

Chapter 1 Property – PPE

Introduction

This chapter focuses on non-current assets acquired to be used in ordinary course of business for more than one year. As these assets are expected to be used for more than one reporting period, we have to consider the models to measure the carrying value of these assets. Details of depreciation and impairment loss will also be discussed in this chapter to demonstrate the ways to allocate the cost over the useful life and ensure the asset are fairly recognised in the financial statements.

HKAS 16 Property, Plant and Equipment

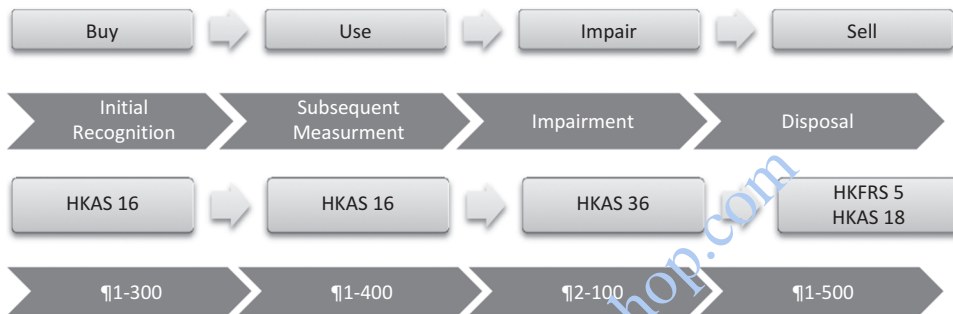
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Flow chart



HKAS 16 Property, Plant and Equipment

¶11-100 Types and examples of non-current assets

Types and examples of non-current assets are as follows:

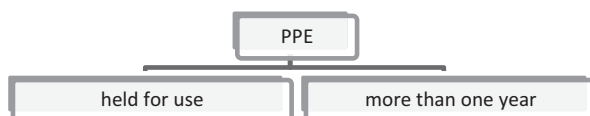
Details	Type	The relevant standard	Chapter
Property, plant and equipment: e.g. building, machinery and motor vehicle used for own business.	Tangible	HKAS 16 Property, Plant and Equipment	1
Investment properties: e.g. 1. building given on rent; 2. plot of land held for capital appreciation only	Tangible	HKAS 40 Investment Property	2
Property, plant and equipment classified as held for sale	Tangible	HKFRS 5 Non-current Assets Held for Sale and Discontinued Operations	6
Property constructed on behalf of third parties	Tangible	HKAS 11 Construction Contracts	14

¶1-200 Definitions

[HKAS 16:6]

Property, plant and equipment are tangible items that are:

- (a) **held for use** in the production or supply of goods or services, for rental to others, or for administrative purposes; and
- (b) expected to be used during **more than one period**.



¶1-310 Initial Recognition

An item of property, plant and equipment shall be recognised in the statement of financial position as assets when:

- (a) It is possible that **future economic benefits** associated with the asset will flow to the entity.
- (b) The entity can **measure** the cost of the asset **reliably**.

¶1-320 Initial Measurement

[HKAS 16:17]

Once an item of property, plant and equipment qualifies for recognition as an asset, it shall be measured at cost initially.

The standard lists the components of the cost of an item of property, plant and equipment.

- (a) **Purchase price**, deduct any trade discount or rebate.
- (b) **Import duties** and non-refundable purchase taxes.
- (c) **Directly attributable costs** of bringing the asset to working condition for its intended use, for example:
 - Cost of employee benefits arising directly from the construction or acquisition of the item of property, plant and equipment;
 - Initial delivery and handling costs;
 - Installation and assembly costs;
 - Cost of testing;
 - Professional fees (architects, engineers).

- (d) **Initial estimate of the unavoidable cost** of dismantling and removing the asset and restoring the site on which it is located (**HKAS 37** Provisions, Contingent Liabilities and Contingent Assets)
- (e) Any **borrowing costs** incurred related to building the asset may be capitalised within the assets too (**HKAS 23** Borrowing Costs)

[HKAS 16:19]

Examples of costs that shall **not** be capitalised as property, plant and equipment are:

- Costs of developing a new facility;
- Costs of promoting a new product or service (including costs of advertising and promotional activities);
- Costs of opening business in a new location or with a new class of customer (including costs of staff training); and
- Administration and other general overhead.

