FAR-1 — FINANCIAL ACCOUNTING & REPORTING 1

Topic: IMPAIRMENT OF ASSETS — IAS 36

1 TOPIC OVERVIEW

WHAT IS IT?
IAS 36 ensures an asset's carrying amount is not stated above its recoverable amount — if it is, the asset is written down and an impairment loss is recognised.

WHY IMPORTANT?
Applies the **prudence concept** — assets must not be overstated. It affects almost every non-current asset (PPE, IP at cost, intangibles, goodwill) and directly changes profit and asset values.

CORE PRINCIPLE
If carrying amount > recoverable amount → impairment loss = the excess, recognised (usually) in profit or loss, writing the asset down to its recoverable amount.

2 KEY DEFINITIONS [IAS 36:6]

Impairment loss: The amount by which the carrying amount of an asset exceeds its recoverable amount.

Carrying amount: Amount at which an asset is recognised after deducting accumulated depreciation/amortisation and accumulated impairment losses.

Recoverable amount: The **higher** of an asset's fair value less costs of disposal and its value in use.

Value in use: The present value of the future (net) cash flows expected to be derived from an asset, including its eventual disposal.

Fair value: The price that would be received to sell an asset in an orderly transaction between market participants at the measurement date.

Costs of disposal: Incremental costs directly attributable to disposal, excluding finance costs and income tax expense.

WORKED CHECK [Examples 01–02]
CA Rs.530,000, VIU Rs.500,000, FVLCD Rs.470,000 → RA = Rs.500,000 (higher) → impairment = Rs.30,000. But if CA is Rs.490,000 (same RA) → no impairment (CA already below RA).

3 SCOPE [IAS 36:2 & 5]

✘ OUTSIDE SCOPE (own mechanism exists)
- Inventories — lower of cost and NRV (IAS 2)
- Investment property measured at fair value (IAS 40)

✔ WITHIN SCOPE (not exhaustive)
- Property, plant & equipment (IAS 16)
- Investment property using the cost model (IAS 40)
- Intangible assets (IAS 38)
- Purchased goodwill (IFRS 3)

4 APPLICATION TO REVALUED ASSETS

Disposal costs NEGLIGIBLE	FVLCD ≈ revalued amount, so RA is necessarily close to/greater than CA → **unlikely impaired**; RA need not be estimated.
Disposal costs NOT negligible	FVLCD is necessarily less than FV → asset **will be impaired if VIU < revalued amount**; apply IAS 36 in full.

WORKED CHECK [Examples 03–04, CA=FV=Rs.500,000 in all cases]
Negligible disposal costs: VIU Rs.600k/480k/100k → RA = 600k/500k/500k → impairment Nil in all three. Disposal costs Rs.50,000: FVLCD = Rs.450,000 → RA = 600k/480k/450k → impairment Nil / Rs.20,000 / Rs.50,000 respectively.

5 IDENTIFYING AN ASSET THAT MAY BE IMPAIRED [IAS 36:9,10,12]

Rule	Detail
Constraint	Not practical/required to test every asset every period (time & cost constraints).
Requirement	Assess at each period end whether any indication of impairment exists; if so, estimate recoverable amount. No indication → no further action.
Exceptions (always test annually)	Intangible asset not yet available for use; intangible asset with indefinite life; goodwill.

EXTERNAL INDICATORS
- Significant decline in value beyond normal passage of time/use
- Adverse changes in technology, markets, economy or law
- Rising market interest rates affecting value in use
- Net assets carrying value exceeds market capitalisation

INTERNAL INDICATORS
- Evidence of obsolescence or physical damage
- Asset becoming idle; plans to discontinue/restructure
- Plans to dispose before expected date; reassessing useful life as finite
- Evidence that economic performance is/will be worse than expected

MEASURING RECOVERABLE AMOUNT — VIU & FVLCD

6 RECOVERABLE AMOUNT — KEY FORMULA & SHORTCUT RULE [IAS 36:19]

RECOVERABLE AMOUNT

Higher of (Fair value less costs of disposal) and (Value in use)

If **either** FVLCD or VIU already exceeds the carrying amount, the asset is **not impaired** — the other amount need not be estimated at all. [Example 07: CA Rs.500,000, FVLCD Rs.600,000 → no impairment regardless of VIU, since FVLCD alone already exceeds CA.]

