

- (c) On the same date, but as a separate purchase to that of Fast Trak plc, Heywood plc acquired Steamdays Ltd, a company that operates a scenic railway along the coast of a popular tourist area. The summarised balance sheet at fair values of Steamdays Ltd on 1 July 1999, reflecting the terms of the acquisition was:

	£000
Goodwill	200
Operating licence	1,000
Property – train stations and land	250
Rail track and coaches	250
Steam engines (2)	1,000
Other net assets	300
Purchase consideration	<u>3,000</u>

The operating licence is for ten years. It has recently been renewed by the transport authority and is stated at the cost of its renewal. The carrying values of the property and rail track and coaches are based on their estimated replacement cost. The engines, and other net assets are valued at their net selling price.

On 1 August 1999 the boiler of one of the steam engines exploded, completely destroying the whole engine. Fortunately no one was injured, but the engine was beyond repair. Due to its age a replacement could not be obtained. Because of the reduced passenger capacity the estimated value in use of the whole of the business after the accident was assessed at £2 million.

Passenger numbers after the accident were below expectations even after allowing for the reduced capacity. A market research report concluded that tourists were not using the railway because of the fear of a similar accident occurring to the remaining engine. In the light of this the value in use of the business was re-assessed on 30 September 1999 at £1.8 million. On this date Heywood plc received an offer of £600,000 in respect of the operating licence (it is transferable). The realisable value of the other net assets has not changed significantly.

Required:

Briefly describe the basis in FRS 11 'Impairment of Fixed Assets and Goodwill' for allocating impairment losses; and show how each of the assets of Steamdays Ltd would be valued at 1 August 1999 and 30 September 1999 after recognising the impairment losses. (8 marks)

(25 marks)

(c) FRS 11 'Impairment of Fixed Assets and Goodwill' says that an impairment loss should be recognised where the recoverable amount of an asset is less than its carrying value. Where possible this should be done for each individual asset. Where this is not possible, the recoverable amount of the asset's smallest income-generating unit has to be determined. This would be necessary where an asset does not have a readily determinable selling price, or where its cash flows are not independent of those of other assets. An impairment loss for an income-generating unit should be allocated in the following order:

- (i) an obvious impairment to specific assets
- (ii) goodwill

(iii) to tangible assets on a pro rata or more appropriate basis

The order in which impairment losses are allocated is based on eliminating those assets that have the most subjective valuation. In addition to the above the FRS adds that an asset (intangible or tangible) with a readily ascertainable market value should not be written down to below its net realisable value. Applying this guidance to the assets of Steamdays Ltd gives the following:

	assets: 1 July 1999 £000	first provision £000	revised assets: 1 August 1999 £000	second provision £000	revised assets: 30 Sept. 1999 £000
Goodwill	200	(200)	nil		nil
Operating licence	1,000	(300)	700	(100)	600
Property – train stations and land	250		250	(50)	200
Rail track and coaches	250		250	(50)	200
Steam engines	1,000	(500)	500		500
Other net assets	300		300		300
	<u>3,000</u>	<u>(1,000)</u>	<u>2,000</u>	<u>(200)</u>	<u>1,800</u>

Notes:

The first impairment loss of £1 million:

- £500,000 must be written off the engines as one of them no longer exists and its recoverable amount (nil) can be assessed individually
- the goodwill of £200,000 must be eliminated; and
- the balance of £300,000 is allocated to the intangible asset of the licence.

The second impairment loss of £200,000:

- the first £100,000 is applied to the licence to write it down to its net selling price
- the balance is applied pro rata to assets carried at other than their net selling prices i.e. £50,000 to both the property and the rail track and coaches.