

Query No. 22

Subject: Non-reversal of impairment in respect of investment in subsidiary in separate financial statements on account of non-reversal of impairment in underlying goodwill.¹

A. Facts of the Case

1. A public limited company (hereinafter referred to as ‘the Company’), which is a wholly owned subsidiary of a listed government company, is in the business of exploration and production (E&P) of oil and gas and other hydrocarbon related activities outside India. The Company has adopted Indian Accounting Standards (Ind AS) w.e.f. 1st April 2016 (Transition Date: 1st April 2015). The functional currency of the Company is assessed as US Dollar (USD) in accordance with the provisions of Ind AS. The Company presents its financial statements in presentation currency which is Indian Rupee (INR).

2. The Company operates overseas projects directly and/or through subsidiaries, by participation in various joint arrangements and investment in associates. Globally, E&P business is carried out by way of joint arrangements or investments in form of subsidiaries/associates. In the separate financial statements, the Company accounts for investments in subsidiary companies at cost in accordance with Ind AS 27, ‘Separate Financials Statements’. In this regard, accounting policy of the Company states that the Company records the investments in subsidiaries at cost less impairment loss, if any.

3. The querist has stated that during the financial year (F.Y.) 2013-14, the Company acquired 60% shares in an overseas company (subsidiary company X) which was having 10% participating interest (PI) in an overseas discovered oil and gas project under development (Project A). In the standalone financial statements (SFS) of that year, the purchase consideration for acquiring 60% shares in company X was accounted as investment in subsidiary company X. Since the purchase consideration paid by the Company, for acquiring 60% shares in company X, was higher than the proportionate net assets of the subsidiary company X at the effective date of acquisition, the difference was recognised as goodwill on business combination in the consolidated financial statements of the Company. Therefore, investment in the subsidiary company X accounted in the SFS of the Company represented the proportionate net assets of the subsidiary company at the time of acquisition as well as the amount recognised towards the goodwill.

4. In accordance with Ind AS 36, ‘Impairment of Assets’, the Company carries out impairment assessment in respect of its ‘Cash Generating Units (CGUs)’ as well as investments in subsidiary, associate and joint venture at the end of each reporting period in order to determine whether there is any indication that these assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the assets and investment is estimated in order to determine the extent of the impairment loss, if any. Accordingly, the Company carried out impairment assessment in respect of the Cash Generating Unit (CGU) comprising assets of the subsidiary company in proportion to its PI in the oil and gas Project-A (CGU X) as well as the investments in subsidiary company X. For the purpose of impairment assessment of CGU X, the value of goodwill was added to the carrying value of assets of subsidiary X for project A as per the requirements of paragraph 80 of Ind AS 36.

¹ Opinion finalised by the Committee on 15.12.2021.

5. For the year ended 31st March 2016, impairment loss of USD 39.43 million was estimated in respect of the CGU X as per Ind AS 36. The said impairment loss was charged in the consolidated financial statements of the Company against the associated goodwill in accordance with paragraph 104 of Ind AS 36. In the standalone financial statements of the Company, an equivalent impairment loss of USD 39.43 million was provided against carrying value of the investment in subsidiary company X considering a permanent decline in the value of underlying assets represented by an impairment loss charged against goodwill which is irreversible subsequently as per paragraph 124 of Ind AS 36.

6. The said total impairment loss of USD 39.43 million in respect of CGU X was carried forward till 31st March 2020. Subsequently, during the impairment assessment of F.Y. 2020-21, recoverable amount of CGU X was computed to be higher than the carrying value of assets of subsidiary company X including the goodwill allocated and accordingly, there was a reversal of impairment provision of USD 39.43 million. The recoverable amount and carrying amount of the CGU X were as follows:

Carrying value of the CGU X (A)	USD 1783.52 million
Recoverable amount (represented by value-in-use) (B)	USD 2041.12 million
Impairment reversal restricted to the amount of impairment loss provided till 31.03.2020 (B-A):	USD 39.43 million

However, since the impairment loss of USD 39.43 million (charged in F.Y. 2015-16) was charged against the goodwill, reversal of such impairment loss was not done by the Company in its consolidated financial statements in F.Y. 2020-21 as per paragraph 124 of Ind AS 36, which states that an impairment loss recognised for goodwill shall not be reversed in a subsequent period.

