



# Insights into PAS 36

## Reversing impairment losses

PAS 36, *Impairment of Assets*, sets out the requirements to follow prior to concluding if and when an asset should be impaired. However, due to the complex nature of the Standard, the requirements of PAS 36 can be challenging to apply in practice.

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](#)' relates to recognising or reversing and impairment losses. This article focuses on part of this step; reversing impairment losses.

For recognizing impairment losses refer to our article '[Insights into PAS 36 – Recognizing impairment losses](#)'.



## Indicators for reversing an impairment loss

In addition to assessing evidence of possible impairment, entities must also assess whether there is any indication a previously recognized impairment loss for an asset (other than goodwill) no longer exists or the assessed impairment amount may have decreased. If an indication of possible reversal is identified, the entity must estimate the recoverable amount of that asset.

### Guidance note: Goodwill impairment cannot be reversed

PAS 36 prohibits any reversal of impairment losses recognized on goodwill. The reason for this is because PAS 36 views any increase in the recoverable amount of goodwill after the recognition of an impairment loss to likely be an increase in the internally generated goodwill (not a reversal of the impairment loss recognised for the acquired goodwill). PAS 38, *Intangible Assets*, prohibits the recognition of internally generated goodwill.

Accordingly, the references to impairment reversals in this article do not include goodwill.

Similar to the list provided in PAS 36 indicating when there might be an impairment loss, the Standard also provides a non-exhaustive list of circumstances when a previously recognized impairment loss may no longer exist. These are summarised below.

### Non-exhaustive list of impairment reversal indicators from PAS 36

#### External sources of information

- Observable indications that the asset's value has increased significantly during the period
- Significant favorable changes (have occurred or are expected) in the technological, market, economic or legal environment
- Market interest rates or other market rates of return on investments have decreased during the period [which will decrease the discount rate used in calculating the asset's value in use (VIU)]

#### Internal sources of information

- Significant favorable changes (have occurred or are expected) in the extent to which an asset is used (or is expected to be used) [e.g., costs incurred during the period to improve or enhance the asset's performance or restructure the operation to which the asset belongs]
- Evidence is available from internal reporting that indicates the economic performance of an asset is, or will be, better than expected.

The reversal of an impairment loss reflects an increase in the estimated service potential of an asset (either from use or from sale) since the date when an entity last recognised the impairment loss for the asset. A reversal of an impairment loss should therefore only be recognized if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. Said differently, an impairment loss is not reversed solely because of the passage of time or the unwinding of the discount, even if the recoverable amount of the asset becomes higher than its carrying amount.

### Guidance note: Disclosure required for an increase in the estimated service potential

The Standard requires the entity to identify and disclose the change in estimates that cause the increase in the estimated service potential. Examples include:

- a change in the basis for measuring recoverable amount [i.e., whether recoverable amount is based on fair value less costs of disposal (FVLCO) or VIU],
- where the recoverable amount was based on VIU, a change in the amount or timing of estimated future cash flows or in the discount rate, or,
- where the recoverable amount was based on FVLCO, and there has been a change in the previously estimated components of the FVLCO amount reflected in the financial statements.

Regardless of whether an impairment loss is reversed for an asset, if the entity identifies an indication that a previously recognized impairment loss may no longer exist, the entity may need to review and adjust the:

- the remaining useful life,
- the depreciation (amortization method), and/or,
- the residual value of the asset.

**Practical insight – Indicators for reversing a previously recognized impairment loss**

Most of the ‘reversal indicators’ listed are the inverse of the loss indicators listed in PAS 36 (discussed in ‘**Insights into PAS 36 – If and when to test for impairment**’); there are however some exceptions to this. In particular, an increase in market capitalization above carrying value of an entity’s net assets is not listed as a reversal indicator.

