Exposure Draft

Accounting Standard (AS) 36

Impairment of Assets

Objective

This para may begin with-

The objective of AS 36 [Impairment of assets] is to make sure that entity's assets are carried at no more than their recoverable amount. The Standard also defines when an asset is impaired, how to recognize an impairment loss, when an entity should reverse this loss and what information related to impairment should be disclosed in the financial statements.

Scope

This para may add-

(h) deferred acquisition costs and intangible assets arising from contracts within the scope of Insurance Contracts.

Definitions

This para may add-

'Impaired asset' means 'an asset that has a market value less than the value listed on the company's balance sheet.'

Identifying an asset that may be impaired

This Para may add-

(8 A) Impairment of Assets seeks to ensure that an entity's assets are not carried at more than their recoverable amount. In other words, it is the higher of fair value less costs of disposal and value in use. With the exception of goodwill and certain intangible assets for which an annual impairment test is required, entities are required to conduct impairment tests where there is an indication of impairment of an asset, and the test may be conducted for a 'cash-generating unit' where an asset does not generate cash inflows that are largely independent of those from other assets.

Para:9 may add-

The recoverable amounts of the following types of intangible assets are measured annually whether or not there is any indication that it may be impaired. In some cases, the most recent detailed calculation of recoverable amount made in a preceding period may be used in the impairment test for that asset in the current period:

- an intangible asset with an indefinite useful life
- an intangible asset not yet available for use
- goodwill acquired in a business combination

Para 10 – ‘may add-

‘External source of Information’

- market value declines
- negative changes in technology, markets, economy, or laws
- increases in market interest rates
- net assets of the company higher than market capitalisation

‘Internal sources’

- obsolescence or physical damage
- asset is idle, part of a restructuring or held for disposal
- worse economic performance than expected

for investments in subsidiaries, joint ventures or associates, the carrying amount is higher than the carrying amount of the investee's assets, or a dividend exceeds the total comprehensive income of the investee.

Measuring recoverable amount

Fair value less costs of disposal

This para may add-

The purpose of measuring recoverable amount is to estimate a market value, not an enterprise-specific value. An enterprise's estimate of the present value of future cash flows is subjective and in some cases may be abused. Observable market prices that reflect the judgement of the marketplace are a more reliable measurement of the amounts that will be recovered from an asset. They reduce the use of management's judgement.

If an asset is expected to generate greater net cash inflows for the enterprise than for other participants, the superior returns are almost always generated by internally generated goodwill stemming from the synergy of the business and its management team. For consistency internally generated goodwill should not be recognised as an asset, these above-market cash flows should be excluded from assessments of an asset's recoverable amount.

However, no preference should be given to the market's expectation of the recoverable amount of an asset over a reasonable estimate performed by the individual enterprise that owns the asset. Also, an enterprise may plan to use an asset in a manner different from the market's view of the best use. Market values are a way to estimate fair value but only if they reflect the fact that both parties, the acquirer and the seller, are willing to enter a transaction. If an enterprise can generate greater cash flows by using an asset than by selling it, it would be misleading to base recoverable amount on the market price of the asset because a rational enterprise would not be willing to sell the asset. Therefore, recoverable amount should not refer only to a transaction between two parties but should also consider an asset's service potential from its use by the enterprise.

Value in use

This para may add-

If an asset's net selling price is higher than its value in use, a rational enterprise will dispose of the asset. In this situation, it is logical to base recoverable amount on the asset's net selling price to avoid recognising an impairment loss that is unrelated to economic reality.

If an asset's net selling price is greater than its value in use, but management decides to keep the asset, the extra loss (the difference between net selling price and value in use) properly falls in later periods because it results from management's decision in these later periods to keep the asset.

When an enterprise expects to dispose of an asset within the near future, the net selling price of the asset is normally close to its value in use. Indeed, the value in use usually consists mostly of the net proceeds to be received for the asset, since future cash flows from continuing use are usually close to nil. Therefore, the definition of recoverable amount is appropriate for assets held for disposal without a need for further requirements or guidance.

Basis for estimates of future cash flows

This para may add-

Understanding and quantification of the value of a set of future cash flows is central to actuarial science and the valuation of uncertain or contingent future cash flows in a wide number of decision-making situations and in the financial reporting of an entity's financial condition.

