

In assessing whether there is any indication that an asset may be impaired, FRS 136 requires an entity to consider both internal and external sources of information.

Paragraph 12 of FRS 136 provides examples of external sources of information as follows:

- significant decline in the market value of an asset
- significant changes in the technological, economic or legal environment
- significant change in the interest rates
- entity's share price less than book value.

In addition, examples of internal sources of information include:

- obsolescence or physical damage of an asset
- lower-than-expected economic performance of a segment
- discontinuance or restructuring of operations.

In summary, an entity is required to test for impairment once there is a triggering indicator represented by any of the examples of external or internal sources of information above. However, one must note that the list of examples provided by FRS 136 is not exhaustive.

¶3-220 Compulsory annual testing

FRS 136 provides an exception to the basic rule above ie an entity **must test, at least annually**, the following assets for impairment:

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

In other words, the annual assessment is required, even if there is no indication of impairment (para 10). The impairment test for intangible assets may be performed at any time during an annual period, provided it is conducted at the same time every year. Different intangible assets may be tested for impairment at different times. However, if the intangible asset was initially recognised during the current annual period, that intangible asset must be tested before the end of the current annual period.

¶3-300 Measurement of impairment loss

How does one compute impairment loss?

FRS 136 defines an impairment loss as the excess of an asset's carrying amount (before impairment loss) over its recoverable amount.

¶3-310 Recoverable amount

Recoverable amount is measured as the higher of "fair value less costs to sell" and "value in use" (para 18).

Recoverable amount = Higher of :
 Fair value (FV) less costs to sell *and*
 Value in use (VIU)
 (ie the greater of these two amounts)

The concept of value in use was brought into play in FRS 136 because it may not always be easy to ascertain the fair value less costs to sell eg in a straight forward sale of a vehicle, the fair value less costs to sell would be the disposal proceeds less any incidental cost of disposal (see 3-320 below). Vehicles are actively traded assets hence expected disposal proceeds can be ascertained fairly easily by reference to publicly available information. However, prices of productive tangible assets like plant and machinery may not be so easily obtained as active markets for used assets are unlikely to exist.

FRS 136 provides a solution by allowing the recoverable amount of an asset to be represented by its value in use, if it is not possible to estimate its fair value less costs to sell.

Moreover, in a situation where an entity needs to decide whether to dispose or maintain the use of an asset, it makes sense to retain the asset if its VIU exceeds its fair value less costs to sell, because the benefits accruing are expected to exceed the sales proceeds.

It may be noted that it is not always necessary to determine both the fair value less costs to sell and value in use. For example, if one of these values exceeds the carrying amount of an asset, the asset is not impaired, and it is not necessary to estimate the other amount.

However, if one of those values is lower than the carrying amount of an asset ie the asset is impaired, it would be necessary to estimate the other amount since the higher amount would be the recoverable amount. Illustration 1 below will explain this point clearly.

Treatment:

The impairment loss of RM4 million (RM15 million less RM11 million) for 20x5 would be charged against the revaluation reserve, as follows:

Dr Revaluation reserve	4,000,000	
Cr Accumulated impairment: Land		4,000,000

Balance of revaluation surplus in 20x5 =RM1m (RM5m-RM4m)

Illustration 6**Facts**

Facts as in Illustration 5. Assume that the recoverable amount (based on estimated fair value less costs to sell) of the land further deteriorated to RM8 million in 20x7, and the company has to provide for an impairment loss of RM3 million (RM11 million – RM8 million).

Treatment:

In this case, of the total impairment loss of RM3 million, RM1 million should be charged against the revaluation reserve, and RM2 million charged to the 20x7 profit and loss account, as follows:

Dr Revaluation reserve	1,000,000	
Dr Impairment loss	2,000,000	
Cr Accumulated impairment loss: Land		3,000,000

In summary:

Year	Cost/Carrying amount at beginning RM'000	Revaluation reserve RM'000	Profit&Loss RM'000	Carrying amount at end RM'000
20X1	10,000			10,000
20X3	10,000	5,000		15,000
20X5	15,000	(4,000)		11,000
20X7	11,000	(1,000)	(2,000)	8,000

The approach above is consistent with the treatment of revaluation increases/decreases in accordance with FRS 116 *Property, Plant and Equipment*.

When the amount estimated for an impairment loss is greater than the carrying amount of the asset to which it relates, FRS 136 provides that the entity should recognise a liability if, and only if, that is required by another standard (para 62).

FRS 136 further provides that after the recognition of an impairment loss, the depreciation (amortisation) charge for the asset should be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining life (para 63) (see Illustration 3)

¶3-600 Cash generating unit (CGU)

As a general rule, the recoverable amount should be estimated for an individual asset. FRS 136 recognises that it may not always be possible to determine the recoverable amount for an individual asset. It introduces "cash generating unit" which is the smallest identifiable group of assets which generate cash inflows that are largely independent of the cash inflows of other assets or group of assets. Hence, in situations when it is not possible to estimate the recoverable amount of an individual asset, the recoverable amount is determined for the CGU to which the asset belongs.

The challenge here is the identification of a CGU which requires considerable judgement.

¶3-610 Identification of CGU

One may need to consider how management monitors the entity's operations (such as by product lines, businesses, individual locations, district or regional areas) or how management makes decisions about continuing or disposing of the entity's assets and operations.

Illustration 7

ABC Bus Company Bhd (the company) provides bus services for the North-South route and the East-West route.

Question: Is each bus route a cash-generating unit?

Analysis:

Scenario A

Assume that the contract with the government is such that the company has the option to run either the North-South route or the East-West route or both the routes. In this case, each bus route generates cash flows independent of the cash flows from the other. Therefore, each bus route is a cash-generating unit.

