

Indicators of Impairment

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Impairment Testing will be done only when indicators of impairment exist.

Indicators of impairment will be of two types :-

Internal Indicators

- Physical damage to an asset.
- Inadequate usage pattern.
- Current expected cash flows are lower than the cash previously estimated.

External Indicators

- Restrictions / bans imposed by govt.
- Change in technology affecting useful life of asset.
- Increase in market interest rates.
- Market capitalisation becomes lower than the book value of net assets.

Even if any one of the above indicators exists we will do the impairment testing.

Points to remember while calculating Net Selling Price and Value in Use

Net Selling Price :-

- Reference can be given to latest transaction of sale of similar asset.
- Reference can be given to the market value of similar asset in the second hand market.

Value in Use

- Projected cash flows should maximum be considered for 5 future years unless a longer projection can be justified. → Eg: license fee for franchising (if in the exam cash flows for more years are projected, then simply consider that).
- If the cash flows are generated in foreign currency, then convert / translate such cash flows into rupees using the exchange rate on the date of impairment testing.
- When cash flows are expressed through probability, then they will be calculated as follows :-

Eg:- Y1 →

a.	100 L	x	0.25	=	25L
b.	150 L	x	0.60	=	90L
c.	175L	x	0.15	=	26.25L
					<u>141.25</u>

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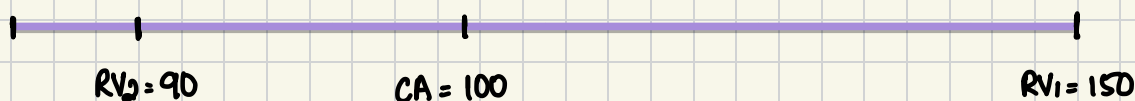
→ If cash flows are expressed in a range, then, calculate the average cash flows.

Y1 :- Highest cash flows = 150L
Lowest cash flows = 120L

$$\text{Average Cash flows} = \frac{120L + 150L}{2}$$

$$= \underline{135L}$$

Impairment of Assets previously revalued upwards



PPE a/c	Dr.	50
To, Revaluation Res.		50

P&L	Dr.	10	Revaluation Res.	50
To, PPE		10	To, PPE	50

Impairment loss of an asset which was earlier revalued upwards will be charged to P&L only to the extent the impairment loss exceeds the balance of revaluation reserve.

$$IL = 60$$

$$RR = \underline{50}$$

$$P\&L = \underline{10}$$

Reversal of Impairment Loss

→ when indicators of impairment cease to exist, impairment loss can be reversed.

→ Impairment loss can be reversed only to the extent the current carrying

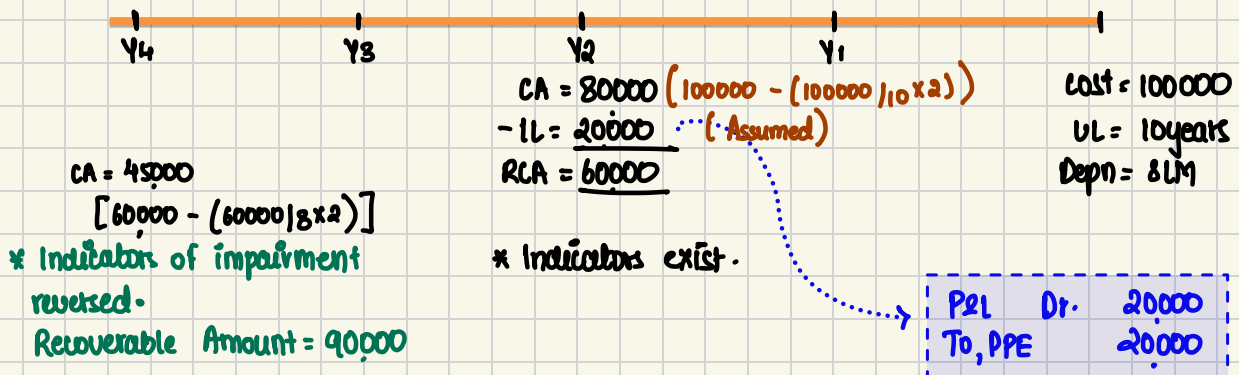
amount of the asset goes up to the normal carrying amount of the asset i.e. the carrying amount of the asset had no impairment taken place.

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Normal carrying amount without impairment



Carrying Amount with Impairment



Impairment loss can be reversed by ₹ 15000 only.

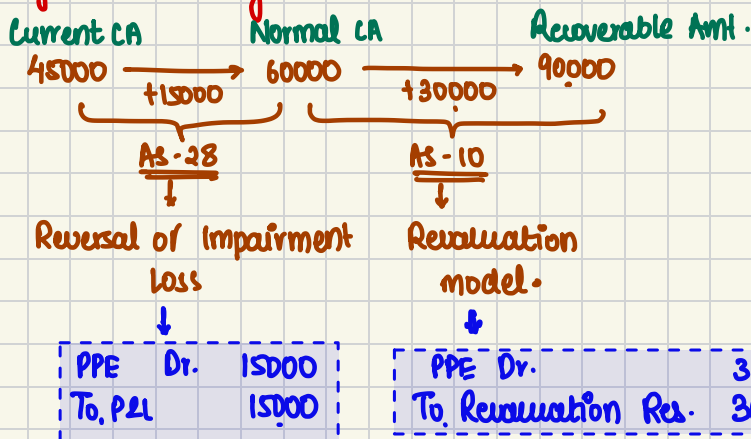


Illustration 4

X Ltd. purchased a Property, Plant and Equipment four years ago for ₹ 150 lakhs and depreciates it at 10% p.a. on straight line method. At the end of the fourth year, it has revalued the asset at ₹ 75 lakhs and has written off the loss on revaluation to the profit and loss account. However, on the date of revaluation, the market price is ₹ 67.50 lakhs and expected disposal costs are ₹ 3 lakhs. What will be the treatment in respect of impairment loss on the basis that fair value for revaluation purpose is determined by market value and the value in use is estimated at ₹ 60 lakhs?

