



Insights into PAS 36

Recognizing impairment losses

PAS 36, *Impairment of Assets*, specifies the accounting for impairment reviews. There are some detailed requirements of PAS 36 that are complex and sometimes difficult to interpret and therefore are challenging to apply when preparing financial statements.

The articles in our ‘Insights into PAS 36’ series have been written to assist preparers of financial statements and those charged with the governance of reporting entities understand the requirements set out in PAS 36, and revisit some areas where confusion has been seen in practice.

Step 6 of applying the guidance in PAS 36 as set out in our article ‘[Insights into PAS 36 – Overview of the Standard](#)’ and relates to recognizing or reversing and impairment losses. This article focuses on part of this step; recognition of impairment losses. For reversing impairment losses, refer to our article ‘[Insights into PAS 36 – Reversing impairment losses](#)’.



Step 6: Recognize or reverse any impairment loss

The requirements for recognizing and measuring impairment losses differ based on the structure of the impairment testing as determined in Step 2, discussed in our article '[Insights into PAS 36 – Scope and structure of an impairment review](#)'. The requirements for recognizing and measuring impairment losses for an individual asset (other than goodwill) are addressed in firstly below; and then the requirements for recognizing and measuring impairment losses for cash-generating units (CGUs) and goodwill are addressed after that.

Recognizing an impairment loss for an individual asset

When the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset needs to be reduced to its recoverable amount and that reduction is recognized as an impairment loss.

For assets accounted for using the revaluation model in PAS 16, *Property, Plant and Equipment* or PAS 38, *Intangible Assets*, the impairment loss is treated in the same way as a downward revaluation in accordance with those standards. Accordingly, any impairment is recognized in other comprehensive income to the extent it does not exceed a previous revaluation surplus. Any excess is recognized in profit or loss.

To the extent the amount estimated for an impairment loss exceeds the carrying amount of the asset to which it relates, an entity shall recognize a liability if, and only if, required by another standard.

Practical insight – Impairment loss exceeds the carrying amount of the asset to which it relates

An unallocated impairment loss for an individual asset (i.e., a loss exceeding the carrying amount of the asset in question) might arise if the asset is expected to generate negative net future cash flows – for example an asset that is nearing the end of its economic life and requires significant decommissioning or holding costs.

In such cases, the value in use (VIU) estimate would be negative. In addition, the entity might need to pay potential buyers to acquire the asset in which case fair value less cost of disposal (FVLCD) would also be negative. In these cases, the entity would not reduce the carrying value of the asset to less than zero. The entity would look to PAS 37, *Provisions, Contingent Assets and Contingent Liabilities*, to determine whether a provision for decommissioning costs must be recognized.

Finally, when an entity recognizes an impairment loss for an individual asset, it must:

- adjust the future depreciation (amortization) charge for the asset to allocate the asset's revised carrying amount, less its residual value (if any) on a systematic basis over its remaining useful life (see example 1 below), and,
- determine any related deferred tax assets or liabilities in accordance with PAS 12, *Income Taxes*, by comparing the revised carrying amount of the asset with its tax base (see example 2 below).

Example 1 – Adjusting future depreciation of an asset after recognizing an impairment

A machine was purchased on 1 January 20X1 by Entity A for CU300,000 with an estimated useful life of 3 years and no residual value; therefore, CU100,000 of depreciation expense was recognized on a straight-line basis for both 20X1 and 20X2 (or CU8,333 per month). At 31 December 20X2, management determines an impairment indicator exists and estimates the recoverable amount of the machine to be CU80,000 (carrying amount at 31 December 20X2 is CU100,000).

Analysis

Entity A recognizes an impairment loss for the difference (CU100,000-CU80,000 or CU20,000). In accordance with PAS 36, the entity also adjusts future depreciation of the machine after recording the impairment at 31 December 20X2 and will therefore recognize CU6,667 per month of depreciation from 1 January 20X3 – 31 December 20X3.

Example 2 – Determining any related deferred tax assets/liabilities after recognizing an impairment

