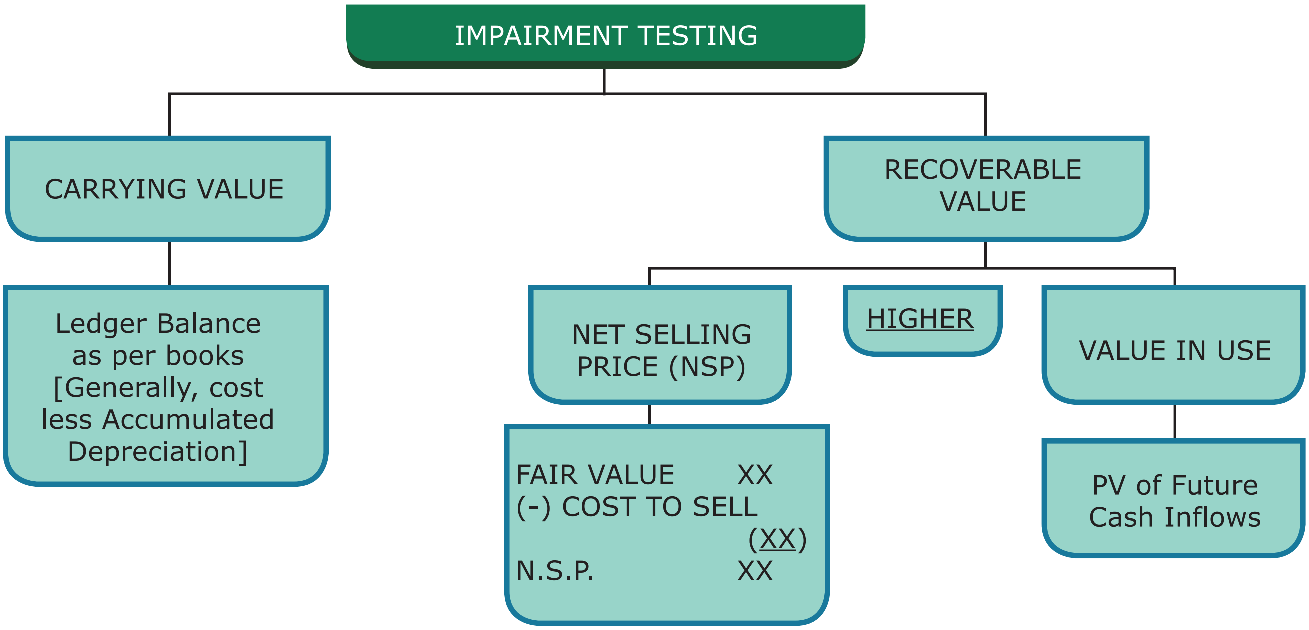
AS 28 – IMPAIRMENT OF ASSETS

(I) Meaning of Impairment

Impairment arises when the carrying value exceeds the recoverable value. Impairment indicates a reduction in the earning capacity of the asset. This standard is applicable to P.P.E, intangibles, and Investment property.



Impairment loss refers to the reduction in the carrying value of the asset i.e.

Impairment loss = Carrying Value – Recoverable Value (if positive)

TREATMENT OF IMPAIRMENT LOSS

1. In case there is an existing Revaluation surplus balance, then the impairment loss should first be written off against Revaluation Reserve.
2. Excess Loss (If any) will be written off against P & L

KEY POINTS

Impairment loss can be recorded only till the time the carrying value of the asset becomes NIL. Any loss beyond that (if any) would not be covered under AS 28. Instead, we should determine whether a provision is needed (if present obligation) or a disclosure should be given (contingent liability), as per AS 28, Provisions and contingencies.