7. In the standalone financial statements, in respect of the carrying value of the investment in subsidiary company X, the Company estimated recoverable amount of the asset to be higher than the carrying value. The recoverable amount of the related asset and carrying value of investment in subsidiary X were as follows:

Carrying value of investment (A)	USD 1913.26 million
Recoverable amount (represented by value-in-use) (B)	USD 2041.12 million
Impairment reversal restricted to the amount of impairment loss provided till 31.03.2020 (B-A)	USD 39.43 million

However, since the impairment loss charged against the underlying assets was not reversed as the same represented impairment in goodwill, accordingly, the impairment loss of USD 39.43 million charged against investment in subsidiary company X was also not reversed in the standalone financial statements of the Company for the F.Y. 2020-21.

8. During the course of supplementary audit of F.Y. 2020-21, C&AG auditors observed that impairment in investment in standalone financial statements of the Company and impairment in goodwill appearing in consolidated financial statements of the Company are

not interrelated to each other as criteria and methodology of impairment in standalone and consolidated financial statements are different. They also observed that impairment reversal in goodwill is prohibited by the Ind AS. However, reversal in investment is allowed by Ind AS 36. Further, any impairment and reversal in investment in standalone financial statements get eliminated while consolidation as per Ind AS 110. Therefore, the Company's plea to link impairment or reversal thereof in respect of carrying value of investment with the impairment estimation and provision in respect of underlying goodwill is not correct.

9. The auditor also observed that impairment in respect of carrying value of investment in subsidiary in standalone financial statements is worked out independently from the impairment in respect of CGU comprising the assets of subsidiary company including the related goodwill as per the provisions of Ind AS 36.

10. On the basis of above observations, the auditor was of opinion that during F.Y. 2020-21, though the Company has correctly not given effect to the reversal of impairment loss charged in the consolidated financial statements against the goodwill as the same could not be reversed as per Ind AS 36, but the Company should have reversed the impairment loss of USD 39.43 million charged in the standalone financial statements against the carrying value of investment in subsidiary company.

11. According to the querist, as noted in paragraph 3 above, the investment in subsidiary company X, as recognised in the standalone financial statements of the Company, represents the goodwill generated on acquisition of the subsidiary company X in addition to the proportionate net assets of the subsidiary. Since there was an impairment loss charged against this goodwill in F.Y. 2015-16 as mentioned in paragraph 5 above, which could not be reversed subsequently as per paragraph 124 of Ind AS 36, it can be construed that there is a permanent decline in the value of underlying assets necessitating a resultant impairment in carrying value of investment in subsidiary company X. Accordingly, carrying amount of investment in subsidiary company X was also reduced by charging an equivalent impairment of USD 39.43 million against the said investment in the standalone financial statements of the Company in F.Y. 2015-16.

12. The querist has further stated that since Ind AS 36 does not allow reversal of impairment loss provided against goodwill in subsequent years, the intention of Ind AS is to assume that there is permanent diminution in the value of goodwill if it has been impaired once, irrespective of the fact that there is subsequently an impairment reversal. As the Company's investment in subsidiary X pertains to the subsidiary's net assets as well as goodwill generated on acquisition, it was construed that carrying value of such investment is also diminished permanently to the extent of diminution in the value of goodwill. Therefore, since the impairment loss charged against the goodwill cannot be reversed, the impairment loss charged against the investment in subsidiary in standalone financial statements should also not be reversed in view of such permanent decline in the value of underlying assets.