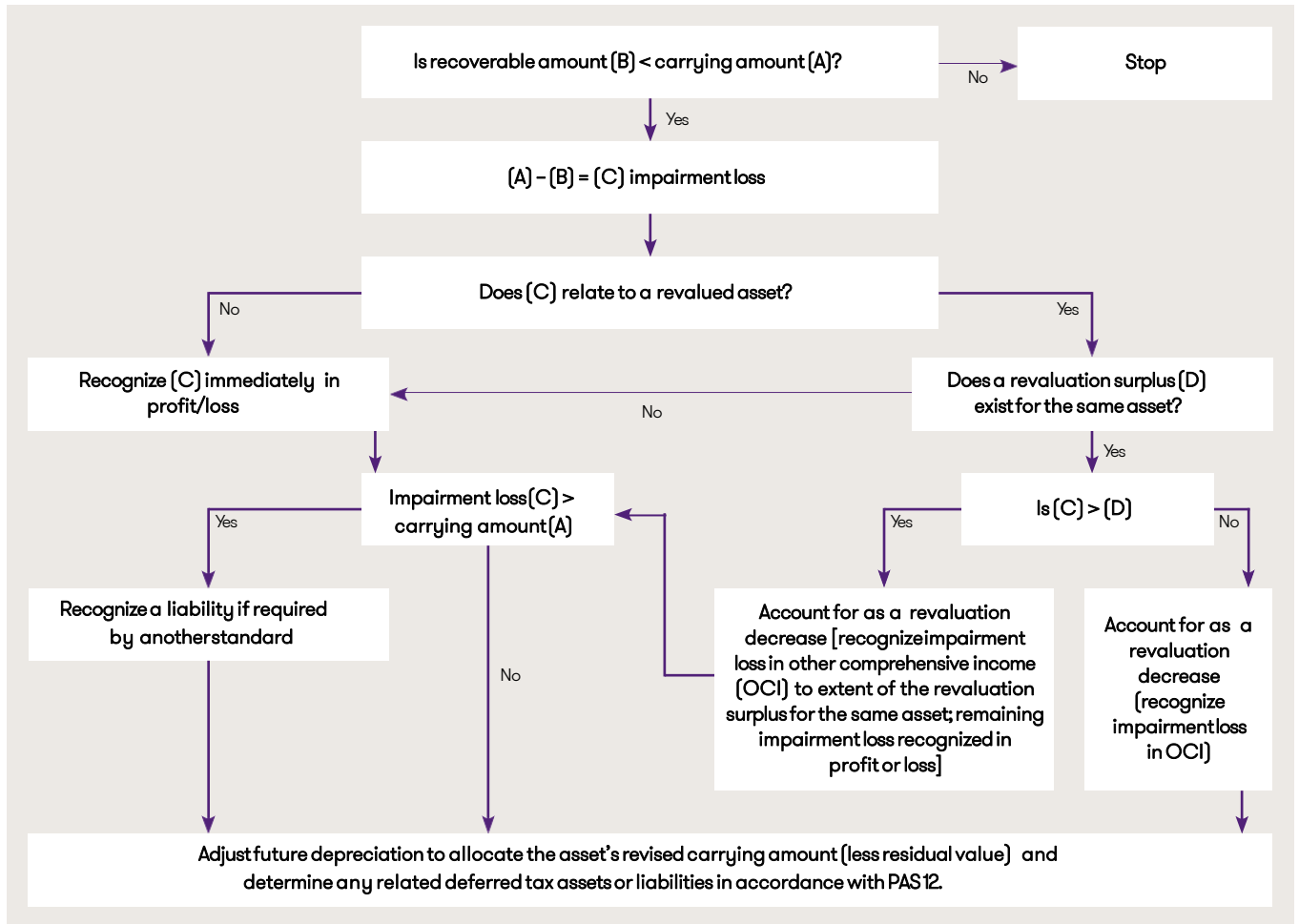
An entity owns a machine with a carrying amount of CU2,000. After finding evidence of an impairment indicator, management estimates the recoverable amount of the machine to be CU1,600. The entity records an impairment loss of CU400 (CU2,000 – CU1,600) for the machine. The tax rate is 35% and the tax base of the machine is CU1,800. Impairment losses are not deductible for tax purposes.

Analysis

The recognition of the impairment loss creates a deferred tax asset of CU70 as shown below, subject to meeting the criteria in PAS12 'Income Taxes' for recognition of deferred tax assets.

	Before Impairment	Effect of Impairment	After Impairment
Carrying amount	2,000	(400)	1,600
Tax base	1,800	-	1,800
Taxable (deductible) temporary difference	200	(400)	(200)
Deferred tax liability (asset) at 35%	70	(140)	(70)

The below diagram summarizes PAS 36's requirements for recording an impairment for an individual asset.



Recognizing an impairment loss for CGUs

An impairment loss must be recognized for a CGU when the recoverable amount of the unit is less than its carrying amount. PAS 36 prescribes the impairment loss to be allocated:

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

However, in allocating the impairment loss, an entity cannot reduce the carrying amount of an individual asset below the highest of:

- its FVLCOB (if measurable),
- its VIU (if determinable), and,
- zero.

These amounts serve as a 'floor' as outlined in the below diagram.

If, for an individual asset within an impaired CGU, it is possible to measure FVLCOB but not VIU (and therefore not possible to determine the individual asset's recoverable amount), then the floor is the higher of FVLCOB and zero. Under this scenario, no impairment loss is recognized for the individual asset if the asset's CGU is not impaired, even if the asset's FVLCOB is less than its carrying amount.