(II)

TIMING OF IMPAIRMENT TESTING

- **ANNUAL IMPAIRMENT TESTING**
  1. Intangibles Under Development
  2. Intangibles with Indefinate Life
  3. Goodwill under Business Combination
- **IMPAIRMENT TESTING WHEN INDICATORS EXIST**
  - All other assets (Note 1)

Note 1

Illustrative Indicators of Impairment

(A) External Indicators

- (i) Adverse Technological Changes
- (ii) Legal Prohibitions
- (iii) Entry of a Strong Competitor
- (iv) Market Capitalisation is less than Book Value (Net Worth)
- (v) Adverse effects due to lockdown

(B) Internal Indicators

1. Physical Damage to the Asset (Flood)
2. Continued Cash Losses

(III) Value in Use [V.I.U] (Present value of Future cash Inflows)

1. Cash Inflow should be calculated **before** deducting Interest and Tax (i.e., Operating cash Inflows)
2. As the cash inflows are before deducting interest and tax, they are attributable to both debt and equity. Hence the appropriate discount factor is **Pre-Tax W.A.C.C**.
3. Cash Inflows/Outflows expected to arise from future restructuring or expected future improvements should not be considered in the value in use unless the entity is committed to restructuring / improvement. Commitment exits if the entity is under a legal/constructive obligation.
4. Salvage value should be considered while calculating value in use.

(IV) Reversal of Impairment

In case there is a subsequent increase in the recoverable value due to *an improvement in the service potential* of the asset, then a reversal of impairment is permitted. This reversal is possible for all assets (*Exception Goodwill*)

Steps for Reversal

(1) Calculate carrying value of the asset ignoring impairment

(2) Estimate Recoverable value on the date of Reversal

(3) The maximum ledgers balance after reversal = the lower of steps 1 and 2

(4) Calculate ledger Balance of the asset on the date of reversal [i.e. After Impairment and Depreciation]

(5) Reversal of Impairment = step 3 – step 4

KEY POINTS

Reversal of Impairment of goodwill is usually not permitted. This is because a Reversal may indirectly recognize self generated Goodwill. However, in case the impairment happens due to an external event (eg legal ban) and that same external event reverses (eg lifting of ban), then reversal of Goodwill impairment is permitted.

(V) Cash Generating Unit (C.G.U)

CGU is the smallest group of assets which are capable of generating largely independent cash flows.

Evaluation of impairment should be done at the CGU level only if the individual asset where indicators of impairment exist is not capable of generating independent cash flows and hence the value in use for the same cannot be reliably determined.

(VI) Allocation of Impairment Loss in case of a C.G.U.

(1) Calculate carrying value of C.G.U i.e., carrying value of individual assets + Allocable Goodwill + Allocable corporate Assets

(2) Calculate Recoverable value for the entire CGU i.e., the higher of total net selling price and total value in use for the entire C.G.U.

(3) Impairment Loss = ① – ② [If positive]

(4) Allocation of Impairment Loss:

(i) First to be written off against Allocable Goodwill.

(ii) Excess loss if any should be written off against all other individual asset (including allocable corporate assets) proportionately in the ratio of their carrying values.

(iii) The allocation of impairment loss should ensure that the carrying values of individual asset/corporate assets should not fall below the individual recoverable value (individual net selling price or the individual value in use whichever is higher), if available.

EXAMPLE

A C.G.U has three identifiable asset – A, B, C apart from an allocable corporate asset (D) and allocable goodwill. The details for the same are as follows:

	A	**B**	**C**	**D**	**G/W**	**Total**
Carrying Value	10	20	30	40	50	150
Net Selling Price	20	20	20	20		80
Value in use	?	?	?	?		90

Calculate Impairment loss and show its allocation

Solution: C.G.U

(1) Carrying Value = 10 + 20 + 30 + 40 + 50 = 150

(2) Recoverable Value =
i.e., Higher of Net Selling Price (80) and Value in use (90)
i.e., 90

(3) Impairment loss = 150 – 90 = 60

A C.G.U has three identifiable asset – A, B, C apart from an allocable corporate asset (D) and allocable goodwill. The details for the same are as follows:

	A	B	C	D	G/W	Total
Carrying Value	10	20	30	40	50	150
Net Selling Price	20	20	20	20		80
Value in use	?	?	?	?		90