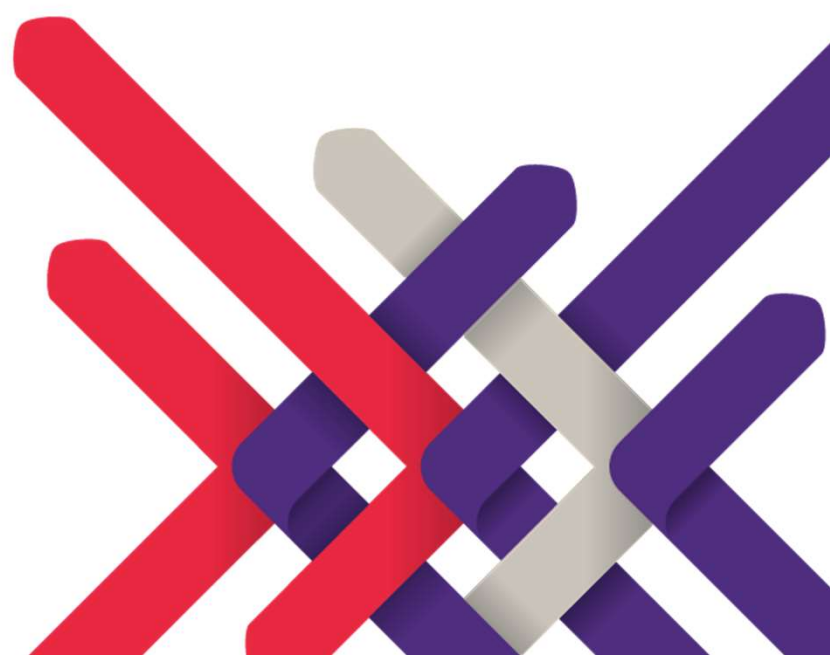
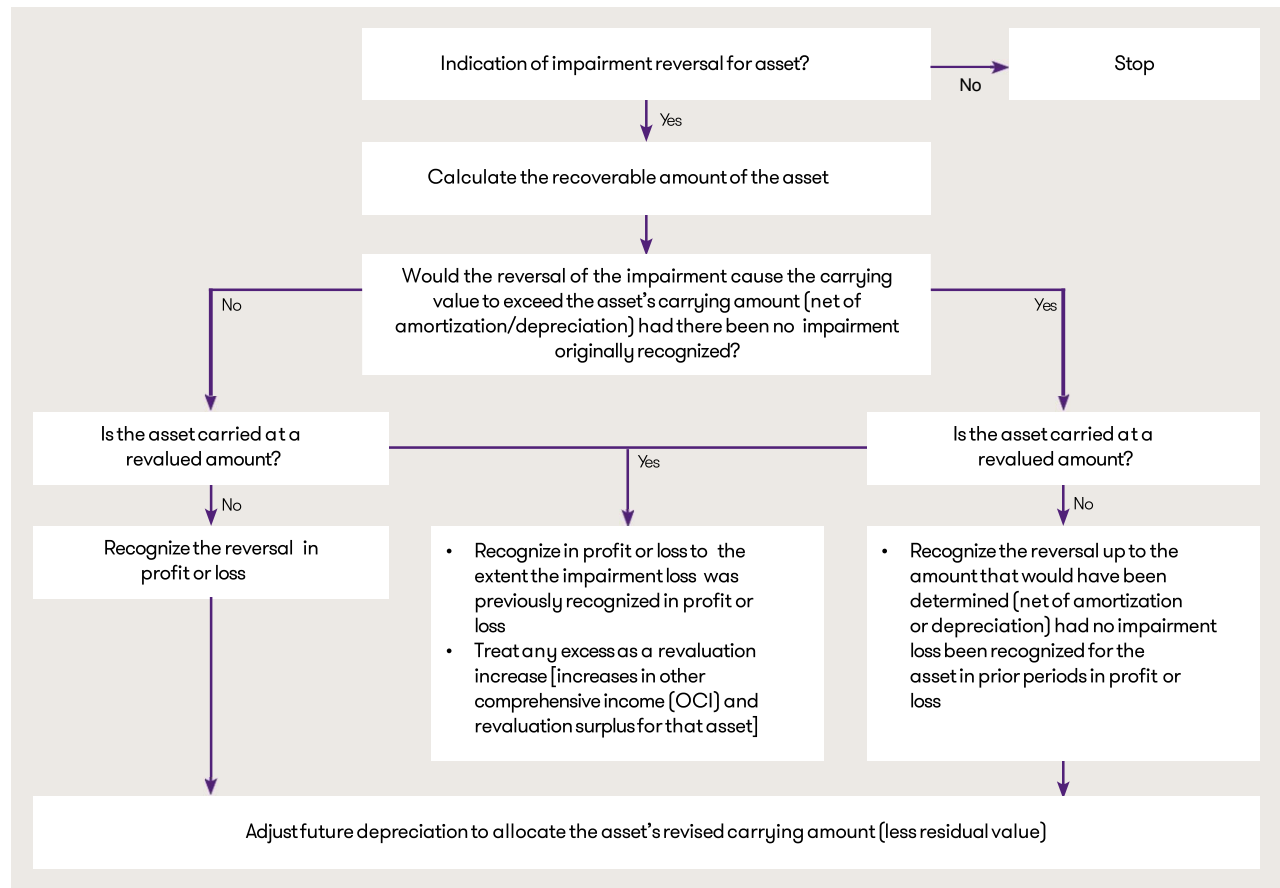
## Reversing impairment losses for individual assets (other than goodwill)