Scenario B

Assume that the contract with the government is such that the company has to run both the North-South route and the East-West route. In this case, each bus route does not generate cash flows independent of the cash flows from the other route. Therefore, each bus route is not a cash-generating unit. The cash-generating unit, in this case, is the company as a whole.

	CGU A	CGU B	CGU C	HQ Building	Research Centre	Z BHD
	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000
Carrying amount(CA)	1,000	1,500	2,000	1,500	5,000	6,500
Impairment loss	<u>nil</u>	<u>307</u>	<u>29</u>	<u>126</u>		<u>462</u>
Adjusted CA	<u>1,000</u>	<u>1,193</u>	<u>1,971</u>	<u>1,374</u>		<u>6,038</u>
Recoverable amount						7,200

• As the recoverable amount exceeds the carrying amount there is no impairment loss for the "larger" CGU.

¶3-700 Impairment of goodwill

Paragraph 55 of FRS 3 *Business Combinations* affirms that goodwill acquired in a business combination should not be amortised but subject to impairment testing annually in accordance with FRS 136.

As goodwill is not an identifiable asset, it cannot be tested for impairment on its own. FRS 136 requires that, for the purposes of impairment testing, goodwill acquired in a business combination should, from the acquisition date, be allocated to each of the acquirer's cash-generating unit that are expected to benefit from the synergies of the combination (para 80).

Each unit to which the goodwill is allocated should:

- represent the lowest level within the entity at which the goodwill is monitored for internal management purposes, and
- not be larger than an operating segment as defined by FRS 8 *Operating Segments* before aggregation (para 80).

FRS 136 provides that a cash-generating unit to which goodwill has been allocated should be tested for impairment annually and whenever there is indication that the unit may be impaired (para 90).

FRS 136 further provides that (para 96):

- 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, and
- if goodwill has been allocated to a cash-generating unit acquired during the current annual period, that unit should be tested for impairment before the end of the current annual period.

In the impairment test, if the recoverable amount of a cash-generating unit, to which goodwill has been allocated, exceeds the carrying amount of the unit, the unit and the goodwill allocated should be regarded as not impaired. However, if the carrying amount of the unit exceeds the recoverable amount of the unit, the entity should recognise the impairment loss (para 90).

As stated earlier, FRS 136 provides that an impairment loss for a cash-generating unit should be allocated to reduce the carrying amounts of the assets of the unit, first to reduce the carrying amount of any goodwill allocated to the cash generating unit, and then to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit (para 104).

Illustration 12

Facts:

In August 20×4, ABC Bhd pays RM15 million to acquire 100% interest in XYZ Bhd which has a manufacturing plant and a supermarket outlet.

Assume that the RM15 million is allocated as follows: RM5 million to the net identifiable assets of the manufacturing business, RM5 million to the net identifiable assets of the supermarket business, RM5 million as goodwill (of which RM3 million is attributable to the manufacturing business, and RM2 million to the supermarket business).

Assume that towards the end of 20×4, the supermarket business of XYZ Bhd was adversely affected because of the diversion of traffic, and the recoverable amount of the supermarket business is estimated at RM6 million. Assume further that the recoverable amount of the manufacturing business is more than RM8 million.

Treatment:

	Manufacturing RM	Supermarket RM	Total RM
Net assets	5,000,000	5,000,000	10,000,000
Goodwill	3,000,000	2,000,000	5,000,000
	8,000,000	7,000,000	15,000,000
Recoverable amount	>8,000,000	6,000,000	

In this case, since the recoverable amount of the supermarket business (RM6 million) is less than its carrying amount (RM7 million), an impairment loss of RM1 million on goodwill of the supermarket business has to be written off in 20×4.

¶3-800 Reversal of impairment loss

FRS 136 requires that an impairment loss recognised in prior years for an asset other than goodwill should be reversed if, and only if, there has been a change in the estimates used to determine recoverable amount since the last impairment loss was recognised (para 114).

Accordingly, similar to the requirement to assess, at each reporting date, whether there is any indication that an asset may be impaired, FRS 136 specifically provides that an entity should assess, at each reporting date, whether there is any indication that an impairment loss recognised in prior periods for an asset other than goodwill may no longer exist or may have decreased.

Examples of triggering indicators provided in paragraph 111 of FRS 136 are as follows:

External sources of information

- the asset's market value has increased significantly
- a significant positive change in the technological, market, economic or legal environment of the business in which the assets are employed
- a decrease in market interest rates that are likely to affect the discount rate used in calculating the asset's value in use and as a result materially increase the asset's recoverable amount

Internal sources of information

- a significant positive change in the use to which the asset is put eg. capital expenditure has been incurred to improve or enhance the asset's performance or costs have been incurred
- the economic performance of the asset is or will be better than expected eg. the actual cash flows generated by the asset are materially higher than was forecasted

If any of the above indicators exists, the entity should estimate the recoverable amount of the asset (para 110). If the recoverable amount is higher than the carrying amount, the carrying amount of the asset should be increased to its recoverable amount (subject to limits discussed below).

¶3-810 Reversal of impairment loss for an individual asset

In the case of an individual asset, an impairment loss is reversed only to the extent that it does not increase the carrying amount of an asset above the carrying amount that would have been determined (net of amortisation

or depreciation) had no impairment loss been recognised in prior years (para 117).

A reversal of an impairment loss should be recognised immediately in the income statement for assets carried at cost and treated as a revaluation increase for assets carried at revalued amount (para 119).

After a reversal of an impairment loss has been recognised, the depreciation (amortisation) charge for the asset should be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life (para 121).

Illustration 16

Facts:

Refer to the case of ABC Bhd in Illustration 3. Assume that in 20×3 the adverse publicity against product XYZ was found to be untrue and that the demand for product XYZ improved and was expected to remain at a high level (such that the recoverable amount of the machinery through the production and sale of product XYZ was expected to exceed RM5,000,000).

