

IMPAIRMENT OF ASSETS (IAS 36)

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1. Purpose & Objective

IAS 36 prevents assets from being carried at more than their **recoverable amount**.

Recoverable amount = **higher of:**

- **Value in use (VIU)**
- **Fair value less costs of disposal (FVLCD)**

If carrying amount > recoverable amount → **impairment loss**.

2. Scope

✓ Applies to:

- Property, Plant and Equipment (IAS 16)
- Intangible Assets – finite & indefinite life (IAS 38)
- Goodwill
- Right Of Use assets – Leases (IFRS 16)
- Investment property at cost
- Associates & Joint Ventures (IAS 28)
- Biological assets at cost

✗ Excludes:

- Inventories (IAS 2)
- Deferred tax assets (IAS 12)
- Employee benefit assets (IAS 19)
- Financial instruments (IFRS 9)
- Investment property at fair value (IAS 40)
- Biological assets at fair value (IAS 41)
- Insurance assets (IFRS 17)

3. Key Definitions

Impairment loss: When carrying amount exceeds recoverable amount.

Recoverable amount: Higher of VIU and FVLCD.

CGU: Smallest group of assets generating **independent cash inflows**.

Corporate assets: Support multiple CGUs (HQ, central IT, etc.).

4. Indicators of Impairment

IAS 36 requires **annual indicator assessment**.

External:

- Market value decline
- Adverse economic/market changes
- Increases in discount rates
- Technological obsolescence

Internal:

- Physical damage
- Poor performance
- Plans to discontinue
- Evidence of obsolescence

5. Recoverable Amount

Recoverable amount = **higher of VIU and FVLCD**

This is the heart of IAS 36. Please refer to our chapters on PPE, Intangible Assets and Leases.

6. Value in Use (VIU) — Formula

VIU = Present value of future cash flows from the asset/CGU.

VIU formula:

$$VIU = \sum \frac{\text{Future Cash Flows}}{(1 + \text{Discount Rate})^t}$$

Cash flows must exclude:

- Tax cash flows
- Financing cash flows
- Restructuring not yet committed
- Future capex that improves performance

Cash flows must include:

- Operating inflows/outflows
- Maintenance capex
- Working capital changes

Discount rate:

- Pre-tax
- Reflects time value + asset-specific risks
- Often WACC adjusted

7. Fair Value Less Costs of Disposal (FVLCD) — Formula

FVLCD = Market price – disposal costs

Disposal costs include:

- Legal fees
- Removal costs
- Broker commissions
- Stamp duties

If no active market exists → use valuation techniques.

8. Impairment Testing Process

Step 1: Identify indicators

Step 2: Determine recoverable amount

Step 3: Compare carrying amount vs recoverable amount

Step 4: Recognise impairment (if necessary)

Step 5: Allocate impairment (if CGU)

Step 6: Disclose

9. Single Asset Impairment

If recoverable amount < carrying amount → impairment.

Journal entry:

Dr Impairment loss (P/L)

Cr Asset name: Accumulated impairment losses (“negative asset”)

10. Cash Generating Units (CGUs)

A CGU is required when an asset **cannot generate independent cash flows**.

CGU impairment allocation order:

1. **Goodwill**
2. **Other assets pro-rata**
 - But not below their individual recoverable amounts
 - Not below zero

CGU identification principles:

- Identify smallest independent inflow
- Consider how management monitors operations
- Consider how decisions are made

CGU boundaries:

- Cannot be larger than an operating segment
- Cannot be smaller than independent inflows

11. Goodwill Impairment

Goodwill **must** be allocated to CGUs or groups of CGUs benefiting from the acquisition.

Rules:

- Test **annually**
- Test when indicators exist
- Goodwill is impaired **first**
- Goodwill impairment **cannot be reversed**

Goodwill allocation:

Allocate based on **synergies** expected from acquisition.