When recoverable amount is recalculated and exceeds the asset’s carrying value, the carrying amount is increased to the recoverable amount subject to a ‘ceiling’ (i.e., an upper limit). The increased carrying amount cannot exceed the carrying amount that would have been determined (net of amortization or depreciation) had no impairment loss been recognized for the asset in prior years.

For assets accounted for using the revaluation model in PAS 16, *Property, Plant and Equipment*, or PAS 38, the reversal of the impairment loss is accounted for in the same way as a revaluation increase in accordance with those standards.



The diagram below depicts the requirements for reversals of impairment losses for individual assets and the following example illustrates their practical application.



#### Example 1 – Reversing a previously recognized impairment loss for an individual asset

At 1 January 20X1, Entity T purchased an item of PP&E (a machine) for CU1,800. Entity T will depreciate the machine on a straight-line basis over its useful life of 15 years. In 20X1, Entity T recognized an impairment loss of CU500 on this machine, having identified indicators showing a reduction in expected demand for the machine output due to the introduction of a superior product released by a competitor. Entity T applies the cost model in accordance with PAS 16 and the impairment loss was recognized in profit or loss. The amounts before and after the recognition of the impairment loss were as follows with respect to the machine:

31 December 20X1	Machine
Historical cost	1,800
Accumulated depreciation	(120)
<b>Carrying amount</b>	<b>1,680</b>
Impairment loss	(500)
<b>Carrying amount after impairment loss</b>	<b>1,180</b>

In 20X3, Entity T determines the competitor product is experiencing technical issues and that its effect on demand for Entity T's output is less than expected. Sales have exceeded forecast and management estimates production will increase by 25%. At 31 December 20X3, Entity T estimates the recoverable amount of the machine in accordance with PAS 36. The recoverable amount of the machine is estimated to be CU1,300.

31 December 20X3	Machine
31 December 20X1 carrying amount after impairment loss	1,180
Accumulated depreciation (20X2 and 20X3)*	(168)
<b>Carrying amount</b>	<b>1,012</b>
Recoverable amount	1,300
<b>Excess of recoverable amount over carrying amount</b>	<b>288</b>

\* Entity T revised the depreciation charge (from CU120 per year to CU84 per year) for the machine based on the revised carrying amount and remaining useful life at 31 December 20X1 (CU1,180/14 years or CU84 depreciation expense per year). Depreciated historical cost of the machine at 31 December 20X3 is as follows:

31 December 20X3	Machine
Historical cost	1,800
Accumulated depreciation (CU120 x 3)	(360)
Depreciated historical cost	1,440
Carrying amount	1,012
<b>Carrying amount after impairment loss</b>	<b>428</b>

#### Analysis

Entity T recognizes a reversal of the impairment loss recognized in 20X1 in accordance with PAS 36. Entity T increases the carrying amount of the machine by CU288 [to lower of recoverable amount (CU1,300) and the depreciated historical cost (CU1,440)]. The increase is recognized immediately in profit or loss and Entity T will again adjust future depreciation to allocate the asset's revised carrying amount.