13. The querist has also stated that it is pertinent to mention that provisions of Ind AS do not specifically deal with the impairment in respect of investment in subsidiary in view of any permanent decline observed in the underlying assets as against Accounting Standard (AS) 13, 'Accounting for Investments', which in paragraph 17 provides that *Long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of a long term investment, the carrying amount is reduced to recognise the decline* (emphasis supplied by the querist). Though ASs are not applicable to the Company and the Company follows Ind ASs, the intention of financial reporting framework in respect of impairment of investments may be borrowed from the provisions of AS 13. Thus, in case there is a

permanent decline in the value of a long-term investment, the carrying value of the investment should be reduced to recognise such decline.

14. Further, the querist has reproduced a relevant case study as given in Question 3 of Educational Material on Indian Accounting Standard (Ind AS) 27, Separate Financial Statements & Indian Accounting Standard (Ind AS) 28, Investments in Associates and Joint Ventures, issued by the erstwhile Ind AS Implementation Group of the Accounting Standards Board of the Institute of Chartered Accountants of India (ICAI) as below:

“Question 3

AB Limited has an existing investment of INR 700 crores in its subsidiary, PQR Limited. The net assets of PQR limited are only INR 400 crores as at March 31, 2018. The value in use as well as fair value less costs to sell of PQR Limited is INR 600 crores.

AB Limited has accounted its subsidiary at cost in its financial statements.

What will be the impairment loss which AB Limited needs to recognise in the separate financial statements?”

The response provided in respect of the above question, after analysing the relevant provisions of Ind AS 36, states that in the instant case, impairment loss of Rs. 100 crores shall be recognised in the statement of profit and loss. *However, it is also important to consider the underlying cash flows that support the investment while considering the investment for impairment* (emphasis supplied by the querist). Therefore, though the educational material considers recoverable amount of the subsidiary instead of the net assets thereof for the purpose of determining impairment in the given question, it emphasises that it is important to consider the underlying cash flows that support the investment while considering the investment for impairment. Accordingly, as per the querist, by inference, the underlying assets of subsidiary along with the associated goodwill are to be considered for the purpose of assessing the impairment (or reversal thereof) and if there is an indication of a permanent decline in the value of such underlying assets, the value of investment should also be reduced accordingly. Similarly, in case of permanent decline in the value of underlying assets, the impairment loss charged earlier in the investment in subsidiary should not be reversed.

15. Moreover, paragraph 114 of Ind AS 36 provides that **an impairment loss recognised in prior periods for an asset other than goodwill shall be reversed if, and 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.** In the case of the Company, the last impairment loss in the value of investment in subsidiary X was recognised on the basis of estimation of permanent decline in the value of underlying assets. There is no change in this estimation since the last impairment loss was charged because the impairment loss charged against the underlying assets (i.e. goodwill) cannot be reversed subsequently. Accordingly, the impairment loss charged against the investment in subsidiary X charged earlier cannot be reversed as there is no change in the basic estimation on the basis of which the earlier impairment loss was recognised.

16. In the light of foregoing, the Company is of the view that a goodwill impairment on consolidation indicates a decrease in the value of investment since acquisition. This also triggers an impairment of the Company’s investment in the subsidiary in the separate financial statements of the Company. Similarly, since the impairment loss against the

goodwill cannot be reversed subsequently, indicating thereby a permanent decline in the value of underlying assets, the impairment loss charged earlier in the value of investment in subsidiary in the SFS cannot be reversed subsequently.

B. Query

17. In view of the above facts, the opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India is solicited on the following issues:

- (a) Whether it is appropriate in the light of provisions of Ind AS 36 that the Company has not reversed the impairment loss recognised earlier against the carrying value of investment in subsidiary in standalone financial statements due to permanent decline in underlying assets represented by an impairment loss charged against the associated goodwill that cannot be reversed subsequently.
- (b) If answer to (a) is no, whether the Company is required to recognise the said reversal of the impairment loss prospectively considering it a change in estimates or a retrospective accounting of reversal of impairment loss is required to be done by the Company.