Should the 'floor' be applicable for an asset, any amount that would have been allocated to the individual asset must be allocated pro rata to the other assets of the unit. The reductions in carrying amounts from applying the above requirements are treated as impairment losses on the individual assets and recognized as outlined above on page 2.

The following diagram demonstrates allocating an impairment loss to assets within a CGU:

1st	Reduce goodwill
2nd	Reduce other assets (as outlined on page 2) on a pro-rata basis using asset carrying amounts at the time the impairment testing is done, subject to the floor
Floor	No asset reduced below highest of its FVLCOB, VIU or zero

The below example illustrates the interaction of these requirements in allocating the impairment loss to individual assets comprising a CGU.

Example 3 – Allocating an impairment loss to assets within a CGU

Entity X carries out an impairment test of CGU 1 on 31 December 20X0. CGU 1 has a total carrying amount of CU800 and consists of two identifiable intangible assets (Asset A, CU400, and Asset B, CU300) in addition to allocated goodwill of CU100. Asset A was also tested for impairment at 31 December 20X0 and found not to be impaired because its FVLCOB (CU450) exceeds its carrying amount (CU400). Management has concluded Asset B's VIU cannot be determined individually and its FVLCOB cannot be measured reliably. The results of the impairment test of CGU 1 show a recoverable amount of CU500; as such, an impairment loss of CU300 must be recognized.

CGU 1	Carrying amount	Recoverable amount (individual asset level)	Impairment loss allocation
Goodwill	100	N/A	100
Asset A	400	450	-
Asset B	300	N/A	200
Total	800		
Recoverable amount of CGU1	500		
Impairment loss	300		300

Analysis

Entity X first allocates the impairment loss to goodwill. Next, Entity X allocates the remaining impairment loss (in this case, CU200) to the individual assets comprising the CGU, subject to the floor. No impairment loss can be allocated to Asset A (due to the floor) as the asset cannot be reduced to less than its recoverable amount. Therefore, the remaining impairment loss of CU200 is allocated to Asset B.

Example 4 – Understanding if the recoverable amount can be determined for individual assets and the effect on recognizing an impairment

A machine has suffered physical damage but is still working, although not as well as before it was damaged. The machine's FVLCOB is less than its carrying amount. The machine does not generate independent cash inflows.

The smallest identifiable group of assets that includes the machine and generates cash inflows are largely independent of the cash inflows from other assets, is the production line to which the machine belongs. The recoverable amount of the production line shows the production line (taken as a whole) is not impaired.

Scenario 1: budgets/forecasts approved by management reflect no commitment of management to replace the machine.

Scenario 2: budgets/forecasts approved by management reflect a commitment to replace the machine and sell it in the near future. Cash flows from continuing to use the machine until its disposal are estimated to be negligible.

Analysis – Scenario 1

The recoverable amount of the machine alone cannot be estimated because the machine's VIU:

- may differ from its FVLCOB, and,
- can be determined only for the CGU to which the machine belongs (the production line).

The production line is not impaired. Therefore, no impairment loss is recognized for the machine. Nevertheless, the entity may need to reassess the depreciation period or the depreciation method for the machine.

Analysis – Scenario 2

The machine's VIU can be estimated to be close to its FVLCOB. Therefore, the recoverable amount of the machine can be determined. Because the machine's FVLCOB is less than its carrying amount, an impairment loss is recognized for the machine.

Remaining (unallocated) amount of an impairment loss for a CGU

When the requirements above have been applied and result in a remaining unallocated amount of impairment loss for a CGU, such an amount is only recognized as a liability if required by another PFRS.

Practical insight – Any remaining (unallocated) amount of an impairment loss for a CGU

This situation might arise for example, in relation to a loss-making CGU that is in need of restructuring. As noted in our article '[Insights into PAS 36 – Value in use: estimating future cash inflows and outflows](#)', the effects of a future restructuring would be excluded from the VIU estimate before the entity has an obligation for the restructuring in accordance with PAS 37. Also, the need for future restructuring may result in FVL COD being negative. In this situation the entity would limit any impairment loss to the carrying value of the CGU's assets and separately evaluate whether the criteria in PAS 37 to recognize a restructuring provision have been met.

Considerations for foreign operations

Any impairment loss is not a partial disposal for the purposes of PAS 21, *The Effects of Changes in Foreign Exchange Rates*. The foreign exchange gain or loss recognized in other comprehensive income on translating the foreign operation's financial statements is not therefore reclassified to profit or loss when recognizing an impairment.

How we can help

We hope you find the information in this article helpful in giving you some insight into PAS36. If you would like to discuss any of the points raised, please speak to your usual P&A Grant Thornton contact or visit www.grantthornton.com.ph/Contact.

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