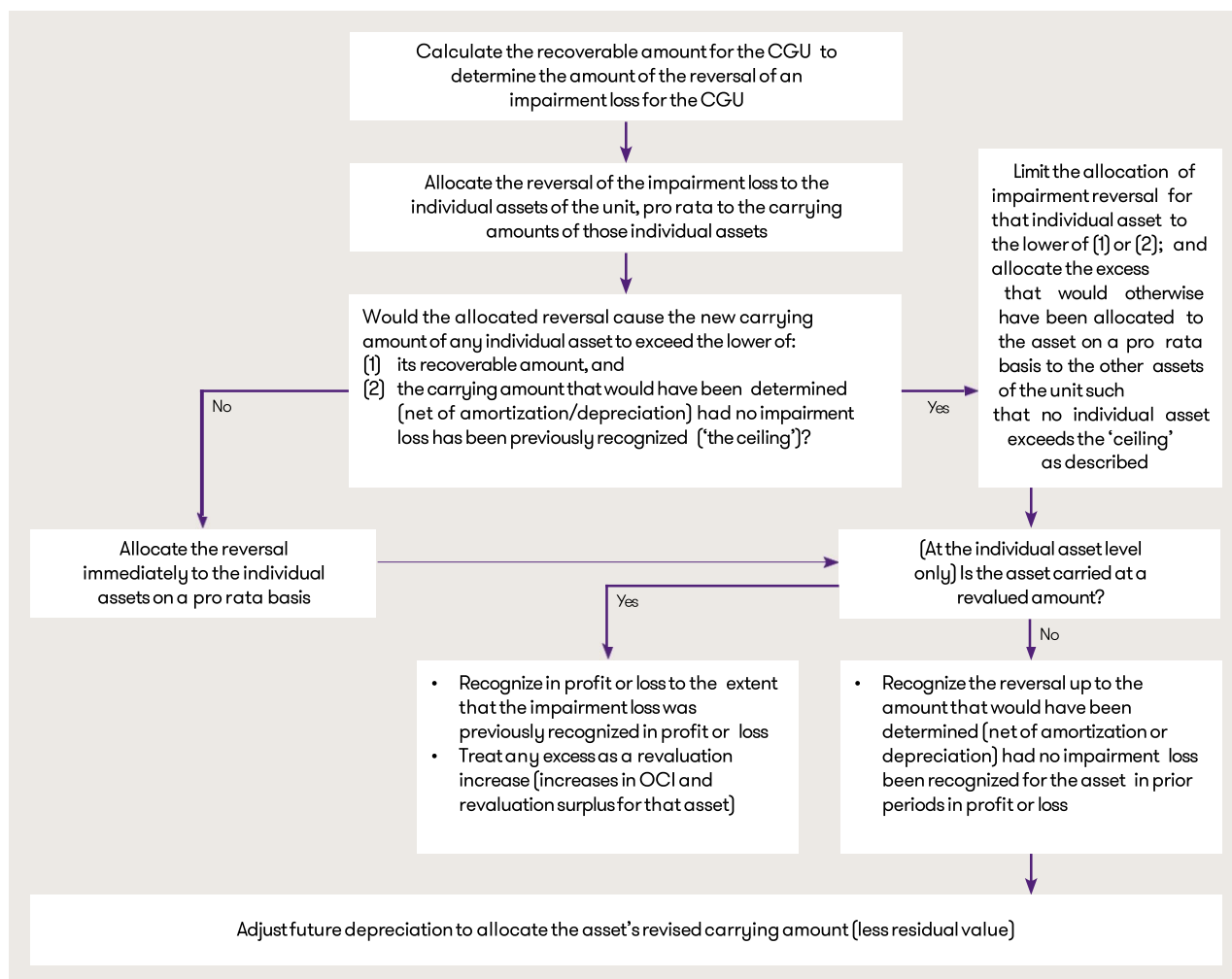
## Reversing impairment losses for cash-generating units