C. Points considered by the Committee

18. The Committee notes that the basic issue raised by the querist relates to recognition of reversal of impairment loss recognised earlier in respect of investment in subsidiary company in the separate financial statements of the Company. The Committee has, therefore, considered only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, accounting in the consolidated financial statements, the methodology used for determining the impairment provision or reversal of the impairment provision including appropriateness of the valuation techniques and inputs or assumptions in determination of impairment loss, determination of functional currency, adjustments on transition to Ind AS, whether the Company ‘controls’ the subsidiary, consolidation requirements as per Ind AS 110, appropriateness of using the term ‘permanent decline’ for value of investment in the context of AS 13, etc. Further, the opinion hereinafter has been expressed considering only Indian Accounting Standards, notified under Companies (Indian Accounting Standards) Rules, 2015.

19. The Committee notes that Ind AS 36, ‘Impairment of Assets’ states as follows:

“122 A reversal of an impairment loss for a cash-generating unit shall be allocated to the assets of the unit, except for goodwill, pro rata with the carrying amounts of those assets. These increases in carrying amounts shall be treated as reversals of impairment losses for individual assets and recognised in accordance with paragraph 119.”

“124 An impairment loss recognised for goodwill shall not be reversed in a subsequent period.

125 Ind AS 38, *Intangible Assets*, prohibits the recognition of internally generated goodwill. Any increase in the recoverable amount of goodwill in the periods following the recognition of an impairment loss for that goodwill is likely to be an increase in internally generated goodwill, rather than a reversal of the impairment loss recognised for the acquired goodwill.”

From the above, the Committee notes that Ind AS 36 requires that an entity should assess at each reporting date, whether there is any indication that an impairment loss recognised in a previous period for an asset *other than goodwill* either no longer exists or has decreased. The Committee notes that the exception in paragraph 124 that prohibits recognition of reversal of impairment loss applies only to goodwill and not to any other assets. The Committee is of the view that goodwill at the CFS level is the goodwill as on the acquisition date, which, once impaired cannot be reversed. This is because, if such reversal of impairment provision is recognised, it would result in recognition of internally generated goodwill.

The Committee further notes that Ind AS 36 states as follows:

“4 This Standard applies to financial assets classified as:

- (a) subsidiaries, as defined in Ind AS 110, *Consolidated Financial Statements*;
- (b) associates, as defined in Ind AS 28, *Investments in Associates and Joint Ventures*; and
- (c) joint ventures, as defined in Ind AS 111, *Joint Arrangements*.

For impairment of other financial assets, refer to Ind AS 109.”

Thus, Ind AS 36 applies to financial assets classified as subsidiaries under Ind AS 110. The Committee also notes that paragraph 9 of Ind AS 27, ‘Separate Financial Statements’ explicitly requires that separate financial statements shall be prepared in accordance with all applicable Ind AS. Therefore, impairment requirements as per Ind AS 36 are equally applicable to investment in subsidiary in separate financial statements. Therefore, investment in a subsidiary in the separate financial statements of the parent shall also be subjected to impairment testing when there are impairment indicators. The Committee is of the view that generally, where an impairment provision is recognised against goodwill arising on consolidation of a subsidiary in the consolidated financial statements, the carrying amount of the parent company’s investment in the relevant subsidiary should also be reviewed for impairment since it indicates a decrease in value since acquisition and thus, there would be impairment indicators. This is because the investment in subsidiary in the separate financial statements and the goodwill on consolidation arising in the consolidated financial statements of the group are initially recognised on the same date and, therefore, are linked. However, it should be noted that criteria and methodology of impairment in separate and consolidated financial statements are different.

The Committee notes that paragraph 4 of Ind AS 36 (as reproduced above) specifically covers investments in subsidiary in the SFS within its scope. If the Standard had intended to prohibit, partly or fully, the recognition of reversal of impairment on investment in subsidiary, similar to the prohibition in case of goodwill, the Standard would have specifically mentioned the same.