Treatment:

In this case, FRS 136 requires ABC Bhd to write back the carrying amount of the machinery previously written down.

The amount of write-back in 20×3 would be equal to the reinstatement of the RM3,000,000 previously written down, reduced by the amount of depreciation of RM750,000 that had not been provided for in 20×2 because of the write-down.

The journal entry required would be as follows:

Dr Accumulated impairment	3,000,000		
Cr Accumulated depreciation		750,000	
Cr Write-back of impairment loss		2,250,000	

	Without impairment		With impairment
	RM		RM
Carrying amount in 20×2	4,000,000	Carrying amount in 20×2	1,000,000
Depreciation	(1,000,000)	Depreciation	(250,000)
Carrying amount in 20×3	<u>3,000,000</u>	Carrying amount in 20×3	750,000
		Write-back required	<u>2,250,000</u>
		New carrying amount	<u>3,000,000</u>

As can be seen above, after the write-back, the machinery would be carried at a book value of RM3,000,000, as it would have been without the write-down in 20×2 and the subsequent write-back in 20×3. Also, the annual depreciation charge for 20×3 to 20×5 will be RM1,000,000 (RM3,000,000 / 3), as it would have been without the write-down and the write-back.

Calculation of the plant's value in use at the end of 20X2

Year	Future cash flows (RM'000)	Discounted at 14% (RM'000)
20X3	420 ¹	368
20X4	570 ²	439
20X5	380 ²	256
20X6	450 ²	266
20X7	510 ²	265
20X8	510 ²	232
20X9	480 ²	192
20X10	410 ²	144
VALUE IN USE		<u>2,162</u>

1. Excludes estimated restructuring costs because a liability has already been recognised.

2. Includes estimated benefits expected from the restructuring reflected in management budgets.

The plant's recoverable amount (value in use) is higher than its carrying amount. Therefore, K reverses the impairment loss recognised for the plant at the end of 20X0.

	RM
Carrying amount at end of 20X0	2,051,000
Less: Depreciation charge (20X1-20X2)	<u>(410,200)</u>
Carrying amount before reversal of impairment	<u>1,640,800</u>
Reversal of impairment loss	<u>521,200</u>
Carrying amount after reversal (equals to VIU)	<u>2,162,000</u>

Calculation of the reversal of the impairment loss at the end of 20X2:

	Historical RM'000	With impairment RM'000
Carrying amount at end of 20X0	3,000	3,000
Impairment loss	-	<u>949</u>
Carrying amount after impairment loss (VIU)	3,000	<u>2,051</u>
Remaining Useful Life	10 years	10 years
Depreciation/year	300	205.1
Depreciation charge for 2 years	<u>600</u>	<u>410.2</u>
Net book value at end of 20X2	<u>2,400</u>	1,640.8
Reversal of impairment loss		<u>521.2</u>
Adjusted carrying amount (VIU at end of 20X2)		<u>2,162##</u>

The reversal does not result in the carrying amount of the plant exceeding what its carrying amount would have been at depreciated historical cost of RM2,400,000. Therefore, the full reversal of the impairment loss of RM521,200 is recognised.

At the end of 20X3, there is a cash outflow of RM100,000 when the restructuring costs are paid. Even though a cash outflow has taken place, there is no change in the estimated future cash flows used to determine value in use at the end of 20X2. Therefore, the plant's recoverable amount is not calculated at the end of 20X3.

13-930 Appendix

Illustration - Treatment of future costs (based on FRS 136 example)

At the end of 20X0, entity F Bhd tests a machine for impairment. The machine is a cash-generating unit. It is carried at depreciated historical cost and its carrying amount is RM150,000. It has an estimated remaining useful life of 10 years.

The machine's recoverable amount (ie higher of value in use and fair value less costs to sell) is determined on the basis of a value in use calculation. Value in use is calculated using a pretax discount rate of 14 per cent.

Management approved budgets reflect:

- estimated costs necessary to maintain the level of economic benefit expected to arise from the machine in its current condition; and
- that in 20X4, costs of RM25,000 will be incurred to enhance the machine's performance by increasing its production capacity

At the end of 20X4, costs to enhance the machine's performance are incurred. Management reworks its budgets to take into account the expected increase in future cash flows as a result of the enhancement, discounted at the same rate of 14%.

At end of 20X0, the calculation of VIU is as follows:

Year	Future cash flows (RM)	Discounted at 14%(RM)
20X1	22,165 ¹	19,443
20X2	21,140 ¹	16,505
20X3	20,550 ¹	13,871
20X4	24,725 ^{1,2}	14,639
20X5	25,325 ^{1,3}	13,153
20X6	24,825 ^{1,3}	11,310
20X7	24,123 ^{1,3}	9,640
20X8	25,533 ^{1,3}	8,951
20X9	24,234 ^{1,3}	7,452
20X10	22,850 ^{1,3}	6,164
VALUE IN USE		<u>121,128</u>

1. Includes estimated costs necessary to maintain the level of economic benefit expected to arise from the machine in its current condition.
2. Excludes estimated costs to enhance the machine's performance reflected in management budgets.
3. Excludes estimated benefits expected from enhancing the machine's performance reflected in management budgets.

The machine's recoverable amount (value in use) of RM121,128 is less than its carrying amount of RM150,000. Therefore, F Bhd recognises an impairment loss for the machine.

fair value cannot be reliably measured, or on a derivative asset that is linked to and must be settled by delivery of such an unquoted equity instrument, the amount of the impairment loss is measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

Such impairment losses should not be reversed.