Any reversal of an impairment loss for a cash-generating unit (CGU) must be allocated to the individual assets that make up the CGU (excluding goodwill). The entity is required to allocate the reversal of an impairment loss to the CGU's assets pro rata to their carrying amounts. This is again however subject to a 'ceiling' whereby no individual asset's carrying amount is increased above the lower of:

- its recoverable amount (if determinable), and,
- its carrying amount that would have been determined (net of amortization or depreciation) had no impairment loss been recognized for the asset in prior periods.

If this 'ceiling' takes effect for one or more of the CGU's assets, the reversal of the impairment loss that would otherwise have been allocated to those assets is allocated on a pro rata basis to the other assets, subject to the same ceiling.

The below flowchart depicts the allocation process.



The following example illustrates the practical application of these requirements.

#### Example 2 – Reversing a previously recognized impairment loss for a CGU with allocated goodwill

Entity T is in the healthcare industry and has identified three CGUs for impairment review purposes (CGU 1, CGU 2, and CGU 3), each located in a different country. In 20X1, Entity T recognized an impairment loss of CU1,250 with respect to CGU 1, following the election of a new government in the country in which CGU 1 operates and anticipated changes in healthcare laws that would reduce demand for Entity T's products. The amounts before and after the recognition of the impairment loss were as follows with respect to CGU 1:

31 December 20X1	Goodwill	CGU 1 identifiable assets	Total
Historical cost	750	1,800	2,550
Accumulated depreciation (20X1)	-	(120)	(120)
<b>Carrying amount</b>	<b>750</b>	<b>1,680</b>	<b>2,430</b>
Impairment loss	(750)	(500)	(1,250)
<b>Carrying amount after im-pairment loss</b>	<b>-</b>	<b>1,180</b>	<b>1,180</b>

In 20X3, Entity T determines the impact of the new healthcare laws is less than expected. Sales have exceeded forecast and management estimates production will increase by 25%. At 31 December 20X3, Entity T estimates the recoverable amount of CGU 1 in accordance with PAS 36. The recoverable amount of CGU 1 is estimated to be CU1,500. It is not possible to determine recoverable amount for any of the individual assets in the CGU.

31 December 20X3	Goodwill	CGU 1 identifiable assets	Total
31 December 20X1	-	1,180	1,180
Accumulated depreciation (20X2 and 20X3)	-	(168)	(168)
<b>Carrying amount</b>	<b>-</b>	<b>1,012</b>	<b>1,012</b>
Recoverable amount			1,500
<b>Excess of recoverable amount over carrying amount</b>			<b>488</b>

\* Entity T revised the depreciation charge (from CU120 per year to CU84 per year) for the identifiable assets of CGU 1 based on the revised carrying amount and remaining useful life at 31 December 20X1. Depreciated historical cost of CGU 1 at 31 December 20X3 is as follows:

31 December 20X3	CGU 1 identifiable assets
Historical cost	1,800
Accumulated depreciation (CU120 x 3)	(360)
Depreciated historical cost	1,440
Carrying amount	1,012
Difference	428

#### Analysis

At 31 December 20X3, Entity T recognizes a reversal of the impairment loss (recognized at 31 December 20X1) in accordance with PAS 36. Entity T will increase the carrying amount of CGU 1's identifiable assets by CU428 [to the lower of recoverable amount (CU1,500) and the depreciated historical cost of the non-goodwill assets (CU1,440) had no impairment loss been recognized in prior periods]. The increase is recognized immediately in profit or loss. The impairment loss recognized for goodwill in 20X1 is not reversed.

## How we can help

We hope you find the information in this article helpful in giving you some insight into PAS 36. 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](http://www.grantthornton.com.ph/Contact).

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