7 DEPRECIATION AFTER IMPAIRMENT/REVERSAL [IAS 36:63 & 121]

After recognising an impairment loss (or its reversal), the depreciation charge for future periods is adjusted to allocate the asset's **revised carrying amount less residual value** systematically over its **remaining useful life**.

8 VALUE IN USE — WHAT TO INCLUDE / EXCLUDE [IAS 36:30–55]

Reflects: estimated future cash flows, possible variations in amount/timing, time value of money (risk-free rate), price for bearing uncertainty, and other factors (e.g. illiquidity) — as cash-flow adjustments or discount-rate adjustments.

✔ INCLUDE

- Cash inflows from continuing use (asset in its current condition)
- Cash outflows necessarily incurred to generate those inflows
- Net disposal proceeds at the end of useful life

✘ EXCLUDE

- Cash flows from financing activities
- Income tax receipts/payments
- Future restructuring not yet committed to
- Improving/enhancing the asset's performance

Once committed to a restructuring, its cost savings/benefits ARE reflected. **Discounting:** use a pre-tax rate reflecting current market time-value of money and asset-specific risks not already adjusted for in the cash flows.

9 FAIR VALUE LESS COSTS OF DISPOSAL [IAS 36:20 & 28]

Can be measured even without a quoted price in an active market. If no reliable basis exists to estimate it → use **value in use** as the recoverable amount instead.

✔ COSTS OF DISPOSAL INCLUDE

Legal costs, stamp duty, costs of removing the asset, direct incremental costs to bring the asset into a condition for sale.

✘ NOT COSTS OF DISPOSAL

Redundancy and restructuring costs incurred after the sale of the business.

10 CALCULATION ROADMAP — IMPAIRMENT QUESTIONS

1. Identify indication of impairment
2. Compute carrying amount at review date
3. Estimate FVLCD and/or VIU (discount cash flows)
4. Recoverable amount = higher
5. Impairment = CA − RA (if positive)
6. Journal entry & revise future depreciation

RECOGNITION — IMPAIRMENT LOSS & ITS REVERSAL

11 RECOGNISING AN IMPAIRMENT LOSS [IAS 36:61]

Non-revalued asset	Impairment loss recognised in full in **profit or loss**.
Revalued asset	Loss recognised in **OCI** up to the balance in that asset's revaluation surplus (reducing the surplus); any **excess** → profit or loss.

Non-revalued asset — Method 1		Method 2	
Dr Impairment loss (P&L)	✓	Dr Accumulated depreciation	✓
Cr Accumulated impairment losses	✓	*Cr Asset*	✓
		Dr Impairment loss (P&L)	✓
		Cr Asset	✓

Revalued asset — Method 1		Method 2	
Dr Impairment loss (OCI)*	✓	Dr Accumulated depreciation	✓
Dr Impairment loss (P&L)**	✓	*Cr Asset*	✓
Cr Accumulated impairment losses	✓		
		Dr Impairment loss (OCI)* / (P&L)**	✓
		Cr Asset	✓

*to the extent of the balance in revaluation surplus. **excess (if any) over that balance.

WORKED CHECK [Ex.11–12]
Cost Rs.500,000, acc. dep. Rs.200,000 (CA Rs.300,000), RA Rs.280,000 → impairment Rs.20,000. With no revaluation surplus → all Rs.20,000 to P&L. With a Rs.7,000 revaluation surplus → Rs.7,000 to OCI, remaining Rs.13,000 to P&L.

12 REVERSAL OF IMPAIRMENT LOSS [IAS 36:110, 117–120]

Assess each period-end for indication that a prior impairment may have decreased/reversed (applies to all impaired assets **except goodwill**, which is never reversed). Reversal recognised immediately in P&L — **capped** so the new carrying amount never exceeds what it would have been (net of depreciation) had no impairment ever been recognised. Any increase above that cap is a revaluation → OCI (only if the entity uses the revaluation model).

Non-revalued asset		Revalued asset (with excess above no-impairment CA)	
Dr Accumulated impairment losses	✓	Dr Accumulated impairment losses	✓
*Cr Reversal of loss (P&L)**	✓	*Cr Reversal of loss (P&L)**	✓
		Dr Asset	✓
		*Cr Gain on revaluation (OCI)***	✓

*to the extent of previously recognised impairment loss, net of the depreciation that would since have reduced it. **any amount in excess of that (only where the revaluation model is used).