There are two distinct, but not totally mutually exclusive families of valuation approaches to future cash flows – a market-based approach and a present value approach. Market based valuation can be viewed as consisting of fundamental) or based on observed values demonstrated by transactions involving comparable sets of future cash flows in an efficient market. Because in most cases an efficient market does not exist, such observations need to be supplemented by the results of present value models, in which case it may form the basis of a fair valuation. They both reflect risk and time preferences of the users of the valuations. In evaluating future cash flows, expected cash flows must be estimated, supplemented by the time value of money and risk preferences. In the case of inefficient markets or markets that respond to many factors in addition to the fundamentals of the particular economic good, there tends to exist a market premium or discount.

Value is a function of the audience and is influenced by not only fundamental values but also by opinions of other parties to a particular transaction and to those similar. Its components are made up of estimates of future cash flows, adjusted for risk, risk preference, and time preference.

Business decision-makers tend to rely on values appropriate to the specific operations of an entity, reflecting the intended use of the economic good, rather than the aggregate consensus of a market, resulting from the many participants in a market, although the market value can substantially influence the value associated with the economic good.

Market values tend to reflect consensus view of a number of buyers and sellers, reflecting consensus risk margins or premium. For the valuation of many liabilities, for which fewer efficient markets exist, value in use may be more appropriately reflected. Although it may not be appropriate to reflect the actual earned rate of assets corresponding to these liabilities, it is appropriate to reflect the type of benefits provided and asset classes and durations associated with the expected settlement of the liabilities.

Adjustment for risk through both a discount rate or through expected cash flows may be appropriate in different situations, although there may be more practical reasons to favour adjustment for provisions for adverse deviations through expected cash flows.

Cash flow projections should be based on the most recent financial budgets/forecasts that have been approved by management, but should exclude any estimated future cash inflows or outflows expected to arise from future restructurings or from improving or enhancing the asset's performance. When a cash-generating unit contains assets with different estimated useful lives, the replacement of assets with shorter lives is considered to be part of the day-to-day servicing of the asset when estimating the future cash flows associated with the asset.

Recognising and measuring an impairment loss

Comments:

Despite the standard being objectively set, it can be difficult in determining the measurement of value attributable in assessing impairment options. The timings and measurement of asset write-downs rely heavily on estimates. A number of features of impairment testing and measurement process make implementation a challenge. Triggering events to indicate impairment are many and vary greatly in significance and severity. Different valuation models are used and there is little conformity in the selection of discount rates. A difference in nature continues to exist between fair values disclosed by management. While the standard seeks to increase transparency and eliminate the subjectivity of accounting for impairments, the exercise for determining if an asset is impaired and by how much remains at management's discretion. It was felt that previously management took advantage of the discretion afforded by accounting rules to manipulate earnings either by not recognising impairment when it has occurred or by recognising it only when it is advantages to do so. The standard now seeks to address this discretion by requiring annual impairment or impairment reviews to be carried out whenever there is an indication of impairment. Even still, there is an element of discretion afforded to the

calculation of impairments and so management incentives to manage earnings can still play a part in any impairment decisions. These estimates might be managed to alter or avoid impairments, limiting the comparability across firms. Additionally, financial statements differ from the management accounts used by an entity and the effect of any impairment further widens a gap already existing between management information accounts used by the board and the financial statements audited and published.

Volatile financial markets and shifting economic conditions can impact the value of a company's assets across the Balance Sheet. It is not surprising that the most frequent write down activities took place during periods of economic recession confirming the strong relationship between asset write-downs and economic conditions. presumed benefits associated with Fair Value accounting, it is shown that in practice managerial self-interests and earnings management concerns appear to motivate many impairment decisions The proposed amendment to AS 36 goes further than any previous standard and subsequent amendments to eliminate any subjectivity involved in highlighting and calculating an impairment loss. While goodwill should be assessed annually for impairment other potentially impaired assets are only reviewed in detail for impairment if there is an indication of impairment, some of which are highlighted by the standard itself, however the indicator of impairment could go unidentified resulting in misleading financial statements. Additionally, many calculations of impairment use management projections which could include error or contain an element of managerial self-interest and manipulation. Generally speaking, the reaction of market participants to any impairment disclosed in the financial statements is of a negative nature with the exception of restructuring costs for which highlight future spend. While the standard seeks to provide a truer and fairer representation of asset value it should be noted with caution the subjective nature of any calculations. Even with an unqualified audit report on the financial statements the audit opinion on impairment is only as good as the information provided and made available to the external auditors. Hence, it can be concluded that AS 36 on Impairment of assets has come far to contribute to improve the transparency of the financial statements by successfully determining when and how impairment reviews should be conducted, however there will remain an element of managerial judgement for which caution should be taken by all users of the financial statements.