Example 1 (Initial measurement of PPE)

A machine was acquired by Fred Co. on 1 January 2012 of below details:

	\$
Manufacturer's listed price	1,575,000
Trade discount – applicable to listed price – 20%	
Early settlement discount taken on listed price – 5%	
Freight charges	45,000
Electrical installation cost	42,000
Staff training costs for use of machine	60,000
Pre-production testing	33,000
Purchase of a three-year maintenance contract	90,000
Estimated costs of disposal	30,000

Required

Calculate the amount recognised on 1 January 2012.

Solution

	\$
Manufacturer's listed price	1,575,000
Trade discount ($\$1,575,000 \times 20\%$)	(315,000)

	\$
Early settlement discount ($\$1,575,000 \times 5\%$)	(78,750)
Freight charges	45,000
Electrical installation cost	42,000
Pre-production testing	33,000
Estimated costs of disposal*	<u>30,000</u>
	<u>1,331,250</u>

Staff training cost shall be recognised in profit or loss. The payment for the three-year maintenance contract shall be recognised as prepayment in SOFP on the date of acquired and then recognised as maintenance expense in profit or loss proportionally at the year end.

*Estimated cost of disposal is an unavoidable cost, it shall be recognised as cost of the asset in according with HKAS 37:

Dr	Machine	\$30,000
	Cr	Provisions
		\$30,000

¶1-330 Application to specific types of asset

Small separate assets

Although HKAS 16 provides criteria that must be met in order for an item of property, plant or equipment to be recognised as an asset, it does not prescribe a unit of measurement for recognition i.e. what value an item should have in order to be recognised as an asset rather than expensed.

Smaller items, such as tools, dies and moulds, are sometimes classified as consumables and written off as an expense. Where these are classified as property, plant and equipment, it is usual to aggregate similar items together and treat them as one.

Spare parts and stand-by equipment

Spare parts, stand-by equipment and servicing equipment are recognised as property, plant and equipment when they meet the definition of property, plant and equipment. Otherwise they are classified as inventory.

Safety and environmental equipment

When items of safety and environmental equipment are acquired they will qualify for recognition where they enable the entity to obtain future economic benefits from related assets in excess of those it would obtain otherwise. The recognition will only be to the extent that the carrying amount of the asset and related assets does not exceed the total recoverable amount of these assets.

Complex assets

For very large and specialised items, an apparently single asset should be broken down into its composite parts. This occurs where the different parts have different useful lives and different depreciation rates are applied to each part, e.g. an aircraft, where the body and engines are separated as they have different useful lives. Expenditure incurred in replacing or renewing a component of an item of property, plant and equipment must be recognised in the carrying amount of the item (and then depreciated to the next replacement date).

Inspections and overhauls

Certain assets require periodic overhauls or inspections in order to operate. The cost of these overhauls/inspections should be included in the carrying amount of the relevant asset and depreciated as a separate element of the asset to the date of the next overhaul/inspection.

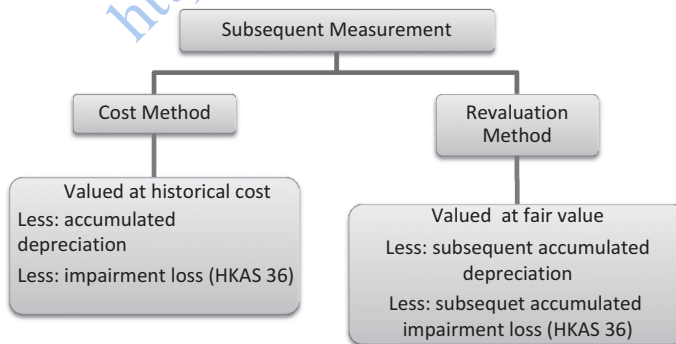
¶11-410 Subsequent Measurement

[HKAS 16:30,31]

HKAS 16 provides two possible treatments, you are required to choose between keeping an asset recorded at cost or revaluing it to **fair value**.

- Cost model:** Carry the asset at its cost deducts any accumulated depreciation and any accumulated impairment losses.
- Revaluation model:** Carry the asset at a revalued amount, being its fair value at the date of the revaluation deducts any subsequent accumulated depreciation and subsequent accumulated impairment losses. The standard makes clear that the **revaluation model is available only if the fair value of the item can be measured reliably**.