Goodwill impairment steps:

1. Determine carrying amount of CGU (including goodwill)
2. Determine recoverable amount
3. Compare
4. Impair goodwill first
5. Allocate remainder to other assets

12. Corporate Assets

Examples:

- HQ building
- Central IT systems
- Shared R&D facilities

Allocation:

- Allocate on a **reasonable and consistent basis**, or
- Test at a higher level (group of CGUs)

13. Reversal of Impairment

Allowed for:

- PPE
- Intangibles with finite life (not infinite life)
- CGUs (excluding goodwill)

Not allowed for Goodwill

Reversal rules:

- Only if estimates change
- Cannot exceed what carrying amount would have been without impairment

14. Disclosures

For each class of asset:

- Impairment losses
- Impairment reversals
- Events leading to impairment
- CGU description
- Key assumptions
- Sensitivity analysis

15. Exam Traps

- Goodwill impairment **cannot be reversed**
- VIU excludes **tax** and **financing** cash flows
- CGU impairment → goodwill first
- Corporate assets must be allocated
- Restructuring cash flows only included if **committed**
- Discount rate must be **pre-tax**
- Inventory impairment → IAS 2

16. FULL WORKED EXAMPLE

A full, multi-asset, exam-level scenario with calculations, tables, allocations, journal entries, and explanations.

Scenario: The Titan Manufacturing CGU

Titan Manufacturing operates a specialised production facility. The facility is treated as **one CGU**.

Carrying amounts (before impairment):

Asset	Carrying Amount (R)
PPE (factory + machinery)	6 000 000
Intangible asset – finite life (patent)	2 000 000
Intangible asset – indefinite life (brand)	1 500 000
ROU asset (IFRS 16 leased asset)	1 200 000
Goodwill	3 000 000
Total CGU carrying amount	13 700 000

Step 1 — Indicators of Impairment

Management notes:

- A major competitor entered the market
- Demand dropped
- Discount rates increased
- The brand's market recognition weakened

Indicators exist → **Impairment test required.**

Step 2 — Determine Recoverable Amount

We calculate **both** FVLCD and VIU.

A) Fair Value Less Costs of Disposal (FVLCD)

Independent valuation results:

- Market value of CGU: **R10 000 000**
- Disposal costs: **R500 000**

$$\Rightarrow FVLCD = 10\,000\,000 - 500\,000 = 9\,500\,000$$

B) Value in Use (VIU)

Management provides 5-year cash flow forecast:

Year Cash Flow (R)

- 1 2 000 000
- 2 2 200 000
- 3 2 300 000
- 4 2 400 000
- 5 2 500 000

- Terminal growth rate: **2%**
- Discount rate (pre-tax): **12%**

Present value of cash flows

Year 1:

$$\frac{2\,000\,000}{1.12} = 1\,785\,714$$

Year 2:

$$\frac{2\,200\,000}{1.12^2} = 1\,753\,306$$

Year 3:

$$\frac{2\,300\,000}{1.12^3} = 1\,636\,000$$

Year 4:

$$\frac{2\,400\,000}{1.12^4} = 1\,524\,000$$

Year 5:

$$\frac{2\,500\,000}{1.12^5} = 1\,419\,000$$

Terminal value:

$$TV = \frac{CF_5 \times (1 + g)}{r - g}$$

$$TV = \frac{2\,500\,000 \times 1.02}{0.12 - 0.02}$$

$$TV = \frac{2\,550\,000}{0.10} = 25\,500\,000$$

Discount terminal value:

$$\frac{25\,500\,000}{1.12^5} = 14\,480\,000$$

Total VIU

$$VIU = 1\,785\,714 + 1\,753\,306 + 1\,636\,000 + 1\,524\,000 + 1\,419\,000 + 14\,480\,000$$

$$VIU = 22\,598\,020$$

Step 3 — Recoverable Amount

Recoverable amount = higher of VIU and FVLCD

- VIU = **22 598 020**
- FVLCD = **9 500 000**

➔ Recoverable amount = **22 598 020**

Step 4 — Compare RA to Carrying Amount

- Carrying amount = **13 700 000**
- Recoverable amount = **22 598 020**

➔ Recoverable amount > carrying amount ➔ no impairment.

Let us now adjust the scenario so that an impairment loss needs to be accounted for.

Management revises cash flows downward due to a sudden contract loss.