Cash-generating units and goodwill

Comments:

Many companies performing an annual goodwill impairment testing exercise that has often resulted in a no impairment conclusion, when impairment has been indicated by underperformance of the acquired business. In fact, the recoverable amount of the acquired goodwill might have fallen below the carrying amount, but the shortfall has been amply shielded by the headroom of other items in the CGU [cash Generating Units] that carries the goodwill. This shielding effect has enabled and will continue to enable an acquirer to use financial engineering to improve its reported performance. An acquirer can pay a substantial

goodwill for a business that generates a superior return on equity. It will never have to recognise any expense in profit or loss for the consumption of the acquired goodwill to generate benefits, after it has allocated it to a CGU with substantial headroom.

it is extremely important for us to acknowledge that the primary issue is the testing methodology's lack of ability to target the acquired goodwill for impairment assessment due to the shielding effect and the replacement. Moderating management over-optimism and applying greater reviewer scepticism are secondary as they only help to improve the execution a testing design that is conceptually not fit for its intended purpose. SIRC of ICAI agree that it is not feasible to design a more effective impairment test. We must acknowledge that in the absence of an effective goodwill impairment testing methodology, the impairment-only model is and will continue to be untenable.

In some cases, where the acquirer has kept the acquired goodwill within a single CGU of the acquired business. The purchase price allocation at fair value has led to a fresh acquisition date position with no headroom and hence no shielding effect. This is an ideal starting point for subsequent goodwill impairment testing. The drawback of this approach, which is beginning to show in the current weakening economic environment, is that some synergistic benefits of the acquisition are realised, through cross selling, in other CGUs. However, it would be a very complex exercise to attribute the synergy value realised elsewhere to the recoverable amount of the CGU that carries the acquired goodwill. If this ED had required goodwill to be isolated within the acquired CGU, there would have been no problem arising from the shielding effect. However, this requirement would be inconsistent with the economic rationale of a business combination to achieve synergy.

Restrictions on the ViU [Value in use] model – including the requirements to exclude future restructurings and/or asset enhancements and use a pre-tax discount rate – do not reflect how acquirers price prospective transactions, nor necessarily the manner in which management itself views the business. As a result, the outcome of the impairment testing process does not reflect either a true business valuation or management's internal perception of value.

There is limited guidance on determining and/or applying the methodology and assumptions required to calculate recoverable amount. There is limited guidance on how an entity should factor risk into cash flow projections. Results in differences of opinion with auditors and regulators on the outcome, especially in times of fast technological disruption and economic instability. The recoverable amount is determined using an inappropriate methodology. The recoverable amount may be overstated, resulting in a delay in impairment recognition and overstatement of assets.

Impairment disclosures do not include all information that users require to make decisions. Key assumptions underlying the impairment calculation are often omitted from the relevant disclosures. Disclosures are not tailored to the business' operations and/or are ambiguous. Analysts are required to substitute with externally available information when assessing performance, which may not accurately align with management's decisions,

It is expressed that the test should not be applied at a micro-level and used as a mechanism for assessing the relative success of an individual business acquisition. Having said that, the statement of financial position is interpreted as the overall store of past management decisions or a historical 'scorecard' of assessing management's ability to effectively allocate resources. In combination with tangible value, it represents an aggregation of the price paid by management for assets. The return on invested capital from these purchases is one way to measure the success of management decisions. We believe that the optimum approach is at a level somewhere higher than an individual acquisition but lower than the whole statement of financial position.

In certain industries, users can make their assessment at a relatively disaggregated level, such as an individual area of interest. This is facilitated by disaggregated supplementary information – often available as part of the operational reports or investors presentations. In other industries often the CGU analysis, segment disclosures, and supplementary information do not align in a meaningful or useful way, leaving it necessary for users to default to a segment-level approach in making their assessments. The activities undertaken vary the size of the investment house and the portfolio of investments followed; the purpose (buy-side or sell-side analysis); and the size of the entity under consideration.