Summary of models



The entity should apply that policy to an **entire class** of property, plant and equipment. **Selective application** to certain assets of a class is **not permitted**.

¶1-420 Depreciation

Depreciation is a systematic allocation of the depreciable amount (cost of an asset less residual value) of an asset over its useful life.

Since a non-current asset has a cost and a limited useful life, and its value eventually decreases, the entity should make a charge in profit or loss to reflect the use that is made by the asset. This charge is known as depreciation. Depreciation must be charged even where an asset appears to be increasing in value over time.

Depreciation was usually treated as an expense, but not where it absorbs the entity in the process of producing other assets. For example, depreciation of plant and machinery would be incurred in the production of goods for sale (inventory items). In such condition, the cost of the new assets produced includes the depreciation.

Depreciation should be commenced when an asset is available for use. In other words, it is in the location and condition necessary for ordinary use.

Depreciation methods

[HKAS 16:60,62]

The standard requires the depreciation method used to reflect the pattern in which the entity expected to consume the asset's future economic benefits. A variety of methods are available and these include the straight line method, the diminishing balance method and the units of production method.

Straight line method: results in a constant annual depreciation charge. This method simply spreads the depreciable amount evenly over the useful life.

Diminishing balance method: results in a higher depreciation charge in the earlier years of an asset's useful life and a lower charge in later years. The depreciation is calculated as a constant percentage of an asset's carrying amount.

The units of production method: results in a charge based on expected output. The charge is therefore higher in periods of higher output and lower when there is a lower output.

Consistency is important. The entity should apply the depreciation method selected consistently from period to period unless altered circumstances justify a change. Where there is a change in method, the entity should quantify and disclose the effect and state the reason for the change. Change of policy is not allowed simply because of the profitability situation of the entity.

The IASB issued Clarification of Acceptable Methods of Depreciation and Amortisation (Amendments to IAS 16 and IAS 38) in May 2014. This is to be adopted by HKICPA and so result in amendments to HKAS 16 and HKAS 38.

The amendments clarify that depreciation methods must reflect a pattern of consumption of economic benefits from an asset rather than a pattern of generation of economic benefits by an asset. Therefore a revenue-based method of depreciation is not allowed.

A revenue-based method of depreciation is a method whereby the depreciation charge in a given year is calculated based on the revenue earned in that year as a proportion of total revenues expected to be generated by the asset over its useful life.

Useful life

[HKAS 16:56,57]

The useful life of a depreciable asset depends on the following factors:

- Expected **physical wear and tear**;
- **Obsolescence**;
- Legal or other **limits** on the use of the assets.

Residual value

[HKAS 16:53]

The residual value of an asset is **immaterial** in most instances. However, if the residual value is expected to be significant, the entity must estimate the residual value at the date of acquisition or at any subsequent revaluation.

Example 2 (Depreciation calculation)

Betty Co. acquired a machine on 1 January 20x1 on the following terms:

	Machine Hour	\$000
Initial cost of machine		1,575
Estimated life in machine hours	9,000	
Hours used in the year ended 31 December 20x1	1,800	
Hours used in the year ended 31 December 20x2	2,700	
Hours used in the year ended 31 December 20x3	1,275	

Required

Calculate the depreciation charge for the first year, second year and third year using:

- a) Straight line method (assume the useful life is 10 years);
- b) Diminishing balance method (assume the depreciation charge at 20%);
- c) Units of production method.

Solution

(a) Straight line method

Depreciation charge for the year ended 31 Dec 2011, 2012 and 2013:

$$= \$1,575,000 / 10 = \$157,500$$

(b) Diminishing balance method

Depreciation charge for the year ended 31 Dec 2011:

$$= \$1,575,000 \times 20\% = \$315,000$$

Depreciation charge for the year ended 31 Dec 2012:

$$= (\$1,575,000 - \$315,000) \times 20\% = \$252,000$$

Depreciation charge for the year ended 31 Dec 2013:

$$= (\$1,575,000 - \$315,000 - \$252,000) \times 20\% = \$201,600$$

(c) Units of production method

Depreciation charge for the year ended 31 Dec 2011:

$$= \$1,575,000 \times 1,800 / 9000 = \$315,000$$

Depreciation charge for the year ended 31 Dec 2012:

$$= \$1,575,000 \times 2,700 / 9000 = \$472,500$$

Depreciation charge for the year ended 31 Dec 2013:

$$= \$1,575,000 \times 1,275 / 9000 = \$223,125$$

Review of useful life and residual value

[HKAS 16:51]

The entity shall review the **useful life and residual value** of property, plant and equipment **at least at the end of each financial year**. The depreciation charge for the current and future periods should be adjusted if the change of expectation is significantly different from previous estimates.