¶4-720 Financial assets carried at amortised cost

The amount of impairment loss should be included in net profit or loss for the period, and the carrying amount of the asset should be reduced to its estimated recoverable amount either directly or through use of an allowance account. The amount of the loss is the difference between the asset's carrying amount and its recoverable amount (para 63).

An entity must first assess whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant (see para 59). If an entity determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment, and for which an impairment loss is or continues to be recognised, are not included in a collective assessment of impairment.

Reversal

If in a subsequent period, the amount of the impairment decreases and the decrease can be objectively related to an event occurring after the write-down, such as improvement in the debtor's credit rating, FRS 139 requires reversal of the impairment loss to be included in the net profit or loss for the period. However, the reversal should not result in a carrying amount of the financial asset that exceeds what amortised cost would have been, had the impairment not been recognised, at the date the write down of the financial asset is reversed (para 65).

If this sounds familiar, please refer to the discussion on reversal of impairment for non-financial assets in earlier sections. The extent of reversal is also restricted so that the reversal will not result in a carrying amount that exceeds what the depreciated historical cost would be (see Illustration 16).

Illustration 4 (Financial assets carried at amortised cost)

Facts

Refer to Illustration 3 (HTM using effective interest rate method).

Assume that after paying the second interest payment on 31 December 20×2, the issuer of the bond announced that, due to financial difficulties, the coupon rate of the bond is to be reduced to 1% (instead of 6%) for each of the next three years, with no change to the face value of RM100,000. In this case, there is an impairment loss.

Treatment

The recoverable amount is to be calculated as the present value of the expected future cash flows (RM1,000 on 31 December 20×3 plus RM1,000 on 31 December 20×4 plus RM101,000 on 31 December 20×5) discounted at the original effective interest rate of 5%, which yields a figure of RM89,107.

Given that the book value of the bond as at 31 December 20×2 is RM102,723 (see Illustration 3), ABC Bhd has to charge an impairment loss of RM13,616 (RM102,723 - RM89,107) to its 20×2 profit and loss account as follows:

31/12/20X2			
Dr	Impairment loss	13,616	
Cr	Investment in HTM bonds		13,616

The journal entries for each of the next three years will be as follows:

31/12/20X3			
Dr	Cash (1% x RM100,000)	1,000	
Dr	Investment in HTM bond	3,455	
Cr	Interest income (5% x 89,107)		4,455

31/12/20X4			
Dr	Cash	1,000	
Dr	Investment in HTM bond	3,628	
Cr	Interest income (5% x [89,107+3,455])		4,628

31/12/20X5			
Dr	Cash	1,000	
Dr	Investment in HTM bond	3,810	
Cr	Interest income (5% x [89,107 + 3,455 + 3,628])		4,810

Dr	Cash	100,000	
Cr	Investment in HTM bond		100,000

(It should be noted that FRS 128 defines a subsidiary and an associate to include an unincorporated entity such as a partnership (para 2).)

¶6-200 Accounting at consolidation level

One needs to consider the issue of impairment:

- at the investor entity's own financial statements level, and
- at the consolidation level

At the investor entity's own financial statements level, the entity will compare its cost of investment with the recoverable amount. Similar to subsidiaries, depending on whether the associate is a quoted or unquoted entity, the investor will compute net FV or VIU as required (see ¶5-500)

At the consolidation level, one needs to understand the mechanism of equity accounting as FRS 128 stipulates that an investment in an associate should be accounted for in the consolidated statements under the equity method.

An exception to the above rule is when an investment in an associate is classified as "held for sale" in accordance with FRS 5 *Non-current Assets Held for Sale and Discontinued Operations*; in which case, it should be accounted for in accordance with FRS 5 (discussed in Chapter 11).

Further, when an investor ceases to have significant influence over an associate, FRS 128 provides that:

- it should discontinue the use of the equity method; instead, it should account for the investment in accordance with FRS 139 *Financial Instruments: Recognition and Measurement* from the date it ceases to have significant influence (para 18), and
- the carrying amount of the investment at the date that it ceased to be an associate should be regarded as its cost on initial measurement as a financial asset in accordance with FRS 139 (para 19).

Illustration 1

This is to illustrate the application of para 18 and 19 of FRS128.

Facts

Assume that P Bhd acquired 30% of A Bhd with net assets of RM1,000,000 in January 20×1 at a cost of RM300,000.

A Bhd made profits of RM100,000 and paid no dividends from January 20×1 to December 20×3. However, 60% of A Bhd was acquired by Z Bhd in December 20×3. Consequently, P Bhd ceased to have significant influence.

Treatment

In this case, P Bhd would use the equity method to account for its investment in A Bhd from January 20×1 to December 20×3 and thereafter use the mark-to-market method under FRS 139.

	RM
Cost of investment (x)	300,000
A Bhd's profits from Jan20×1-Dec20×3	100,000
Share of A Bhd's profits (30%)(y)	30,000
Carrying amount(x+y)	330,000

The amount of RM330,000 would be considered as the cost of the investment in A Bhd, the measurement of which will be guided by FRS 139.

¶6-300 Basic principles of equity accounting

Under the equity method of accounting, the investment account is initially recorded at cost but is subsequently periodically adjusted to take up the investor's proportionate share of the increase or decrease in the net assets of the associate. The investment income consists of the investor's proportionate share of the investee's periodic profit or loss.

However, there are two exceptions to the above general rule:

1) *Investor's share of losses of associate exceeds carrying amount of investment in associate*

As provided in paragraph 29 of FRS 128, if the investor's share of losses of the associate exceeds the carrying amount of the investment, the loss recognised is restricted to the carrying amount of the investment, and the investment account is reported at nil balance (in other words, the investment account should not be reported at credit balance). If the associate subsequently reports profits, the investor resumes including its share of those profits only after its share of the profits has made up for the share of the losses not recognised (para 30).

