Full impairment of a Property Plant and Equipment Purchased in the Current Financial Year

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Introduction

'LSI Rubbers (PVT) LTD' is operating as a group of companies, which produces and sells Rubber, Tea, Coconut and Cinnamon. Major portion of its income is recorded to be received from rubber production. A machine has been purchased by the company which causes for about major portion of surgical gloves produced to be recognized as defects.

Discussion of the Issue

A machine (Glove Line for its surgical division) worth of LKR 18 million has purchased by the company, which is above the materiality level by three months, before the yearend of 31st March 2015.It is revealed during the stock count for the particular division, that there were a stock of about 84,000 units of surgical gloves, which has been identified as defects due to the new machine purchased 3 months before the year end. This machine is supposed to produce 12 units at a time out of which almost 5 units are identified as defects most of the time.

Repair cost incurred by the company in relation to this machine was almost above the carrying value of the particular machine. Inability to sell the machine is the main problem faced by the company because it is very difficult to find a similar manufacturer who is willing to buy this machine in Sri Lanka.

Impairment = Carrying amount (accounting records) >Recoverable amount (FV-Cost to sell/Value in use)

Determination of recoverable amount

- Fair value(FV) less cost to sell the asset
  The FV on which the company can realize the asset, was unable to obtain as there was no identified open market or willing buyer to purchase the asset.

- Value in Use
  Cash flows calculated based on management assessment on the forecasted net cash inflow by sale of Surgical Gloves manufactured by this machine less any scrap value expected, discounted to obtain the present value of the net cash inflows

Primarily focused areas by the auditors are as follows;

1. Identifying internal and external impairment indications.

Internal indications

- Usage of machinery was not in full capacity.
- Company has spent more than the value of the machine for the repairs.
- About 5 of 12 units that the machine produces at a time were defects.

External indications

- Machine cannot be sold easily to an external party due to lack of surgical glove manufactures in Sri Lanka

2. Inquire the management on non-assessment of impairment and their plans on the identified machine.

Implication of the Issue

Not assessing the impairment indications (according to IAS 36) in relation to the machine, which used to manufacture surgical gloves, was the key identified issue of the company. The resultant impacts to the financial statements were misstated.

Inability to perform an impairment test by the company has caused for the non-current assets to be overstated, hence a correct picture was not provided to the users by the financial statements.

Conclusion and Recommendations

According to IAS 36, 'a company should asses the internal and external indications relating to asset or a cash-generating unit and then to be assessed any impairment losses relating to that particular asset.'

LSI Rubbers (PVT) LTD identified the impairment loss relating to Glove line machine for the period.

Necessary adjustments to the financial statements have made in relation to the impairment of assets based on the impairment evaluation and adequate disclosures were made by the company in relation with this asset impairment.

- *Discount Rate* - weighted average cost of capital of 16%
- *Resale value*- 15% of the cost of the asset

Audit results discovered that for this machine, the company has spent more than the value of that particular machine. Hence it is recommended a full impairment provision of the machine by the company, which is recorded as follows.

Impairment Losses (P&L)	Dr
Provision for impairment	Cr