Changing useful life or residual value are treated as changes in accounting estimates and are accounted for prospectively as adjustments to future depreciation. (HKAS 8)

Changes in accounting estimates will be discussed in more detail in chapter 10.

Example 3 (Review of useful life)

A machine costs \$200,000 and has a useful life of 20 years since its acquisition on 1 January 20x1. At the end of the second year of use, the asset is assessed to have a remaining useful life of ten years. The company adopts the straight line depreciation method.

What will be the depreciation charge for 20x3?

Solution

	\$
Original cost	200,000
Depreciation 20x1-20x2 ($\$200,000 \times 2/20$)	<u>(20,000)</u>
Carrying amount on 1 January 20x3	<u>180,000</u>

Remaining life = 10 years

Depreciation charge for 20x3 ($\$180,000/10$) = \$18,000

¶1-430 Revaluation

[HKAS 16:31]

Where an entity chooses to apply the revaluation model to property, plant and equipment, the revalued assets shall be carried at a revalued amount deduct any subsequent depreciation and impairment losses. Revalued amount is the fair value of the asset at the date of revaluation.

HKFRS 13 requires the entity to consider the following in determining fair value:

- ▶ The asset being measured.
- ▶ The **principal market** (the market with the greatest volume and level of activity) or where there is no principal market, the **most advantageous market** (that the asset can achieve the best price) in which an orderly transaction would take place for the asset
- ▶ The **highest and best use of the asset** and whether it is used on a standalone basis or in conjunction with other assets.
- ▶ Assumptions used by the market participants for pricing the asset while considering the above factors.

HKFRS 13 provides a hierarchy of inputs for arriving at fair value. It requires the entity to use level 1 input where possible:

Level 1	Quoted prices in active markets for identical assets that the measurement date could be accessed by the entity.	✓ ✓ ✓
Level 2	Inputs other than quoted prices that are directly or indirectly observable for the asset.	✓ ✓
Level 3	Unobservable inputs for the asset.	✓

Frequency of revaluations

[HKAS 16:34]

Valuations must keep up to date so that the carrying amount of a revalued asset does not differ materially from its fair value. In some cases, revaluation is necessary annually, whereas in others it might be necessary to revalue the item only every three or five years.

Accounting for a revaluation

[HKAS 16:39,40]

PPE is carried at fair value less accumulated depreciation less impairment loss. Any gain on the PPE is credited to Revaluation reserve account (RR) and loss to be expensed to P/L unless there is an existing RR on the PPE. Then, the impairment loss is set off against such RR. If the RR is insufficient, then the excess of impairment is expensed to P/L and vice versa.

Annually, there would be excess depreciation charged and this amount is to be realised from RR to retained earnings; bypass the P/L.

Example 4 (Revaluation differences)

a. Revaluation Surplus

A building was purchased on 1 Jan Year 4. A revaluation deficit of \$1M was charged to profit and loss account on 31 December Year 4. On 31 December Year 5, a revaluation surplus of \$4M was made.

Accounting entries:

Dr	Buildings [30 – (10-4)]	\$4M	
Cr	Profit or loss		\$1M
	(To reverse the revaluation deficit charged to profit or loss account in Year 4)		
Cr	Revaluation surplus		\$3M

b. Revaluation Deficit

A building has a carrying amount of \$1M and a revaluation surplus of \$100,000 included in the balance of the revaluation reserve account at 1 Jan Year 5. The revalued value of the building at 31 December Year 5 is \$0.7M.

Accounting entries:

Dr	Revaluation surplus	\$100,000	
Dr	Profit and loss	\$200,000	
Cr	Building		\$300,000

Example 5 (Depreciation adjustment resulting from revaluation surplus)

A property was purchased at a cost \$10M and has a useful of 50 years. At the end of Year 20, the property was revalued at \$30M and its useful remains unchanged.

