the asset Factors to consider
  - Discount rate is independent of the enterprise's capital structure
  - The discount rate should be asset specific rate, if the same is not available then the following may be considered:
    a) WACC
    b) The enterprise's incremental borrowing rate or other market
    c) Other market borrowing rate

Recognition and Measurement

- **IF Recoverable Amount < Carrying Amount of an Asset** Impairment Loss =Carrying Amount less Recoverable Amount

- **Impairment loss to be recognized:**
  - As an expense in the P&L account (if there is no revaluation)
  - As a decrease in revaluation reserve (if carried at revalued amount)

- **After recognition:**
  - Adjust depreciation/amortisation charge for the asset in future periods
  - Allocate the asset's revised carrying amount less residual value, on a systematic basis over its remaining useful life

Recognition of impairment loss for a CGU

- First write-down any goodwill allocated to the CGU

- Then, to the other assets of the CGU on pro rata on the basis of the carrying amount of each asset in the CGU

- **The carrying amount of an asset (which is part of CGU) should not be reduced below the highest of** :

  - Its net selling price (if determinable)
  - Its value in use (if determinable)
  - Zero

- The amount of the impairment loss that would otherwise have been allocated to the asset should be allocated to the other assets of the CGU on a pro-rata basis

Reversal of Impairment

- **Points to check at each reporting period:**

  - Whether accumulated impairment loss may no longer exist or may have decreased (look for indicators –external and internal)

  - Impairment loss except goodwill can be reversed if, and only if, there has been a change in estimates (not because of increase in PV of cash flows as they become closer)

  - Increased carrying amount not to exceed the carrying amount that would otherwise exist if no impairment loss had been recognized.

Projected Cash flows – Discounted – Using WACC rate

Microsoft Office
Excel Worksheet

Case Study - 1

Valuation of Limestone Mine for Impairment Testing in the books of a leading India cement company.

Impairment testing of Mine:

Valuation of Mineral rights is challenging. The method and approach used for valuation usually depends on the development status of mineral property, the extent and reliability of information available.

Background:

The mining lease was granted for limestone over an area of 96.25 hectares of land for a period of 20 years from 1995 till 2015. However, the company had applied for lease renewal and as per the Rule 24A (6) of Rajasthan Minor Mineral Concession Rules, 1986, the status of this lease was under “Deemed Renewal”.

Trigger:

The mining operations were stalled after initial 3 years of operations due to land tax matters, mining lease approval and demand notice by state government regarding royalty payment by erstwhile owners of the mine.

Case Study - 1

Valuation of Limestone Mine for Impairment Testing in the books of a leading India cement company.
Impairment testing of Mine:
Challenges and factors considered in valuation:

- The mine was held in a subsidiary company with no other operations. Hence, the value of mine was considered as the value of the company.
- Lack of active trading market for limestone and heterogeneous nature of the mines made it challenging to determine market price of limestone to be considered for determination of cash flows.
- Mining transactions are infrequent and not reported in public, most mines are auctioned by the government. Also each mine would have its own geographical and location based challenges and hence, market multiples could not be considered.
- During the site visit it was found that, the mining lease was granted for total area of 96 hectares but the company did not have surface rights of 47 hectors.
- used I**ncome approach** to estimate the value in use of this mine. The value of mine was considered as the value of subject company since the company did not have any other operations

Valuation of Gas based Power Plant in the books of a leading India Power company.

Impairment Testing of Power Plant:

Case Study - 2

Background:

The power company was in the process of developing 2400 MW (800 Mw x 3) combines cycle gas based power plant on the eastern cost of India. The Company had incurred and expense of about INR 8000 Cr but none of the modules were commissioned.

Trigger:

The first phase of development of 800 MW was completed. However, even the phase 1 had not commenced commercial production as the project was awaiting allocation of gas from the Government for generating power.

Challenges and factors considered in valuation:

•No clear visibility of availability of gas from Government. Hence it was difficult to estimate the plant load factor for the completed module.

•Power plant unviable after considering operations based on Regasified Liquified Natural Gas.

•Company was in the process of shifting the gas turbines to Iraq or Bangladesh which are power deficit nations.

•Estimation of capital expenditure for completion of other modules in India and in other nations was a complex exercise.

•Transactions are not frequent in gas based power plants in India, hence market multiples could not be considered.

•**Income approach** was used to estimate the value in use of this plant. The valuation was estimated under various scenarios i.e a combination of some modules operating in India and other outside India. Sensitivity analysis was also conducted based on the availability of gas, plant load factor and discount factors etc.

Disclosure

- **For each class of assets, the financial statements should disclose:**
  - Amount of impairment loss
  - line item(s) of the income statement in which those impairment losses are included
  - Amount of reversals of impairment losses
  - Line item(s) of the income statement in which those impairment losses are reversed
  - Amount of impairment losses recognized directly against revaluation surplus
  - Amount of reversals of impairment losses recognized directly against revaluation surplus

Disclosure- Material Loss or Reversal

- **Enterprise should disclose:**
  - Events and circumstances
  - Amount of loss or reversal recognized
  - Nature of asset/CGU
  - Reported segment of asset/CGU
  - CGU – if grouping has changed, describe current and former grouping and reasons for the change in grouping

Disclosure- Material Loss or Reversal

- **Enterprise should disclose:**
  - Recoverable amount – net selling price or value in use. Describe basis etc
  - Main classes of assets affected by impairment losses or reversals
  - Main events and circumstances that led to loss/reversal

Microsoft Office Excel Worksheet