Disclosures for impairment of non-financial assets

This article aims to:

– Summarise the disclosure requirements in relation to impairment of non-financial assets.

Background

With the onset of Indian Accounting Standards (Ind AS), a number of entities have utilised the transition option to revalue items of Property, Plant and equipment (PPE). While the option of revaluation was available in the erstwhile accounting standards as well, not many companies opted to revalue. This leads to an important question in one’s mind – Are the items of PPE reflected at values that it would be expected to fetch in the market? Apart from revaluation, the other categories of non-financial assets are generally carried at historic cost less accumulated depreciation/amortisation. Hence, it is important to ensure that the depreciated cost of the non-financial assets at least reflects the recoverable values, so that the non-financial assets are not materially overstated. ‘Impairment’ serves as this check to ensure that the non-financial assets to which the standard applies are carried at no more than the recoverable amounts.

The objective of this article is not to emphasise on the concept/methodology followed for impairment but to provide an insight into the key indicators/disclosure aspects for various categories of non-financial assets to which the standard applies. These disclosures are required not only when a non-financial asset is impaired, but also when the management asserts that there is no impairment. For instance, how has the management ensured that the non-financial assets are not impaired? This article focuses on the disclosure requirements for PPE, intangibles and investment in subsidiaries, associates and joint ventures.

Requirements for PPE

Ind AS 36, Impairment of Assets is applied to the individual assets. However, a single asset is not generally tested for impairment on a stand-alone basis when it generates cash inflows only in combination with other assets as part of a larger Cash Generating Unit (CGU). Cash flows are to be interpreted as cash inflows and not net cash flows. The PPE would comprise core operating assets of the entity – for instance plant and machinery in case of a manufacturing entity. Corporate assets are generally tested for impairment at a CGU level, unless the asset is to be disposed.

Impairment testing of PPE is performed only when there is an indicator of impairment. Some of the key indicators relevant for PPE are enumerated below:

- The value of an asset has declined significantly during the period. For instance, if a core operating asset used by a manufacturing entity to produce specific goods has become outdated as a result of introduction of a newer, more efficient version of the core operating asset, then this could be a potential indicator that the core operating asset may not fetch its current book value.
• Significant changes in the technological, economic or legal environment in which the entity operates that could have an adverse effect on the entity or on the market to which the asset is dedicated. For instance, a company manufactures chemicals for industrial purposes at its factory. The chemical waste created during the process is likely to affect the water and the soil underneath. The relevant authorities have passed a legal requirement that the plant manufacturing the chemicals shall strictly comply with compliance tests or else be decommissioned. This is a potential indicator that the chemical plant needs to be tested for impairment.

• Market interest rates or other market rates of return on investments have increased during the period, and those increases could affect the discount rate used in the computations. This would typically affect the value in use computation which is based on the present value of cash flows discounted using a market rate of return. As the discount rate increases, the value in use is expected to decrease and is a potential impairment indicator.

Other possible indicators of impairment could be an evidence of obsolescence or physical damage to the asset or a plan to dispose the asset earlier than expected.

The above list is only indicative and entities would be required to consider other factors /indicators relevant to the industry in which the entity operates, laws governing the jurisdiction and other entity specific indicators. If an entity has any of the aforementioned indicators and the management performs an impairment test and identifies impairment of certain PPE, then following disclosures become significant and should be disclosed in the financial statements:

• Amount of impairment losses recognised in the statement of profit and loss during the period including the line item in which the impairment losses are included. In practice, as entities in India are allowed to only present expenses nature-wise, entities generally disclose impairment loss as a separate line item.

• Amount of reversals of impairment losses recognised in the statement of profit and loss during the period including the line item in which those impairment losses are reversed.

• Amount of impairment losses on revalued assets recognised in other comprehensive income during the period.

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Further, disclosure of the above information is required to be presented along with the information provided for the class of assets to which the asset relates. Generally, any impairment related information pertaining to PPE is provided along with the PPE reconciliation in the notes to the financial statements.

Example 1: Impairment indicator – Change in the use of the asset

Entity ABC uses equipment E to manufacture a specialised product S. Over the period, there has been a substantial reduction in the demand for product S. Therefore, the management of ABC has decided to use equipment in manufacture of another product X, which is expected to be profitable. However, the management has not assessed equipment E for impairment.

Entity ABC should assess equipment E for impairment due to decline in market demand for product S, as change in the use of an asset is an indicator of impairment regardless of what the equipment is redirected to perform. The impairment assessment would include factors such as change in customer’s preferences and change in use of equipment to assess the recoverable amount. If there is an impairment loss, then this should be disclosed along with the line item within which it is included. Further, as the equipment would form part of the PPE note in the financial statements, the impairment should be disclosed in the PPE reconciliation.

Requirements for intangible assets

Impairment testing for intangibles depends on the nature of the intangible asset:

• For intangible assets with indefinite useful lives and for intangibles not yet available of use (for instance ERP implementation is in-progress), annual impairment testing is required regardless of whether impairment indicators exist. Further, the impairment test is to be performed at the same time each year.

• For other intangible assets (patents, trademarks, software, etc.), impairment testing would be performed only if there is an indicator of impairment. The indicators of impairment are similar to the ones discussed in the PPE section.
The disclosures required for intangibles can be broadly split into two categories viz. disclosures pertaining to impairment of intangibles that are mandatorily to be tested for impairment on an annual basis, and for other assets where impairment is tested only when there is an indication of impairment. Disclosures pertaining to impairment loss/reversal for intangible assets are the same as discussed in the PPE section and this should be provided for each class of intangible.