Revised VIU = R8 000 000

Now compare:

- FVLCD = 9 500 000
- VIU = 8 000 000
- Recoverable amount = **9 500 000** (higher of the two)
- Carrying amount = **13 700 000**

Impairment = 13 700 000 – 9 500 000 = **4 200 000**

Now we can proceed with the 5th Step.

Step 5 — Allocate Impairment (CGU Rules)

Order of allocation:

1. **Goodwill first**
2. Other assets **pro-rata**
3. But not below individual recoverable amounts

Step 5A — Impair goodwill first

Goodwill = 3 000 000; Impairment = 4 200 000

➔ **Write off goodwill fully.**

Remaining impairment:

$$4\,200\,000 - 3\,000\,000 = 1\,200\,000$$

Step 5B — Allocate remaining impairment pro-rata

Assets eligible (excluding goodwill):

Asset	Carrying Amount
PPE	6 000 000
Patent (finite)	2 000 000
Brand (indefinite)	1 500 000

Asset	Carrying Amount
ROU asset	1 200 000
Total	10 700 000

Pro-rata percentages:

- PPE: $6\,000\,000 / 10\,700\,000 = 56.07\%$
- Patent: $2\,000\,000 / 10\,700\,000 = 18.69\%$
- Brand: $1\,500\,000 / 10\,700\,000 = 14.02\%$
- ROU: $1\,200\,000 / 10\,700\,000 = 11.21\%$

Allocate R1 200 000 impairment

Asset	%	Allocation (R)
PPE	56.07%	672 840
Patent	18.69%	224 280
Brand	14.02%	168 240
ROU asset	11.21%	134 640
Total		1 200 000

Step 6 — New Carrying Amounts

Asset	Before	Impairment	After
Goodwill	3 000 000	(3 000 000)	0
PPE	6 000 000	(672 840)	5 327 160
Patent	2 000 000	(224 280)	1 775 720
Brand	1 500 000	(168 240)	1 331 760
ROU asset	1 200 000	(134 640)	1 065 360
Total	13 700 000	(4 200 000)	9 500 000

CA matches recoverable amount → 

Step 7 — Journal Entry

Dr Impairment loss – CGU (P/L)	4 200 000	
Cr Goodwill: Cost		3 000 000

Cr PPE: Accumulated impairment losses	672 840
Cr Patent: Accumulated impairment losses	224 280
Cr Brand: Accumulated impairment losses	168 240
Cr ROU Asset: Accumulated impairment losses	134 640

17. Question Bank

SECTION A — MULTIPLE-CHOICE QUESTIONS (20)

MCQ 1:

The recoverable amount of an asset is:

- A. The higher of carrying amount and fair value
- B. The lower of VIU and FVLCD
- C. The higher of VIU and FVLCD
- D. The lower of carrying amount and VIU

➔ **Answer: C**

➔ **Explanation:** IAS 36 defines recoverable amount as the *higher* of VIU and FVLCD.

MCQ 2:

Which of the following assets is **NOT** within the scope of IAS 36?

- A. PPE
- B. Goodwill
- C. Inventory
- D. Indefinite-life intangibles

➔ **Answer: C**

➔ **Explanation:** Inventory is completely governed by IAS 2.

MCQ 3:

Goodwill must be tested for impairment:

- A. Only when indicators exist
- B. Annually and when indicators exist
- C. Only at acquisition
- D. Never

➔ Answer: B

MCQ 4:

Which cash flow is **excluded** from VIU?

- A. Maintenance capex
- B. Working capital changes
- C. Tax cash flows
- D. Operating inflows

➔ Answer: C

MCQ 5:

An impairment loss for a CGU is allocated:

- A. Pro-rata to all assets
- B. First to PPE
- C. First to goodwill
- D. First to indefinite-life intangibles

➔ Answer: C

MCQ 6:

Which of the following **cannot** be reversed?

- A. PPE impairment
- B. Goodwill impairment
- C. Patent impairment
- D. ROU asset impairment

➔ Answer: B

MCQ 7:

A CGU is:

- A. The smallest group of assets generating independent cash inflows
- B. A reporting segment
- C. A legal entity
- D. A cost centre

➔ Answer: A

MCQ 8:

Which discount rate is used in VIU?