Any assumption that the market can 'predict' impairments may be flawed due to the following reasons:

a. It is not always possible to assess the opposite outcome - i.e. where the market predicts an impairment that does not occur. Therefore, the number of confirmatory results may be misleading.

b. A period of share price stability after an impairment announcement should not be taken to mean that the impairment was expected. At most this should be interpreted as an event not impactful enough to affect price, in the context of all other factors.

c. Both the impairment test and lodgement of full financial statements are only required once a year, whereas material developments, must be reported to the market under continuous disclosure obligations associated with the SEBI listing rules. It therefore follows that material impairments announced in the annual report should generally be already known to the market in most cases and no meaningful reactions should be anticipated from this source when the report is released.

the ViU [Value-in-use] approach should reflect management's intentions for the use of the asset over the forecast period and therefore is expected to align as much as possible with management's budgets. For this reason, the recommendation centres on a modified-single model approach, essentially a rebuttable presumption that ViU is the most appropriate basis to use unless the asset is genuinely expected to be realised through sale. The updated ViU model will be easier and more relevant for preparers, offering substantial time and cost-savings. Entities examine budgets in detail each year so the authors see this as an appropriate starting point for the impairment test. The suite of recommendations in this section aim to allow management to align with budgets as much as possible – albeit certain items may continue to be excluded, for example where budgets are not organic i.e.

factoring in a future business acquisition or non-organic growth. The use of ViU reflects the value expected to arise from continuing use of an asset and from its disposal in the future and not the value expected to arise from a hypothetical immediate sale which management does not intend to make. Removal of the restriction on restructurings will assist with preparer acceptance of the removal of the FVLCD option from the standard for ongoing operations. This is particularly for those entities that have specifically used the FVLCD model in the past because the ViU model did not serve their needs. The ED's objective must be to promote an approach to impairment that is more budget-aligned to ensure entities are not disadvantaged by removing the FVLCD option for assets that will continue to be used in the organisation.

Disclosure

Comments:

The ED provide further guidance on the definition of a key assumption, being those to which the impairment model is most sensitive, to encourage more informative disclosure. To revise the disclosure requirements to provide more coherent disclosure principles regardless of the method chosen to determine recoverable amount. Also to incorporate an additional disclosure objective to provide information to help investors understand the subsequent performance of the acquired business, having regard to the commercially-sensitive nature of the information.

There is a consistent gap between their expectations and those 'key assumptions' that are actually disclosed. While discount rate and revenue growth rate are often disclosed – likely because those are specifically cited within the standard – the following were also offered by analysts as being considered 'key assumptions' that are not always disclosed, where applicable:

a. EBITDA margin

b. Interest paid

c. Expected life

d. Cost profile

the above are common omissions and it was with the caveat that these may not be 'key assumptions' in all cases. Key assumptions are considered those to which the CGU or group of CGUs' recoverable amount is most sensitive. On this basis an input may not be 'key' because it is not relevant for the industry, or because it does not have a material impact on the impairment outcome across a large range. Further, the practice of identifying a few inputs and disclosing the impact in isolation, regardless of whether they are relevant, or not is rarely helpful. It appears there are some common assumptions that are described as 'key' across financial statements, despite those assumptions not having a significant impact on impairment testing outcomes in many cases, it is clear that ED require further guidance to

assist in determining what their key assumptions are, and to encourage more informative disclosure.

Many entities will fulfil this requirement by simply disclosing that there is sufficient headroom such that a reasonably possible change in assumption would not lead to an impairment. However, it should be acknowledged that the term 'reasonably possible change' is highly subjective and difficult for a user to predict and/or interpret, and in practice, a source of much debate with regulators. It was consistently agreed that, combined with the skeletal approach to disclosing key inputs, the disclosure is poorly presented and lacking any real analytical value.

The standard's definition of a key assumption refers to its sensitivity in the context of the calculation performed. Therefore, a quality disclosure in this area would involve a preliminary exercise to determine the inputs that fall within this definition and then disclosure of information explaining the amount by which each would need to change to effect an impairment. This should give consideration to the flow-on effect of any individual change, for example, a sustained change in interest rates will affect the risk-free rate built into a discount rate and is also expected to have a commensurate effect on the price index which might underpin the growth rate used. It is another fact that in order for this information to be truly useful, a fully dynamic impairment model would be required, which is often not practical. However, there can be another view that the impact of isolated changes to key assumptions would be useful to obtain, subject to a suitable level of materiality. It is acknowledged that key assumptions may be correlated in an economic sense and changes in one key assumption may be accompanied by changes to other assumptions in more complete scenario estimates. Nonetheless, information on the impact of isolated changes to key assumptions was thought to provide valuable information to analysts who utilise the valuations under changing market and economic circumstances, and also to assess the uncertainties within the valuations themselves. Further, where included, the disclosures give a high-level sense of the 'safe' range of each input and whether the outcome would be 'better or worse' were a particular result to eventuate. However, when the question is 'by how much' the analysts expect investors to turn to them for an assessment of the quantitative effect of that information, rather than relying on the limited information available from the financial statements.