Impairment disclosures for intangibles with indefinite life and those not yet available for use require more extensive details to be captured as part of the notes in the financial statements. The standard provides a detailed illustrative example highlighting some of the disclosures that are required/expected by the standard setters. Some of the important disclosures are as following:

- Estimates used to measure the recoverable amount of a CGU when an intangible asset with an indefinite useful life is included in the carrying amount of that unit.
- For each CGU (group of units) for which the carrying amount of intangible assets with indefinite useful lives allocated to that unit (group of units) is significant in comparison with the entity’s total carrying amount of intangible assets with indefinite useful lives:
  - The carrying amount of intangible assets with indefinite useful lives allocated to the unit (group of units)
  - The basis on which CGUs (group of CGUs) recoverable amount has been determined (i.e. value in use or fair value less costs of disposal)
- When the CGU’s (group of CGUs) recoverable amount is based on value in use, key assumptions of cash flow projections, description of management’s approach to determine the value assigned to each key assumption, the period of projected cash flows, growth rates and discount rates used.
- When the CGU’s (group of CGUs) recoverable amount is based on fair value less costs of disposal and valuation techniques are used to measure fair value less costs of disposal, key assumptions for determination of fair values less costs of disposal, description of management’s approach to determine the value assigned to each key assumption, the level of fair value hierarchy as per Ind AS 113, Fair Value Measurement and any change in valuation technique, if any.

Requirements for associates and joint arrangement in the consolidated financial statements

With regard to associates and joint ventures, objective evidence of impairment includes:

- Significant financial difficulty of an associate or joint venture
- A breach of contract such as default or delinquency in payments
- If it is probable that the associate or joint venture will enter bankruptcy or other financial restructuring
- The disappearance of an active market for net investment because of financial difficulties
- Significant or prolonged decline in the fair value of an investment in an equity instrument below its cost.

The above list is only indicative and entities would be required to consider other factors/indicators relevant to the industry in which the entity operates.

For associates and joint venture, an impairment assessment is usually performed in two successive steps:

- Step 1: Apply the equity method to recognise the investor’s share of any impairment losses for the investee’s identifiable assets;
- Step 2: When there is an indication (as mentioned above), test the investment as a whole and recognise any additional impairment loss.

Example 2: Impairment of joint ventures

Company N has two joint ventures BN and NS and holds 50 per cent in each of the joint ventures. NS has been making losses since inception. However, BN has been making profits year on year. Further, company N has been in talks with the other joint venturer (LB) of BN to purchase the other 50 per cent in BN. LB has offered to sell the 50 per cent stake at the original cost less 30 per cent to company N. The management of company N has not performed impairment assessment for either of the joint ventures. Both joint ventures have been accounted for using the equity method.

Impairment assessment is required whenever there is an indication of impairment. With regard to joint venture NS, the fact that the joint venture is loss making is a potential indicator of impairment. While the joint venture has been accounted using equity method i.e. share of losses would have been absorbed, this does not necessarily imply that the investment is fully recoverable. Therefore, an impairment assessment should be performed to ensure that the carrying amount is fully recoverable after applying the equity method.
Joint venture BN has been profitable and in the absence of any other indicators, no impairment testing was required over the years. However, with the step acquisition of the additional stake at a bargain purchase price, company N should assess whether its existing investment is fully recoverable by considering relevant factors.

Some of the key disclosures required if the joint ventures are impaired are mentioned below:

- The amount of impairment loss and the line item in which the loss is presented
- A brief on the indicators/factors that led to the impairment assessment
- Whether the recoverable amount was determined on the basis of fair value less costs to sell or value in use
- Whichever methodology is used, the key assumptions, discount rate, fair value levels, other relevant inputs should be disclosed.

**Requirements for investment in subsidiary, associate and joint venture in the separate financial statements**

Investment in subsidiary, associate and joint venture that an entity elects to account for in accordance with Ind AS 109, *Financial Instruments* are outside the scope of Ind AS 36. If an entity elects to account for investment in subsidiaries, associates and joint ventures at cost in its separate financial statements, then Ind AS 36 would apply.

Impairment testing is performed only when there is an indicator of impairment. In addition to the indicators of impairment mentioned earlier in the article, the receipt of dividend income from a subsidiary, associate or joint venture is considered as a possible indication of impairment in separate financial statements when:

- The carrying amount of the investment in the separate financial statement of the entity exceeds the carrying amounts of the investee’s net assets including associated goodwill in the consolidated financial statements;
- The dividend exceeds the total comprehensive of the subsidiary, associate or joint venture in the period in which the dividend is declared.

With respect to subsidiaries, once an impairment indicator has been identified, the impairment testing follows same guidance as mentioned in the step 2 for associates/joint ventures. However, a different approach may be appropriate if the assets of the subsidiary form part of a larger CGU for the group’s perspective. In such situations, it may be necessary to conclude, from the perspective of the separate financial statements, that the investment in the subsidiary generates cash inflows independently only in combination with other assets within the group. Otherwise, an artificial impairment loss may be recognised.

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**Consider this**

- Impairment assessment is required to ensure that the carrying amount of the assets do not exceed the recoverable amount.
- Impairment assessment is typically performed at a CGU level. A CGU is the smallest group of assets capable of independently generating cash inflows.
- Impairment testing is required for the following categories of non-financial assets:
  - For PPE and intangibles with definite useful lives only if there is an indication of impairment
  - For intangibles with indefinite useful lives, impairment is required on an annual basis regardless of indication of impairment
  - For investment in subsidiary, associate and joint venture, only if there is an indication of impairment. The impairment indicators are the same as indicators for financial assets under Ind AS 109, however the impairment testing would be governed by Ind AS 36.
- Ind AS 36 requires a number of detailed disclosures when impairment loss has been recognised or reversed during the period.