At the end of Year 20, the following accounting entries reflect the revaluation:

Dr	Property	\$24M	
Cr	Revaluation		\$24M

In Year 21, the following adjustments are to be made:

Depreciation based on revalued amount $\$30M \times 1/30$	\$1M
Depreciation based on original cost $\$10M \times 1/50$	<u>0.2M</u>
Depreciation increase related to revaluation surplus re regarded as realised	<u>\$0.8M</u>

Accounting entries:

Dr	Revaluation surplus	\$0.8M	
Cr	Retained profits		\$0.8M

Being realisation of part of revaluation reserve due to additional depreciation provided on revaluation surplus.

Example 6 (Depreciation adjustment)

a. Review of useful life

A machinery costs \$100 and has a useful life of 10 years. At the end of second year after use, the asset is assessed to have a remaining useful life of 5 years. The company adopts straight line depreciation method.

Existing annual depreciation charge = $\$100/10 = \10

Revised annual depreciation charge = $\$(100 - 20)/5 = \16

b. Review of depreciation method

Similar data as above but the company changes from the straight line method to the reducing balance. The carrying amount of \$80 is to written off from Year 3 onwards using the reducing balance method over its remaining useful life.

Example 7 (Derecognition)

Same data as in Example 5, the property was sold at the beginning of Year 22 at \$33M.

Accounting entries:

Dr	Bank (Disposal proceeds)	\$33M	
Dr	Accumulated depreciation	\$1M	
	Cr Property		\$30M
	Cr Profit and loss		\$4M

Being revalued property disposed of at a profit

Dr	Revaluation reserve	\$23.2M	
	Cr Retained profit		\$23.2M

Being realisation of revaluation reserve upon disposal of asset.

The following analysis shows that the distributable profits remain the same, whether the property is revalued or not:

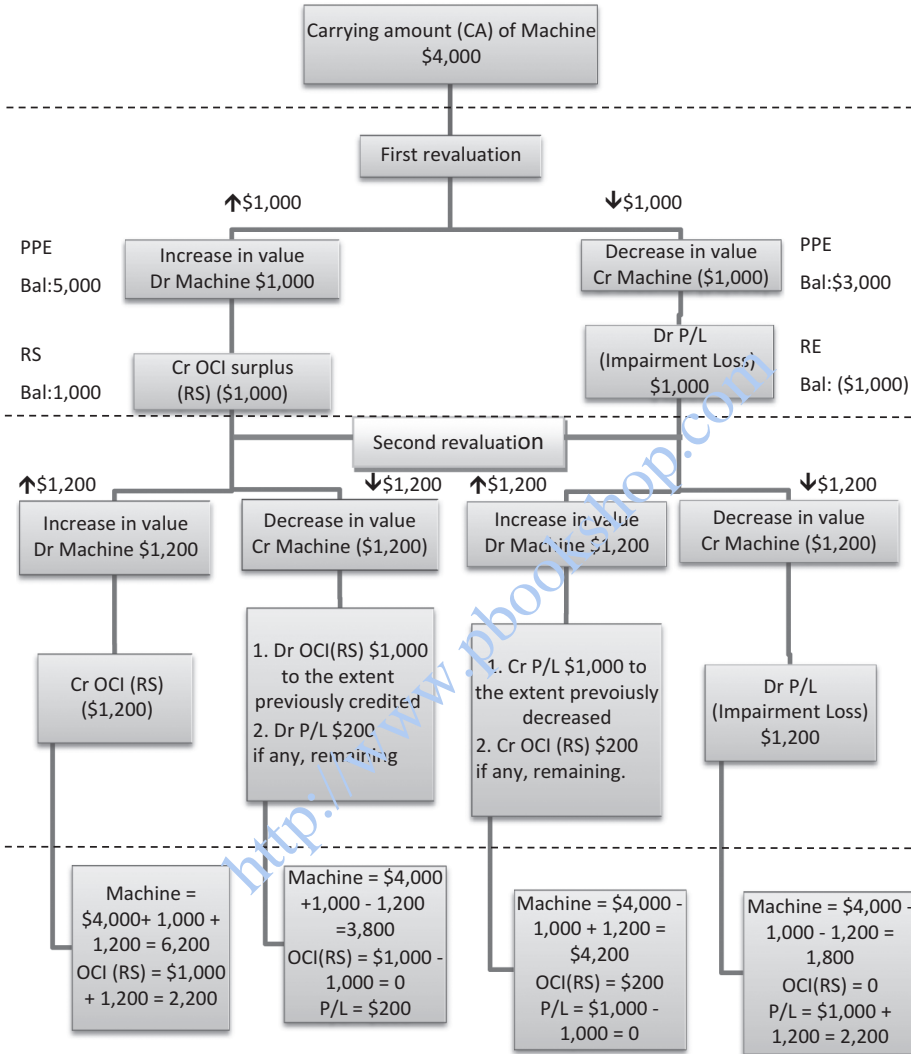
Without revaluation of the asset

Cost	\$10M
Less: accumulated depreciation ($\$0.2 \times 21$ years)	<u>(\$4.2M)</u>
Carrying amount	\$5.8M
Disposal proceeds	<u>(\$33.0M)</u>
Profit realised in disposal	<u>27.2M</u>

With revaluation of the asset

Profit on disposal (as above)	\$4.0M
Revaluation surplus transferred to retained profits	<u>\$23.2M</u>
	<u>\$27.2M</u>

Summary for revaluation



Depreciation is ignored.

¶11-440 Measurement of recognition: asset exchange transactions

An entity is required to measure an item of PPE acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets, at fair value unless the exchange transaction lacks commercial substance.

Example 8 (Exchange of Assets)

A ship owner has properties which carry a book value of \$10M. He is going to exchange his properties for a ship which has a market value of \$20M by paying an additional sum of cash of \$5M.

Solution

The ship owner shall capitalize the ship at a value of \$20M. The properties are deemed to be disposed at \$15M (\$50M - \$5M), thus a profit of \$5M (\$15M - \$10M) is recognised on disposal of the properties.

¶1-500 Disposal

[HKAS 16:68]

When an asset is permanently **withdrawn from use, or sold or scrapped**, and the entity does not expect to have future economic benefits from its disposal, it should be derecognised from the statement of financial position.

Gains or losses are the difference between the estimated net disposal proceeds and the carrying amount of the asset. The entity should recognize it as income or expense in profit or loss.

[HKFRS 5:6]

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

Derecognition

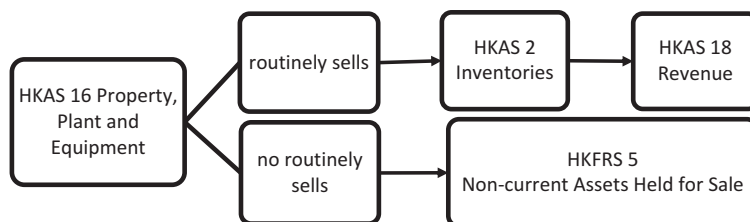
[HKAS 18]

The standard requires entity to **derecognise the carrying amount** of an item of property, plant or equipment that it disposed of on the date the **criteria for the sale of goods in HKAS 18 Revenue** would be met. This also applies to parts of an asset. Derecognition will be discussed in more detail in Chapter 13.

[HKAS 16:68A]

An entity that, in the course of its ordinary activities, routinely sells items of property, plant and equipment that it has held for rental to others shall transfer such assets to inventories at their carrying amount when they cease to be rented and become held for sale (HKAS 2 Inventories). The proceeds from the sale of such assets shall be recognised as revenue in accordance with HKAS 18 Revenue. HKFRS 5 does not apply when assets that are held for sale in the ordinary course of business are transferred to inventories.

Summary (Disposal of property, plant and equipment)



¶11-600 Disclosure

[HKAS 16:73,74,77,79]

HKAS 16 has detailed disclosure requirements for each class of property, plant and equipment.

- (a) **Measurement bases** for determining the gross carrying amount (if more than one, the gross carrying amount for that basis in each category).
- (b) **Methods of Depreciation** used.
- (c) **Useful life** or depreciation rates used.
- (d) **Gross carrying amount** and accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period.
- (e) **Reconciliation** of the carrying amount at the beginning and end of the period showing:
 - Additions;
 - Disposals;
 - Acquisitions through business combinations;
 - Increases/decreases during the period from revaluations and from impairment losses;
 - Impairment losses recognised in profit or loss;
 - Impairment losses reversed in profit or loss;
 - Depreciation;
 - Net exchange differences (from translation of statements of foreign entity);
 - Any other movements.