- A. Post-tax
- B. Pre-tax
- C. After financing
- D. Risk-free rate only

➔ Answer: B

MCQ 9:

Corporate assets:

- A. Are ignored in impairment tests
- B. Must be allocated to CGUs on a reasonable basis
- C. Are tested individually
- D. Cannot be impaired

➔ Answer: B

MCQ 10:

If FVLCD = R5m and VIU = R4m, recoverable amount is:

- A. R4m
- B. R5m
- C. R9m
- D. R1m

➔ Answer: B

MCQ 11:

Which is an **external** indicator of impairment?

- A. Physical damage
- B. Obsolescence
- C. Market value decline
- D. Poor performance

➔ **Answer: C**

MCQ 12:

Which is an **internal** indicator?

- A. Increase in interest rates
- B. Market decline
- C. New competitor
- D. Asset damage

➔ **Answer: D**

MCQ 13:

Impairment loss is recognised in:

- A. OCI
- B. Equity
- C. Profit or loss
- D. Retained earnings

➔ **Answer: C**

MCQ 14:

VIU cash flows must exclude:

- A. Operating inflows
- B. Restructuring costs not yet committed
- C. Maintenance capex
- D. Working capital changes

➔ **Answer: B**

MCQ 15:

A brand with indefinite life:

- A. Must be amortised
- B. Must be tested annually
- C. Cannot be impaired
- D. Is measured at cost only

➔ **Answer: B**

MCQ 16:

If an asset's carrying amount is R800k and recoverable amount is R600k, impairment is:

- A. R200k
- B. R600k
- C. R800k
- D. None

➔ **Answer: A**

MCQ 17:

Which asset is tested **annually regardless of indicators**?

- A. PPE
- B. ROU assets
- C. Goodwill
- D. Inventory

➔ **Answer: C**

MCQ 18:

Impairment reversal cannot increase an asset above:

- A. Fair value
- B. Recoverable amount
- C. What carrying amount would have been without impairment
- D. Cost

➔ **Answer: C**

MCQ 19:

FVLCD includes:

- A. Tax cash flows
- B. Disposal costs
- C. Financing costs
- D. Depreciation

➔ **Answer: B**

MCQ 20:

A CGU's impairment loss is allocated to PPE:

- A. Before goodwill
- B. After goodwill
- C. Only if VIU is used
- D. Only if FVLCD is used

➔ **Answer: B**

SECTION B — SHORT-FORM QUESTIONS (10)

Q1

Define recoverable amount.

A: *Higher* of VIU and FVLCD.

Q2

List two internal indicators of impairment.

A: Physical damage, poor performance.

Q3

List two external indicators.

A: Market decline, increase in discount rates.

Q4

Name two assets requiring **annual** impairment testing.

A: Goodwill, indefinite-life intangibles.

Q5

Can goodwill impairment be reversed?

A: No.

Q6

What is a CGU?

A: Smallest group of assets generating independent cash inflows.

Q7

What discount rate is used in VIU?

A: Pre-tax rate.

Q8

Name one cash flow excluded from VIU.

A: Tax cash flows.

Q9

What is the first step in impairment testing?

A: Identify indicators.

Q10

How is impairment allocated within a CGU?

A: Goodwill first, then other assets pro-rata.

SECTION C — LONG-FORM CASE STUDIES (3)**CASE STUDY 1 — Medium Difficulty**

Scenario: A CGU has the following carrying amounts:

- PPE: R4 000 000
- Patent: R1 000 000

- Brand (indefinite): R800 000
- Goodwill: R1 200 000

Total = R7 000 000

Recoverable amount = R5 000 000.