Solution :- Impairment loss : Carrying Amount - Recoverable Amount

$$= \begin{array}{r} 75L \\ - 10.5L \end{array} \rightarrow \text{P\&L Dr.}$$

Carrying Amount :-

$$\begin{array}{rcl} \text{Cost} & = & 150L \\ - \text{Depn } (150/10 \times 4) & = & (60L) \\ \text{Carrying Amount} & = & 90L \\ - \text{revaluation loss} & = & (15L) \rightarrow \text{P\&L Dr.} \\ \text{CA after revaluation} & = & \underline{\underline{75L}} \end{array}$$

Recoverable Amount :- Higher of

1. Value in use
2. Net Selling Price

Value in use = 60L

Net Selling Price :-

$$\begin{array}{rcl} \text{Selling Price} & = & 67.5L \\ - \text{cost of selling} & = & (3L) \\ & = & \underline{\underline{64.5L}} \end{array}$$

Recoverable Amount = 64.5L

Quote :- As per AS-28: Impairment of Assets, when the carrying amount of an asset exceeds the recoverable amount impairment loss will on the asset to bring down the carrying amount to its recoverable amount. Such impairment loss will be debited to P\&L a/c.

Recoverable amount of an asset is the higher of

1. Net Selling Price.
2. Value in use.

Illustration 1

Ergo Industries Ltd. gives the following estimates of cash flows relating to Property, Plant and Equipment on 31-12-20X1. The discount rate is 15%.

Year	Cash Flow (₹ in lakhs)
20X2	4000
20X3	6000
20X4	6000
20X5	8000
20X6	4000
Residual value at the end of 20X6	= ₹ 1000 lakhs
Property, Plant and Equipment purchased on 1-1-20XX	= ₹ 40,000 lakhs

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Useful life	= 8 years
Net selling price on 31-12-20X1	= ₹ 20,000 lakhs
Calculate on 31-12-20X1:	
(a) Carrying amount at the end of 20X1	
(b) Value in use on 31-12-20X1	
(c) Recoverable amount on 31-12-20X1	
(d) Impairment loss to be recognized for the year ended 31-12-20X1	
(e) Revised carrying amount	
(f) Depreciation charge for 20X2.	

Note: The year 20XX is the immediate preceding year before the year 20X0.

↳ 2019

Carrying amount at the end of 2021 (₹ lakhs)

1. Cost	= 40000
2. less: depreciation (40,000-1000)/8 x 3	= 14625
3. Carrying amount	= <u>25375</u>

Value in use on 31.12.21 (₹ lakhs)

Year	Cashflows	Discounting factor	Discounted Cash Flows
2022	4000	0.8696	3478.4
2023	6000	0.7561	4536.6
2024	6000	0.6575	3945
2025	8000	0.5718	4574.4
2026	4000	0.4972	1988.8
2026	1000	0.4972	497.2
			<u>19020.4</u>

Value in use = 19020.4 lakhs

Recoverable Amount as on 31.12.21 : Higher of

1. Net Selling Price	= 20000 Lakhs
2. Value in use	= 19020.4 lakhs

Recoverable amount = 20000 lakhs

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Impairment loss to be recognised f.t.y.e. 31.12.21

1. Carrying amount = 25375 lakhs
2. Recoverable amount = 20000 lakhs
3. Impairment loss = 5375 lakhs

Revised Carrying Amount as on 31.12.21

1. Normal Carrying Amount = 25375 lakhs
2. less: Impairment loss = (5375) lakhs
3. Revised carrying Amount = 20000 lakhs

Depreciation f.t.y.e. 31.12.22

1. Carrying amount as on 1.1.22 = 20000 lakhs
2. Residual amount = 1000 lakhs
3. Depreciable amount = 19000 lakhs
4. Remaining useful life = 5 years
5. Depreciation for the year 31.12.22 = 3800 lakhs

Illustration 2 → Homework

X Ltd. is having a plant (asset) carrying amount of which is ₹ 100 lakhs on 31.3.20X1. Its balance useful life is 5 years and residual value at the end of 5 years is ₹ 5 lakhs. Estimated future cash flow from using the plant in next 5 years are:

For the year ended on	Estimated cash flow (₹ in lakhs)
31.3.20X2	50
31.3.20X3	30
31.3.20X4	30
31.3.20X5	20
31.3.20X6	20

Calculate "value in use" for plant if the discount rate is 10% and also calculate the recoverable amount if net selling price of plant on 31.3.20X1 is ₹ 60 lakhs.

8. Venus Ltd. has a fixed asset, which is carried in the Balance Sheet on 31.3.20X1 at ₹ 500 lakhs. As at that date the value in use is ₹ 400 lakhs and the net selling price is ₹ 375 lakhs.

Homework

From the above data:

- (i) Calculate impairment loss.
- (ii) Prepare journal entries for adjustment of impairment loss.
- (iii) Show, how impairment loss will be shown in the Balance Sheet.



10. From the following details of an asset

Discussed in class

Homework

- (i) Find out impairment loss = 15.3
- (ii) Treatment of impairment loss
- (iii) Current year depreciation

Particulars of asset:

Cost of asset	₹ 56 lakhs
Useful life period	10 years
Salvage value	Nil
<u>Current carrying value</u>	₹ 27.30 lakhs
Useful life remaining	3 years
<u>Recoverable amount</u>	₹ 12 lakhs
Upward revaluation done in last year	₹ 14 lakhs