The financial statements shall also disclose the following:

- (a) Any recoverable amounts of property, plant and equipment;
- (b) Existence and amounts of **restrictions on title**, and items pledged as security for liabilities;

- (c) Accounting policy for **the estimated costs of restoring the site;**
- (d) Amount of expenditures on account of **items in the course of construction;**
- (e) Amount of commitments to **acquisitions.**

Further disclosures of **revalued assets** are required, in addition to those required by HKFRS 13 Fair Value Measurement

- (a) Basis used to revalue the assets;
- (b) Effective date of revaluation;
- (c) An independent value whether is involved;
- (d) Carrying amount of each class of property, plant and equipment that would have been included in the financial statements had the assets been carried at cost less accumulated depreciation and accumulated impairment losses;
- (e) Revaluation surplus.

Template for presentation and disclosure (Audited financial statements) – HKAS 16

Statement of Financial Position as at 31 Mar 20x3			
	Notes	20x3	20x2
		\$	\$
Non-Current Assets			
Property, plant and equipment	6	<u>5,300</u>	<u>3,000</u>
Current Assets		<u>2,200</u>	<u>2,500</u>
Current Liabilities		<u>1,000</u>	<u>1,000</u>
Net Current Assets		<u>1,200</u>	<u>1,500</u>
Net Assets		<u>6,500</u>	<u>4,500</u>
Share Capital		100	100
Retained Profits		<u>6,400</u>	<u>4,400</u>
		<u>6,500</u>	<u>4,500</u>

Notes to Accounts (Extract)

Significant Accounting Policies

Property, plant and equipment and depreciation

Property, plant and equipment are stated at cost less accumulated depreciation and any identified impairment loss.

The depreciable amount of an item of property, plant and equipment is allocated on a systematic basis over its estimated useful lives using the straight balance method. The principal annual rates used for depreciation are as follows:-

Furniture, fixtures and equipment 10%

(6) PROPERTY, PLANT AND EQUIPMENT

COST

At 1/4/20x2	4,000
Addition	<u>3,000</u>
At 31/3/20x3	<u>7,000</u>

ACCUMULATED DEPRECIATION

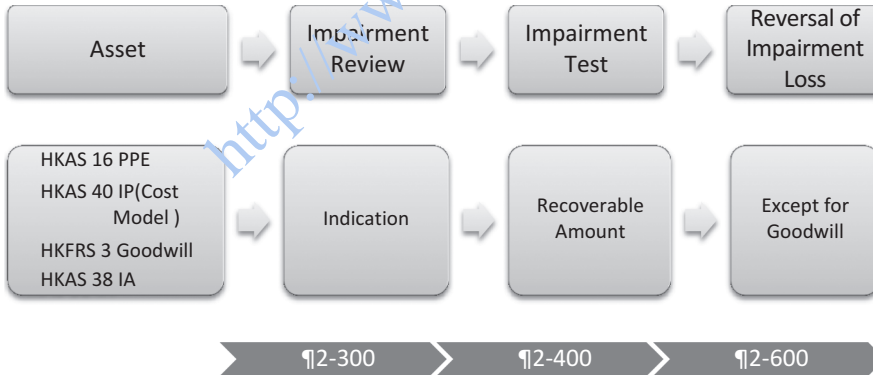
At 1/4/20x2	1,000
Charge for the year	<u>700</u>
At 31/3/20x3	<u>1,700</u>

NET BOOK VALUE

At 31/3/20x3	<u>5,300</u>
At 31/3/20x2	<u>3,000</u>

HKAS 36 Impairment of Assets

Flow chart



¶12-100 Definitions

Impairment loss

An impairment loss is the amount by which the **carrying amount of an asset or a cash-generating unit exceeds its recoverable amount.**

Recoverable amount

The recoverable amount of an asset or a cash-generating unit is the **higher of its fair value less costs to sell and its value in use.**

[HKAS 36:6]

A **cash generating unit (CGU)** is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

¶12-200 Cash generating units

[HKAS 36:6,66]

When it is not infeasible to calculate the recoverable amount of a single asset, then its **cash generating unit (CGU)** shall be measured instead.

The standard explains the important concept of cash generating units. As per basic rule, the **asset** should calculate the recoverable amount of an asset **individually**. However, there will be occasions when it is not available to estimate such a value for an individual asset, particularly in the calculation of value in use. This is because cash inflows and outflows cannot be attributed to the individual asset.

If it is not available to calculate the recoverable amount for an individual asset, the entity should measure the recoverable amount of the asset's **cash generating unit** instead.