Illustration 2

Facts

P Bhd held a 30% interest in B Bhd and significant influence can be demonstrated. The carrying amount of the investment in B Bhd as at 1 January 20×7 was RM100,000.

For the year ended 31 December 20×7, B Bhd reported a loss of RM400,000. Subsequently, B Bhd reported a profit of RM500,000 for the following year ended 31 December 20×8.

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Impairment loss	120	-	(a)120	-
Share of loss	-	-	(b)100	100
PBT	280	16		316
Tax	80	6		86
PAT	200	10		230
MI	-	-	(e)4	4
Profit	-	-		226
Dividend	100	-		100
RP for year	100	10		126
BRP	400	-	(c)20	380
ERP	500	10		506
Share capital	200	100	(d)60	200
			(f)40	
			(e)4	44
MI	-	-	(f)40	
Inv in S	60	-	(d)60	-
Inv in A	80	-	(a)120	80
			(c)20	
Net assets	560	110		670

(III) Consolidated accounts

P Bhd and its subsidiary**Consolidated profit and loss account****For the year ended 31 December 20x8**

	RM'000	
Sales	1,000	
Less : COS	(340)	
Gross profit	660	
Less: Operating expenses	(244)	
Operating profit	416	
Less: Share of loss of associate	(100)	
Profit before Tax	316	
Less Tax:		
Group	(86)	
Associate	0	
Profit after tax	230	

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Attributable to:	
Equity holders of parent	226
Minority interest	<u>4</u>
	<u>230</u>
Notes to accounts:	
Beginning retained profit	380
Add profit for the year	226 ⁽²⁾
Less: dividend	<u>(100)</u>
Ending retained profit	<u>506⁽³⁾</u>

P Bhd and its subsidiary**Consolidated balance sheet****As at 31 December 20x8**

	RM'000
Share capital	200
Retained profit	506
Minority interest	<u>44</u>
	<u>750</u>
Investment in associate	80 ⁽⁴⁾
Other net assets	<u>670</u>
	<u>750</u>

Notes to the solution:

- (1) CJE (a) is to reverse out the impairment loss accrued by the parent so as to avoid double counting the loss.
- (2) The group profit of RM226,000 may be proved as follows:

	RM
P Bhd's profit after tax	200,000
Add back: Impairment loss on A Bhd	<u>120,000</u>
Adjusted profit	320,000
Add: Share of S Bhd's after tax profit (60% x RM10,000)	6,000
Less: Share of A Bhd's after tax loss (40% x RM250,000)	<u>(100,000)</u>
Group after tax profit	<u>226,000</u>

Chapter 9

INVESTMENT PROPERTY (FRS 140)

Definition and basis of measurement	¶9-100
Cost model	¶9-200
Fair value model	¶9-300

¶9-100 Definition and basis of measurement

Investment property is defined in FRS 140 as property (namely, land or building) held to earn rentals or for capital appreciation or both, rather than for use in the business or for sale in the ordinary course of business (para 5).

FRS 140 requires an investment property to be measured at cost upon initial recognition (para 20).

However, subsequent to initial recognition, an entity is allowed to choose either the cost model or the fair value model as its accounting policy and should apply that policy to all investment properties (para 30). An entity is effectively disallowed to change from fair value model to cost model.

¶9-200 Cost model

If an entity chooses the cost model, it should measure all its investment properties in accordance with FRS 116 *Property, Plant and Equipment* requirements for assets carried at cost.

Under FRS 116, assets may be carried at cost or revalued an amount.

Besides subjecting assets to depreciation, FRS 116 also requires assets to be subjected to the impairment test in accordance with the provisions of FRS 136.

As discussed earlier, any impairment loss arising should be charged to income immediately, unless it reverses a previous revaluation (in which case it should be charged to the revaluation reserve account). Thus, under the cost model, an investment property should be carried at cost less accumulated depreciation and less accumulated impairment.

Illustration 1

Facts

ABC Bhd (the company) is a computer manufacturer. It adopts a 31 December accounting year-end, and the straight line method of depreciation.

On 1 January 20x1, the company uses its excess cash to buy a factory for investment purposes. The factory is rented out to another manufacturer. The factory costs RM50,000,000, and is expected to have a useful life of 50 years with no salvage value.

Treatment

In this case, the factory should therefore be accounted as investment property under FRS 140. If the company chooses to use the cost model, the investment property will be carried at cost and subject to depreciation (and impairment). The relevant journal entries for the first two years will be as follows:

1/1/20x1	Dr	Investment property	50,000,000	
	Cr	Cash		50,000,000
		(purchase of a factory for investment purposes)		
31/12/x1	Dr	Depreciation expense	1,000,000	
	Cr	Accumulated depreciation		1,000,000
		(depreciation charge for the year)		
31/12/x2	Dr	Depreciation expense	1,000,000	
	Cr	Accumulated depreciation		1,000,000
		(depreciation charge for the year)		

¶9-300 Fair value model

If an entity chooses the fair value model, it should measure all its investment properties at fair value (except for those whose fair value cannot be reliably determined on a continuing basis under para 53).

Under the fair value model, the investment property is measured at its fair value, reflecting the market conditions at the balance sheet date (para 38). A gain or loss arising from a change in the fair value is recognised in profit or loss for the period in which it arises (para 35).

It may be noted that, under the fair value model, there is no need for depreciation, and no need for impairment testing.

Chapter 10

INTANGIBLE ASSETS (FRS 138)

Impairment of assets ¶10-100

¶10-100 Impairment of intangible assets

Paragraph 111 of FRS 138 *Intangible Assets* states that an entity should apply FRS 136 to determine whether an intangible asset is impaired.

FRS 138 differentiates intangible assets with finite useful lives from those with indefinite useful lives. The former are subject to amortisation and an impairment test is carried out only when, in accordance with FRS 136, there is an indication that the assets are impaired.

