IMPAIRMENT TEST

What is impairment? Indicators and Benefits

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WHAT IS IMPAIRMENT?

The impairment of a fixed asset can be described as an abrupt decrease in fair value due to physical damage, changes in existing laws creating a permanent decrease, increased competition, poor management, obsolescence of technology, etc. In case of a fixed-asset impairment, the company needs to decrease its book value in the balance sheet and recognize a loss in the income statement.

All assets, either tangible or intangible, are prone to impairment. A tangible asset can be property, plant and machinery, furniture and fixtures, etc. whereas intangible assets can be goodwill, patent, license, etc.

Under IAS 36 - Impairment of Assets, an entity is required to review at each balance sheet date whether there is any indication that an asset may be impaired.

External indicators

- Drastic change in economic or legal factors affecting the company or its assets
- Significant fall in the market price of the asset
- Muted demand for a medium-term period due to global macroeconomic conditions

Internal indicators

- Asset as a part of a restructuring or held for disposal
- Obsolescence or physical damage of the asset
- Inability to bring in post-merger synergy benefits that were expected earlier
- Worse economic performance than what is expected

IMPAIRMENT VS. AMORTIZATION

Though both terms may seem similar, impairment relates more to a sudden and irreversible decrease in the value of an asset, for example, the breakdown of a machine due to an accident. Generally, amortization is believed to be a systematic decrease in the book value of an intangible asset, based on the planned amortization plan.

BENEFITS OF IMPAIRMENT TEST

- Impairment charges provide investors and analysts with different ways to assess a company's management and its decision-making track record. Managers who write off or write down assets because of impairment might not have made good investment decisions or lacked the vision before making that kind of investment.
- Proper Tax payment. In many cases impairment test results decrease in entities property Taxes.
- Many business failures are heralded by a fall in the impairment value of assets. Such disclosures act as early warning signals to creditors and investors.
- To show the true rate of return on capital employed.
- To conserve adequate funds in the business for replacement of fixed assets at the end of their useful lives. Provision for depreciation based on historic cost will show inflated profits and lead to payment of excessive dividends.
- To show the fair market value of assets which have considerably appreciated since their purchase such as land and buildings.
- To negotiate fair price for the assets of the company before merger with or acquisition by another company.
- To enable proper internal reconstruction, and external reconstruction.
- When the company intends to take a loan from banks/financial institutions by mortgaging its fixed assets. Proper revaluation of assets would enable the company to get a higher amount of loan

BRIEFLY ABOUT US

Moore abc established in 2008 is one of the leading firms in the country providing financial and tax accounting and reporting services, valuation, audit and related services covering all regions of Georgia.

Contact us @ info@moore.ge to get more information about Impairment test and other valuation services.