The Committee further notes that neither Ind AS 27 nor Ind AS 36 requires or permits breaking up the investment in subsidiary in separate financial statements into the individual underlying assets and liabilities of the subsidiary. At separate financial statements level, the investment in a subsidiary represents a financial instrument, although there may be certain scope exclusions in Ind AS 32, Ind AS 107 and Ind AS 109. An interest in a financial instrument is not split into further underlying assets/liabilities unless specifically required or permitted by a standard.

Further, the Committee notes that in the CFS, Ind AS 36 requires the impairment testing to be performed at least annually for CGUs (which may consist of a subsidiary) with goodwill. If there is an impairment, the same is required to be recognised against goodwill and other assets as per the requirements of Ind AS 36. Where there is evidence of reversal of impairment, the same is recognised against other assets as per the requirements of Ind AS 36. Ind AS 36 prohibits recognition of reversal of impairment against goodwill. The Committee notes that none of these requirements construe that there is other than temporary decline in the value of investments in subsidiary in the SFS.

20. The Committee also notes that the Company has estimated similar recoverable amounts at consolidated financial statements (CFS) level (paragraph 6 above) and at separate financial statements (SFS) level (paragraph 7 above). The Committee notes that at SFS level, the recoverable amount of an investment in a subsidiary (being a CGU) would normally be based on the value in use or fair value less costs of disposal based on the parent's share of estimated cash flows from the investment in subsidiary. On the other hand, at CFS level, the net assets of the subsidiary are presented in the CFS and therefore, there may be different CGU at CFS level considering the requirements of Ind AS 36. Thus, the CGU at CFS level being different from the CGU at the SFS level, there may be differences in the recoverable amount at consolidated financial statements and at separate financial statements level. There could be further possible differences in the recoverable amounts at consolidated financial statements level and at separate financial statements level due to factors, such as, the level at which cash generating unit is determined, impact of intra-group transactions, business synergies arising outside the subsidiary/sub-group and the first time adoption exemption for business combination availed by the group.

21. The Committee further notes that the querist has justified the non-recognition of reversal of previous impairment loss in the investment in the subsidiary in the separate financial statements, based on submission that the investment partly consists of goodwill. The Committee notes that goodwill results from a business combination involving the acquisition of a controlling interest in the equity instruments of the acquiree. Goodwill relating to the business combination is recognised only in the acquirer's consolidated financial statements, and not in its separate financial statements. The Committee also notes that the querist has referred to an FAQ in ICAI's Educational Material on Ind AS 27 and to AS 13 under Companies (Accounting Standards) Rules, 2006 for non-recognition of reversal of impairment of goodwill in separate financial statements. However, neither the Educational Material nor AS 13, prohibit or disallow recognition of reversal of previously recognised impairment loss in the separate financial statements.

22. With regard to the issue as to whether the Company is required to recognise the said reversal of the impairment loss prospectively considering it a change in estimates or a retrospective accounting, the Committee notes that Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors' states as follows:

“41 Errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with Ind ASs if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are approved for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information

presented in the financial statements for that subsequent period (see paragraphs 42–47).

42 Subject to paragraph 43, an entity shall correct material prior period errors retrospectively in the first set of financial statements approved for issue after their discovery by:

- (a) restating the comparative amounts for the prior period(s) presented in which the error occurred; or**
- (b) if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.”**

As per Ind AS 8, material prior period errors are corrected retrospectively by restating the comparative amounts for prior periods in which the error occurred. If the error occurred before the earliest period presented, the opening balance of equity/retained earnings for the earliest period presented are adjusted. Since, in the extant case, the Company should have accounted for reversal of impairment in its separate financial statements as discussed above, the same results into a prior period error, which should be rectified as per the afore-mentioned requirements of Ind AS 8.

D. Opinion

23. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 17 above:

- (a) The current accounting treatment in the separate financial statements of the Company with regard to non-recognition of the reversal of impairment loss recognised in past, is not in line with the requirements of Ind AS 27 and Ind AS 36, as discussed in paragraphs 19-21 above.
- (b) The Company should correct the accounting treatment as a prior period error retrospectively in the first set of financial statements approved for issue after the discovery of the error, as discussed in paragraph 22 above.