On the other hand, intangible assets with indefinite useful lives should not be amortised but, as explained in 3-200, should be tested for impairment annually and whenever there is an indication that the intangible asset may be impaired.

The impairment test for intangible assets may be performed at any time during an annual period, provided it is conducted at the same time every year. Different intangible assets may be tested for impairment at different times. In the event the intangible asset was initially recognised during the current annual period, that intangible asset must be tested before the end of the current annual period.

However, FRS 136 allows a concession, where the most recent detailed calculation of recoverable amount may be used in the impairment test in the current period, provided:

- if the asset is part of a CGU, the assets and liabilities comprising the CGU have not changed significantly since the most recent calculation of recoverable amounts
- the previously calculated recoverable amount exceeded the carrying amount by a substantial margin, and
- the likelihood that an updated calculation of the recoverable amount would be less than the carrying amount is remote.

Chapter 11

NON-CURRENT ASSETS HELD FOR SALE (FRS 5)

Classification ¶11-100
Measurement ¶11-200

¶11-100 Classification

A specific standard, FRS 5, was issued to deal with the measurement of assets (and disposal groups) that are held for disposal and the presentation and disclosures of discontinued operations.

FRS 5 requires an entity to classify a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use.

FRS 5 supplements this principle with a series of criteria that must be met:

- the asset (or disposal group) is available for immediate sale in its present condition, and
- the sale must be deemed to be highly probable, which the standard defines as "significantly more likely than probable"

¶11-200 Measurement

On initial classification as held for sale, non-current assets (or disposal groups) are measured at the lower of carrying amount and fair value less costs to sell.

FRS 5 provides that immediately before the initial classification of a non-current asset (or a disposal group) as held for sale, the carrying amount of the asset (or of all the assets and liabilities in the disposal group) should be measured in accordance with the applicable FRS eg FRS 116 *Property, Plant and Equipment* and FRS 102 *Inventories*.

On subsequent remeasurement of a disposal group, the carrying amounts of any assets and liabilities included in a disposal group that are not within the measurement requirements of FRS 5 should be remeasured in accordance with those applicable FRSs before the fair value less costs to sell of the disposal group is measured (para 19).

Business 2					
Item D	100	140	100		
Item E	170	150	150		
Sub total	270	290		270	
Total	770	750#	700	730	750#

Hence, writing down inventories to net realisable value on an "item by item" basis will yield an inventory valuation of RM700. On the bases of "class of business" and "entire inventory", the inventories are valued at RM730 and RM750 respectively. In accordance with the requirement of FRS 102, the ending inventories of XYZ Bhd should be reported at RM700.

Illustration 2

This illustration demonstrates how the practice of writing inventories down based on a class of inventory, a class of business, or an overall basis results in offsetting losses incurred against unrealised gains.

Based on the data in Illustration 1 above, the losses incurred and the unrealised gains for each item of inventories may be computed as follows:

	Cost	NRV	Losses incurred	Unrealised gains
	RM	RM	RM	RM
Business 1				
Item A	190	170	20	
Item B	180	190		10
Item C	130	100	30	
Business 2				
Item D	100	140		40
Item E	170	150	20	
Total	770	750	70	50

The figure of RM700 obtained by writing down inventories "item by item" in Illustration 1 may also be arrived at by deducting all losses incurred of RM70 from the historical cost of RM770.

On the other hand, the figure of RM750 obtained under the basis of "entire inventory" in Illustration 1 is equal to the historical cost of RM770 less losses incurred of RM70 plus unrealised gains of RM50.

Also, the figure of RM730 obtained under "class of business" in Illustration 1 is equal to the historical cost of RM770 less losses incurred of RM50 (the loss of RM20 on Item E in Business 2 is ignored) plus unrealised gain of RM10 on Item B in Business 1.

Thus, in the determination of the lower of cost and net realisable value of inventories, under the "item by item" basis, only losses incurred are accounted for. However, under the "class of business" or "entire inventory" bases, losses incurred are offset by unrealised gains. Moreover, under the "class of business" basis, some of the losses may not be taken into account.

¶12-300 Reinstatement of cost

As mentioned earlier, FRS 102 provides for the net realisable value of an item of inventory to be reassessed in each subsequent period. When the circumstances that previously caused inventories to be written down below cost no longer exist, FRS 102 requires the amount of write-down to be reversed, so that the new carrying amount is the lower of the cost and the revised net realisable value (para 34). This is effectively similar to the principle of reversing impairment losses allowed under FRS 136.

Illustration 3

Facts

Assume that F Bhd bought a piece of stock for RM100 in October 20×1. The company's accounting year ends on 31 December 20×1.

The piece of stock is still on hand at the end of 20X1 and in 20X2 and its NRV is estimated at RM70.

In this case, for the 20×1 financial statements, the inventory has to be written down and carried at RM70.

Assume further that this piece of inventory is still on hand as at 31 December 20×2 and its net realisable value is now estimated to be RM90.

Treatment

In accordance with the provision of paragraph 34, the piece of stock should be reinstated to its carrying amount of RM90 (at lower of cost of RM100 and net realisable value of RM90).

	Cost/carrying amount	Loss(written off) /back	NRV
Year end 31/12/20X1	RM100	(RM30)	RM70
Year end 31/12/20X2	RM70	RM20	RM90

If the net realisable value of the inventory is estimated to be RM110 as at 31 December 20×2, it will be stated at RM100, in accordance with the provision of paragraph 34 and the lower of cost and net realisable value rule.

25%, ABC Bhd will therefore carry a deferred tax liability of RM20,000 (instead of RM50,000) in its balance sheet as at 31 December 20x1.