WORKED CHECK [Ex.13–14]
Cost Rs.100,000, 10-yr life, impaired to Rs.72,000 in Yr1 (loss Rs.18,000). By Yr2 CA = Rs.64,000; no-impairment CA would have been Rs.80,000 (cap). RA now Rs.95,000 → reversal capped at **Rs.16,000** to P&L (80,000−64,000), NOT the full Rs.31,000. Under the revaluation model, the extra Rs.15,000 (95,000−80,000) goes to **OCI** as a revaluation gain.

FINANCIAL STATEMENT IMPACT, EXAM STRATEGY & QUICK RECAP

13 REVALUATION-MODEL SCENARIO — FULL WORKED CHECK [Example 16 pattern]

Cost Rs.240,000, 20-yr life; revalued to Rs.250,000 at start of Yr3 (surplus Rs.34,000). By end of Yr3, CA (on revalued amount, 18 yrs left) = Rs.236,111. Yr4 impairment review: RA = Rs.100,000 → impairment = Rs.136,111.

- Rs.32,111 (= Rs.34,000 surplus − Rs.1,889 incremental depreciation already transferred) → **OCI**, reducing surplus to zero
- Remaining Rs.104,000 → **profit or loss**
- Yr4 depreciation thereafter = Rs.100,000 ÷ 10 years = **Rs.10,000** (based on the post-impairment recoverable amount)

14 FINANCIAL STATEMENT IMPACT

STATEMENT OF PROFIT OR LOSS

- Impairment loss (non-revalued assets, or the excess beyond a revaluation surplus)
- Reversal of impairment loss (capped at pre-impairment CA)
- Revised depreciation charge post-impairment/reversal

STATEMENT OF FINANCIAL POSITION

- Asset — carrying amount reduced by accumulated impairment losses (non-current asset)
- Revaluation surplus (equity/OCI) — reduced by impairment on revalued assets; increased by reversal gains above the no-impairment cap

! ⚠ EXAM TRAPS — COMMON MISTAKES

- Comparing carrying amount to **only one** of FVLCD or VIU when the other, if calculated, would already exceed CA — remember, if either exceeds CA, no impairment and no need to compute the other.
- Using **gross** disposal proceeds in value in use instead of net cash flows, or omitting the terminal disposal proceeds altogether.
- Including **financing cash flows or tax** in value in use — these are always excluded.
- Including cash flows from an **uncommitted restructuring** or from enhancing the asset — only committed, current-condition cash flows count.
- Forgetting that a **conditional trade-in value** (only available on replacement) is not appropriate fair value for FVLCD purposes.
- Recognising the whole impairment loss in **P&L** when a revaluation surplus exists for that asset — the loss must first reduce OCI/surplus.
- Reversing an impairment loss **without capping it** at the carrying amount that would have existed had no impairment ever occurred.
- Reversing an impairment loss on **goodwill** — goodwill impairment is never reversed.
- Forgetting to **recompute depreciation** on the new (post-impairment or post-reversal) carrying amount over the remaining useful life.
- Confusing recognition (CA vs RA comparison) with measurement (how VIU/FVLCD are calculated) — both are tested, but separately.

15 QUICK DECISION TREE — ANSWERING ANY IAS 36 QUESTION

1 Question given → 2 Indication of impairment (or reversal)? → 3 Compute CA, FVLCD, VIU → 4 RA = higher; compare to CA → 5 Journal entry (revalued vs non-revalued) → ✔ FS effect / final answer

IAS 36 — IMPAIRMENT OF ASSETS IN 60 SECONDS

Impairment loss = CA − RA (only when CA > RA).

RA = higher of FVLCD and VIU. If either alone exceeds CA, stop — no impairment.

VIU = PV of future net cash flows from use + disposal proceeds; excludes tax, financing, uncommitted restructuring.

Test annually regardless of indicators: intangibles not yet in use, indefinite-life intangibles, goodwill.

Non-revalued asset: loss/reversal fully through P&L.

Revalued asset: loss → OCI up to surplus, excess to P&L; reversal → P&L up to no-impairment CA, excess to OCI.

Reversal cap: never exceed the CA (net of depreciation) that would exist had no impairment occurred. Goodwill impairment is never reversed.

After impairment/reversal: depreciate revised CA (less residual value) over remaining useful life.

Journal (loss): Dr Impairment loss / Cr Accumulated impairment losses (or Cr Asset directly).