Name: Sounder Rajan SP

M no 237299

Place: Chennai

Mail: sounderrajansubramanian2709@gmail.com

Mobile: 9940153273

Subject: Comments on Exposure draft on Accounting Standard (AS) 36 Impairment of Assets

1) I welcome the opportunity provided for sending comments on Exposure draft on Accounting Standard (AS) 36 Impairment of Assets

2) My view

Existing	Proposed change	Comments	Rational
Para 6 and 117 (g) Value in use is the present value of future cash flows expected to be drive from an asset or cash generating unit or a reasonable estimate thereof. Explanation: The definition of the term 'value in use' in the proviso implies that instead of using the present value technique, a reasonable estimate of the 'value in use' can be made. Consequently, if an SMC/SME chooses to measure the 'value in use' by not using the present value technique, the relevant provisions of AS 36, such as discount rate etc., would not be applicable to such an SMC/SME.	Technique of estimation is required to indicated	At present the standard is judgmental	Users require some indicative guidelines to implement the same on a uniform basis
Para 7 d Paragraph 113-118 specify the information to be disclosed about impairment losses and	Para 7 d Paragraphs 113-118 specify the information to be disclosed about impairment losses and	At present there are no guidance for testing goodwill or intangible with indefinite useful life	It would be better to include intangible in scope or else define impairment asset in intangible standards

reversals of impairment losses for assets and cash- generating units.	reversals of impairment losses for assets and cash- generating units. Also specify additional disclosure requirements for cash-generating units to which goodwill or intangible assets with indefinite useful lives have been allocated for impairment testing purposes.		
Para 8 8An asset is impaired when its carrying amount exceeds its recoverable amount. Paragraphs 10-12–14 describe some indications that an impairment loss m may have occurred. If any of those indications is present, an entity is required to make a formal estimate of recoverable amount.	Para 8 An asset is impaired when its carrying amount exceeds its recoverable amount. Paragraphs 10-12–14 describe some indications that an impairment loss may have occurred. If any of those indications is present, an entity is required to make a formal estimate of recoverable amount. Standard does not require an entity to make a formal estimate of recoverable amount if no indication of an impairment loss is present.	At present standard requires estimation even when there are no indication	It would be onerous on the entities implementing AS 36
Missing intangible testing	Irrespective of whether there is any indication of impairment, an entity shall also: test an intangible asset with an indefinite useful life or an intangible asset not yet available for use for impairment annually by comparing its carrying amount with its recoverable amount. This impairment test may be performed at any time during an annual period, provided it is performed at the same time every year.	At present intangible is not covered	It would be better to include intangible in scope or else define impairment asset in intangible standards

	Different intangible assets may be tested for impairment at different times. However, if such an intangible asset was initially recognised during the current annual period, that intangible asset shall be tested for impairment before the end of the current annual period. test goodwill acquired in an amalgamation for impairment annually The ability of an intangible asset to generate sufficient future economic benefits to recover its carrying amount is usually subject to greater uncertainty before the asset is available for use than after it is available for use. Therefore, this Standard requires an entity to test for impairment, at least annually, the carrying amount of an intangible asset that is not yet available for use. If a cash-generating unit described in paragraph 88 includes in its carrying amount an intangible asset that has an indefinite useful life or is not yet available for use and that asset can be tested for impairment only as part of the cash-generating unit. The annual impairment test for a cash-generating unit to which goodwill has been allocated may be performed at any time during an annual period, provided the test is		

	performed at the same time every year. Different cash- generating units may be tested for impairment at different times. However, if some or all of the goodwill allocated to a cash-generating unit was acquired in amalgamation during the current annual period, that unit shall be tested for impairment before the end of the current annual period.		

I concur that views stated above are my individual opinion and not of any organization where I am working or not of any committee or organization I am connected with.

Regards

Sounder Rajan

M No 237299