	Without impairment	With impairment
	RM	RM
Cost at 1/1/20x1	300,000	300,000
Less: Depreciation	(100,000)	(100,000)
Less: Impairment	Nil	(120,000)
Carrying amount at 31/12/20x1	<u>200,000</u>	<u>80,000</u>
Tax base	Nil	Nil
Taxable temporary difference	<u>200,000</u>	<u>80,000</u>
Deferred tax liability @25%	50,000	20,000

Illustration 2

Facts:

Refer to Illustration 1. Instead of accelerated capital allowances, assume the tax laws allow an initial allowance of 20% and an annual allowance of 20%. The tax base of the computer is therefore RM180,000 (60% x RM300,00)

As at 31 December 20x1, the computer is damaged and its recoverable amount is estimated at RM80,000.

Treatment:

	RM
Cost at 1/1/20x1	300,000
Less: Depreciation	(100,000)
Less: Impairment	(120,000)
Carrying amount at 31/12/20x1	<u>80,000</u>
Tax base	180,000
Deductible temporary difference	<u>(100,000)</u>
Deferred tax asset @25%	(25,000)

(Note: In accordance with FRS 112 *Income Taxes*, an entity recognises a deferred tax asset only to the extent that it is probable that taxable profits will be available against which the deductible temporary difference can be utilised.)

Chapter 15

SOME PRACTICAL ISSUES

Introduction to some practical issues	¶15-100
Goodwill written against reserves	¶15-200
Impairment of investment in equity instrument categorised as available-for-sale financial asset due to "significant or prolonged" decline in fair value	¶15-300

¶15-100 Introduction to some practical issues

FRSs are formulated with the aim to cater for all situations. However, there may be occasions where the application of FRSs hits a snag due to local laws/practices. The following paragraphs discuss a couple of such issues that has been identified and the suggested solutions.

¶15-200 Goodwill written against reserves

In Malaysia, companies may apply to the court for approval under sec 64 of the *Companies Act 1965* to reduce their share capital (capital reduction) and share premium. There have been cases in the past where courts have approved the writing off of goodwill directly against the companies' reserves. In those cases, the companies would quite often write off goodwill directly against their share premium account.

FRS 136 very clearly requires the impairment of goodwill to be charged to the income statement and does not permit the impairment of goodwill to be directly charged against reserves.

It would not be legally wrong for a company to charge the impairment of goodwill directly against its reserves if it has obtained the court's approval pursuant to s 64 of the *Companies Act 1965*. However, for financial reporting purposes, such treatment does not comply with FRS 136.

In order to comply with FRS 136 as well as to charge impairment of goodwill against reserves as sanctioned by the court's approval, the company should firstly charge the impairment to the income statement and make a transfer (of the amount of impairment) from retained earnings to a share premium account. Such a transfer should be disclosed in the Statement of Changes in

Chapter 16

DISCLOSURE REQUIREMENTS

Introduction to disclosure requirements	¶16-100
Disclosure requirements of FRS 136	¶16-200
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Illustration: Disclosure about cash-generating units with goodwill or intangible assets with indefinite useful lives	¶16-900

¶16-100 Introduction to disclosure requirements

Whilst the mechanics of identifying impaired assets, computing impairment loss and exercising judgement in estimating cash flows to compute value in use are challenging, compliance with the disclosure requirements of FRSs is equally important and can also be challenging at times as the disclosure requirements may not be contained in one single FRS. Practically, many preparers refer to published financial statements of public listed companies as a guide. Alternatively, they usually have their external auditors to help.

¶16-200 Disclosure requirements of FRS 136

Impairment loss

For each class of assets, FRS 136 requires the following to be disclosed:

- the amount of impairment losses recognised in profit or loss during the period and the line item(s) of the income statement in which those impairment losses are included, and
- the amount of impairment losses recognised directly in equity during the period

Reversal of impairment

Similarly for each class of asset, the following should be disclosed:

- the amount of reversal of impairment losses recognised in profit or loss during the period and the line item(s) of the income statement in which those impairment losses are reversed, and
- the amount of reversal of impairment losses recognised directly in equity during the period

¶16-300 Additional disclosure requirements of FRS 136

If impairment losses or reversals are material

If an impairment loss for an individual asset or a cash-generating unit is recognised or reversed during the period and is **material** to the financial statements of the reporting entity as a whole, FRS 136 requires additional disclosures as follows (para 130):

- the events and circumstances that led to the recognition or reversal of the impairment loss
- the amount of the impairment loss recognised or reversed
- for an individual asset:
 - the nature of the asset, and—if the entity reports segment information in accordance with FRS 8 *Operating Segments*, the reportable segment to which the asset belongs;
- for a cash-generating unit:
 - a description of the cash-generating unit (such as whether it is a product line, a plant, a business operation, a geographical area or a reportable segment as defined in FRS 8)
 - the amount of the impairment loss recognised or reversed by class of assets and, if the entity reports segment information in accordance with FRS 8, by reportable segment, and
 - if the aggregation of assets for identifying the cash-generating unit has changed since the previous estimate of the cash-generating unit's recoverable amount (if any), the entity should describe the current and former way of aggregating assets and the reasons for changing the way the cash-generating unit is identified

APPENDICES

ILLUSTRATIVE NOTES FROM FINANCIAL STATEMENTS OF SELECTED PLCs IN MALAYSIA

United Malacca Berhad (Plantation)	¶17-100
Maybank (Financial services)	¶17-200
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Media Prima Berhad (Commercial television and radio broadcasting, media-advertising)	¶17-800

¶17-100 PLC: United Malacca Berhad

Principal activity: Plantation

Financial year end: 30 April 2011

Accounting policy on impairment

Note 2.9 Impairment of other non-financial assets

The Group assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when an annual impairment assessment for an asset is required, the Group makes an estimate of the asset's recoverable amount.