Example 9 (CGU)

A private railway is owned by a mining enterprise which supports its mining activities. The enterprise could sell the private railway only for scrap value and the private railway does not generate cash inflows from continuing use that are largely independent of the cash inflows from the other assets of the mine.

Solution

It is not possible to estimate the recoverable amount of the private railway because it cannot determine the value in use of the private railway and it is probably different from scrap value. Therefore, the enterprise estimates the recoverable amount of the cash generating unit to which the private railway belongs, that is, the mine as a value.

¶12-300 Impairment Review

[HKAS 36:10]

All assets require an impairment test when there is an indication of impairment at the reporting date. In addition, annual impairment test should be performed for certain assets. They are:

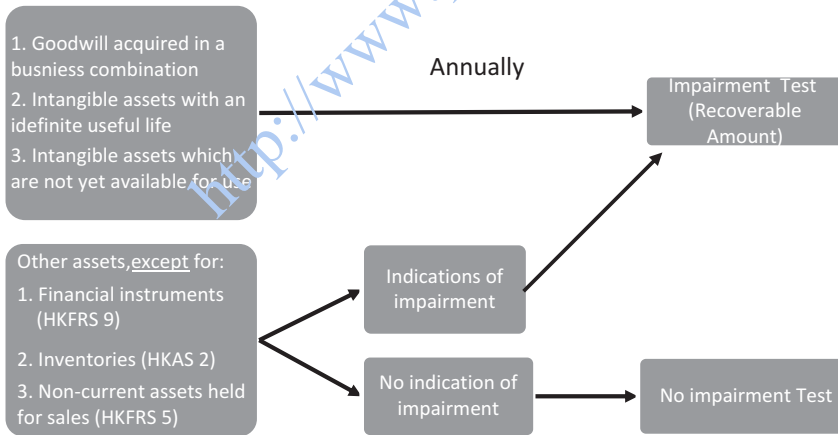
- goodwill acquired in a business combination;
- intangible assets with an indefinite useful life;
- intangible assets which are not yet available for use.

Note that the concept of **materiality** applies, and only material impairment needs to be identified.

Management has to identify assets that may impair. HKAS 36 provides guidance on how to identify such assets:

External sources of information	Internal sources of information
<ul style="list-style-type: none"> ▶ unexpected decrease in asset's market value ▶ changes in the technological, market, economic or legal environment in which the entity operates ▶ changes in market rates of interest/ interest that may change the value of the asset ▶ reduction in the carrying amount of an entity 	<ul style="list-style-type: none"> ▶ evidence of obsolescence or physical damage to asset ▶ significant changes in the extent to which or the manner in which the asset may be used ▶ current period operating loss, an expectation of continuing losses or outflow ▶ loss of key employees

Summary of impairment review



For an investment in a subsidiary, jointly controlled entity or associate, the investor recognises a dividend from the investment and evidence is available that:

- (i) the carrying amount of the investment in the separate financial statements exceeds the carrying amounts in the consolidated financial statements of the investee's net assets, including associated goodwill; or

- (ii) the dividend exceeds the total comprehensive income of the subsidiary, joint venture or associate in the period the dividend is declared.

Where there are indications of impairment, or for those assets which require testing annually, the entity must perform an impairment test. This involves comparing the carrying amount of the asset with its recoverable amount.

¶12-400 Impairment Test

Impairment should be determined by comparing the carrying amount of the asset with its **recoverable amount**.

The recoverable amount of an asset is the higher of the asset's **fair value less costs to sell** and **its value in use**.

¶12-410 Fair value less costs to sell

[HKAS 36:28]

According to the requirements of HKFRS 13 Fair Value Measurement, the fair value should be established. It defines as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Further detail will be discussed more detail in Chapter 21.

HKAS 36 clarifies that costs of disposal may include legal costs, stamp duty and similar transaction taxes, costs of removing the asset, and direct incremental costs to bring an asset into condition for its sale. They do not, however, include termination benefits (as defined in HKAS 19) and costs associated with reducing or reorganising a business following the disposal of an asset are not direct incremental costs to dispose the asset.

¶12-420 Value in use

The entity need to estimate future cash flows and discount them in order to obtain their present value.

The discount rate used to derive present value of the future cash flows should represent management's best estimate of the economic situation that the remaining useful life of the asset will be existed over.

Management should ensure that the assumptions on which its current cash flow projection are based and consistent with past actual result and predictable future changes.