Calculate Impairment loss and show its allocation

Solution: C.G.U

(1) Carrying Value = 10 + 20 + 30 + 40 + 50 = 150

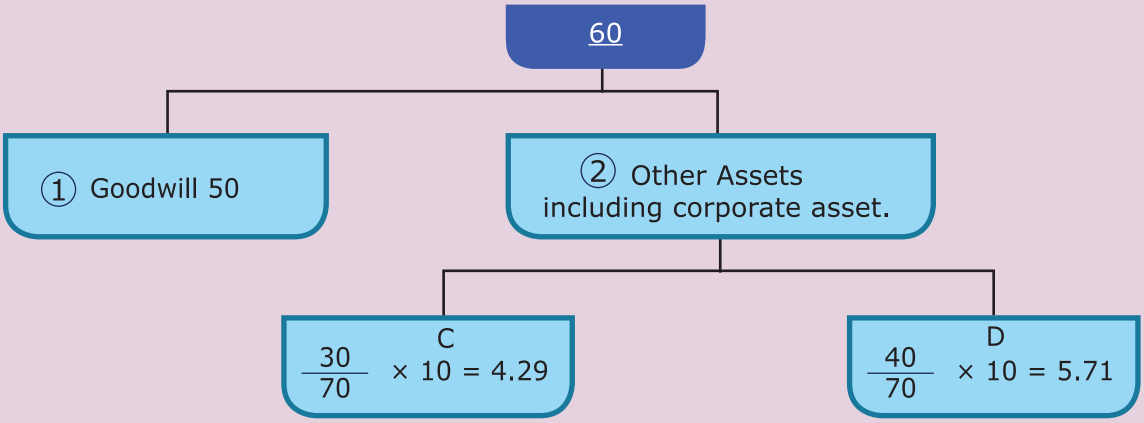
(2) Recoverable Value =
i.e., Higher of Net Selling Price (80) and Value in use (90)
i.e., 90

(3) Impairment loss = 150 – 90 = 60

(4) Allocation of Impairment Loss

(i) Out of 60, first 50 should be allocated to Goodwill.

(ii) The excess loss of 10 (60 – 50) should be allocated to all the 4 remaining assets proportionately. However, A & B have their carrying value to be less than or equal to their individual Net Selling Prices and hence there is no impairment in A & B. The loss of 10 needs to be borne by C and corporate asset D in the ratio of their carrying values i.e. 30:40



Journal Entry

Impairment Loss a/c	Dr.	60	
To Goodwill a/c			50
To C a/c			4.29
To D [Corporate Asset] a/c			5.71

Reversal of Impairment Loss in case of C.G.U

The principles of reversal for a C.G.U are the same as that of individual assets. i.e.

(i) Reversal can happen only if there is an improvement in service potential

(ii) Goodwill Impairment cannot be reversed.

(iii) The reversal should ensure that the carrying value after reversal cannot exceed the lower of carrying value ignoring impairment and recoverable value.

(VII) Apropriate Allocation Ratio for Allocable Corporate Assets

Allocation of Corporate assets should be based on the time based weighted average carrying values i.e. carrying value of CGU x the life of CGU or the life of corporate asset (whichever is shorter)

This is because the corporate asset would be utilized by the CGU which has a higher carrying value to a greater extent. Further the corporate asset will be utilized by the CGU which has a longer life to a greater extent and hence both should be considered. If life is not given, we can take the ratio of carrying values directly

UNALLOCABLE CORPORATE ASSETS

(1) Calculate Impairment loss for smaller CGUs after allocating the carrying value of allocable corporate assets (X) and ignoring un allocable corporate assets (Y).

(2) Find the Revised carrying values for each of the smaller CGUs and the allocable corporate assets after deducting impairment loss.

(3) Unallocable corporate assets can be allocated to a larger CGU (i.e. entity as a whole)

(4) Impairment loss is calculated for the larger CGU. The loss if any is to be borne by the unallocable asset (Y) as the smaller CGUs (including allocable corporate assets) are already at the lower of their carrying values or recoverable values and they cannot be impaired further.