An asset's recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (CGU).

In assessing value in use, the estimated future cash flows expected to be generated by the asset are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Where the carrying amount of an asset exceeds its recoverable amount, the asset is written down to its recoverable amount. Impairment losses recognised in respect of a CGU or groups of CGU are allocated first to reduce the carrying amount of any goodwill allocated to those units or groups of units and then, to reduce the carrying amount of the other assets in the unit or groups of units on a pro-rata basis.

Impairment losses are recognised in profit or loss except for assets that are previously revalued where the revaluation was taken to other comprehensive income. In this

case the impairment is also recognised in other comprehensive income up to the amount of any previous revaluation.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increase cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised previously. Such reversal is recognised in profit or loss unless the asset is measured at revalued amount, in which case the reversal is treated as a revaluation increase.

Note 2.13 Impairment of financial assets

The Group and the Company assess at each reporting date whether there is any objective evidence that a financial asset is impaired.

(a) Available-for-sale financial assets

Significant or prolonged decline in fair value below cost, significant financial difficulties of the issuer or obligor, and the disappearance of an active trading market are considerations to determine whether there is objective evidence that investment securities classified as available-for-sale financial assets are impaired.

If an available-for-sale financial asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortisation) and its current fair value, less any impairment loss previously recognised in profit or loss, is transferred from equity to profit or loss.

Impairment losses on available-for-sale equity investments are not reversed in profit or loss in the subsequent periods. Increase in fair value, if any, subsequent to impairment loss is recognised in other comprehensive income. For available-for-sale debt investments, impairment losses are subsequently reversed in profit or loss if an increase in the fair value of the investment can be objectively related to an event occurring after the recognition of the impairment loss in profit or loss.

(b) Unquoted equity securities carried at cost

If there is objective evidence (such as significant adverse changes in the business environment where the issuer operates, probability of insolvency or significant financial difficulties of the issuer) that an impairment loss on financial assets carried at cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment losses are not reversed in subsequent periods.

(c) Trade and other receivables and other financial assets carried at amortised cost
To determine whether there is objective evidence that an impairment loss on financial assets has been incurred, the Group and the Company consider factors such as

Note on movement in impaired loans, advances and financing

11. LOANS, ADVANCES AND FINANCING				
(vi) Movement in impaired loans, advances and financing ("impaired loans") (2010: "non-performing loans) are as follows:				
Movements in impaired loans advance and financing				
	Group		Bank	
	2011	2010	2011	2010
	RM'000	RM'000	RM'000	RM'000
At 1 July				
– as previously stated	6,186,320	6,715,232	4,639,731	5,036,313
– effect of adopting FRS 139	3,772,543	–	3,189,043	–
At 1 July, as restated	9,958,863	6,715,232	7,828,774	5,036,313
Impaired during the year	5,929,985	4,622,381	3,211,874	2,795,711
Reclassified as performing	(2,730,159)	(2,190,759)	(1,677,728)	(1,525,988)
Recovered during the year	(2,004,428)	(1,430,570)	(1,420,027)	(874,761)
Amount written off	(2,610,648)	(1,682,059)	(1,624,278)	(925,144)
Converted to securities	(37,863)	–	(37,863)	–
Amount transferred from other debts	–	97,095	–	97,095
Exchange differences and expenses debited	89,751	55,000	96,744	36,505
Acquisition of subsidiaries	161,361	–	–	–
At 30 June	8,756,862	6,186,320	6,377,496	4,639,731
Less:				
– Individual allowance on impaired loans	(2,932,129)	–	(2,115,897)	–
Less:				
– Specific allowance on non-performing loans	–	(3,864,832)	–	(2,842,531)
on performing loans	–	(3,619,792)	–	(2,602,091)
	–	(245,040)	–	(240,440)
Net impaired loans, advance and financing	5,824,733	2,321,488	4,261,599	1,797,200
Net loans advances and financing				
Gross loans, advances and financing	261,179,763	213,258,440	186,868,514	157,078,873
Add: Islamic loans sold to Cagamas	682,679	1,137,321	–	–
	261,862,442	214,395,761	186,868,514	157,078,873
Less:				
– Individual allowance	(2,932,129)	–	(2,115,897)	–
Less:				
– Specific allowance	–	(3,864,832)	–	(2,842,531)
Net loans, advances and financing (including Islamic loans sold to Cagamas)	258,930,313	210,530,929	184,752,617	154,236,342

(vi) Movement in impaired loans, advances and financing ("impaired loans") (2010: "non-performing loans) are as follows: (cont'd)

Ratio of net impaired loans (2010: non-performing loans)

	Group		Bank	
	2011	2010	2011	2010
Post FRS 139	2.25%	–	2.31%	–
Pre FRS 139				
– Including specific allowance on performing loans	–	1.10%	–	1.17%
– Excluding specific allowance on performing loans	–	1.22%	–	1.32%
(vii) Impaired (2010: non-performing) loans, advances and financing by economic purpose are as follows:				
	Group		Bank	
	2011	2010	2011	2010
	RM'000	RM'000	RM'000	RM'000
Purchase of securities	116,667	47,268	82,257	39,213
Purchase of transport vehicles	276,671	239,296	111,271	131,263
Purchase of landed properties				
– Residential	1,277,777	1,754,048	1,058,965	1,391,121
– Non-residential	290,538	331,100	264,828	300,608
Personal use	126,271	168,062	111,542	137,982
Credit card	77,764	68,790	53,642	50,203
Purchase of consumer durables	1,163	1,635	1,159	1,632
Construction	523,361	511,676	433,545	415,140
Working capital	5,575,238	2,824,549	3,996,647	2,057,314
Others	491,412	239,896	263,640	115,255
	8,756,862	6,186,320	6,377,496	4,639,731