Required:

- Calculate impairment
- Allocate impairment
- Provide journal entries

Solution:

a) Impairment = 7 000 000 – 5 000 000 = **2 000 000**

b) Allocate:

- Goodwill first → R1 200 000; Remaining = R800 000
- Pro-rata to PPE, patent, brand:
 - PPE: $4/5.8 \times 800k = 551k$
 - Patent: $1/5.8 \times 800k = 138k$
 - Brand: $0.8/5.8 \times 800k = 110k$

c) Journal entry:

Dr Impairment loss – CGU	2 000 000	
Cr Goodwill: Cost		1 200 000
Cr PPE: Accumulated impairment losses		551 000
Cr Patent: Accumulated impairment losses		138 000
Cr Brand: Accumulated impairment losses		110 000

CASE STUDY 2 — Low Difficulty

Scenario:

- Carrying amount of CGU = R15 000 000
- FVLCD = R12 000 000
- VIU = R10 500 000

Assets:

- Goodwill: R3 000 000
- PPE: R8 000 000
- Software: R2 000 000
- Brand: R2 000 000

Required:

- a) Determine recoverable amount
- b) Calculate impairment
- c) Allocate impairment

Solution:

- a) Recoverable amount = **12 000 000**
- b) Impairment = 15 000 000 – 12 000 000 = **3 000 000**
- c) Allocation:
 - 1. Goodwill → 3 000 000; Remaining impairment = 0
 - ➔ No further allocation.

CASE STUDY 3 — High Difficulty (Corporate Assets + CGUs)

Scenario: Two CGUs: Alpha and Beta.

Corporate HQ building supports both.

Carrying amounts:

Asset	Alpha	Beta
PPE	5m	4m
Intangibles	2m	1m
Goodwill	1m	2m

Corporate HQ building = R3m (allocated 60% to Alpha, 40% to Beta)

Recoverable amounts:

- Alpha: R6m
- Beta: R5m

Required:

- a) Determine impairment for each CGU
- b) Allocate impairment
- c) Journal entries

Solution:

Alpha CGU

Carrying amount = $5m + 2m + 1m + (3m \times 60\%) = 5 + 2 + 1 + 1.8 = \mathbf{9.8m}$

Recoverable amount = 6m

➔ Impairment = **3.8m**

Allocate:

- Goodwill first: 1m; Remaining: 2.8m

Pro-rata to PPE + intangibles + HQ portion: $5m + 2m + (3m \times 60\%) = 8.8m$

- PPE: $5/8.8 \times 2.8m = 1,590,909$
- Intangibles: $2/8.8 \times 2.8m = 636,364$
- HQ: $1.8/8.8 \times 2.8m = 572,727$

Let us check if it adds up: $1,590,909 + 636,364 + 572,727 = 2.8m$ ✓

Beta CGU

Carrying amount = $4 + 1 + 2 + (3m \times 40\%) = 4 + 1 + 2 + 1.2 = \mathbf{8.2m}$

Recoverable amount = 5m

➔ Impairment = **3.2m**

Allocate:

- Goodwill first: 2m; Remaining: 1.2m

Pro-rata to PPE + intangibles + HQ portion: $4m + 1m + (3m \times 40\%) = 6.2m$

- PPE: $4/6.2 \times 1.2m = 774,194$
- Intangibles: $1/6.2 \times 1.2m = 193,548$
- HQ: $1.2/6.2 \times 1.2m = 232,258$

Let us again check if it adds up: $774,194 + 193,548 + 232,258 = 1.2m$ ✓

Journal entries:

Dr Impairment loss – Alpha CGU	3 800 000	
Dr Impairment loss – Beta CGU	3 200 000	
Cr Alpha: Goodwill: Cost		1 000 000
Cr Alpha: PPE: Accumulated impairment losses		1 590 909
Cr Alpha: Intangibles: Accumulated impairment losses		636 364
Cr HQ Building: Alpha: Accumulated impairment losses		572 727
Cr Beta: Goodwill: Cost		2 000 000
Cr Beta: PPE: Accumulated impairment losses		774 194
Cr Beta: Intangibles: Accumulated impairment losses		193 548
Cr HQ Building: Beta: Accumulated impairment losses		232 258

18. Professional Judgement

Sound **professional judgement** is required to properly apply this Standard in practice. The last Case Study is the perfect specimen to illustrate this. It can reasonably be argued that the impairment of the two CGUs has no effect on the value of the HQ building. In such a case, no impairment would be allocated to the building, only to the components of the CGUs.
