

Applicability of AS 28 to Telecom Industry

A. Facts of the Case

1. A public sector company, registered under the Companies Act, 1956, under the Ministry of Telecommunication and Information Technology, Government of India, maintains its accounts on the basis of mercantile system. The main business of the company is to provide telecommunication related services to the public.

2. The querist has stated that Accounting Standard (AS) 28, 'Impairment of As-

sets', issued by the Institute of Chartered Accountants of India, introduces the concept of cash generating unit. As per the querist, since the main thrust of AS 28 is on identification of the cash generating unit, in the context of the company in question, it may be the exchange/switch as a whole which is generating cash, and not individual assets or the group of assets, forming part of the network. According to the querist, the assets cannot generate cash on their own in a stand-alone status and even in case of exchanges or part of exchanges, they cannot generate cash without the connectivity of cable and other network el-

ements, etc. Further, all the exchanges are also interconnected for providing telecommunication services for basic and mobile connectivity and, hence, it can not be said that even one exchange can be treated as a cash generating unit on its own strength, as telecom networking consists of various assets, viz., switches, cables, building, lines and wires, subscribers installations, etc. As per the querist, in the telecom industry, even if the assets are

generating future cash flows, the disposal value as on the date will be much less than the carrying amount.

3. The querist has further stated that it is important to note that as on 31.3.2005, out of the total fixed assets of the company of Rs. 64686.29 million, the 'Apparatus and Plant', which is the main exchange equipment of the company, is worth Rs. 26625.45 million, and cables, lines and wires, which are interconnected with the exchange equipment are worth Rs. 25846.46 million. Thus, these components, i.e., apparatus, plant and cables, lines and wires account for around 81.12% of net fixed assets.

4. According to the querist, the exchanges/switches etc., are unique to the telecom industry and the future sale price in case of disposal is also very negligible considering the fact that they are not general public utility items and also the competition in the telecom sector, with a volatile and fast changing scenario, and quick obsolescence factor of the exchanges/switches, etc., lowers their usefulness to others in the industry even if disposal is made.

B. Query

5. The querist has sought the opinion of the Expert Advisory Committee on the following issues:

- (a) Whether the company (telecom industry) should be exempted from AS 28.
- (b) If not, then what would be a cash generating unit in case of the company and the method of application of AS 28 to the company.

C. Points considered by the Committee

6. The Committee notes that AS 28 does not exempt the telecom industry. Accordingly, the said Standard is applicable to an enterprise carrying on telecom business.

7. The Committee notes the definitions of the

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The following is the brief version of an opinion given by the Expert Advisory Committee of the Institute in response to a query sent by a member. This is being published for the information of readers.

terms 'Recoverable amount', 'Value in use' and 'Cash generating unit' (CGU) provided in paragraph 4 of AS 28 as reproduced below:

"Recoverable amount is the higher of an asset's net selling price and its value in use."

"Value in use is the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life."

"A cash generating unit is the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets."

8. The Committee further notes paragraph 64 and paragraphs 66 to 69 of AS 28, as reproduced below:

"64. If there is any indication that an asset may be impaired, the recoverable amount should be estimated for the individual asset. If it is not possible to estimate the recoverable amount of the individual asset, an enterprise should determine the recoverable amount of the cash-generating unit to which the asset belongs (the asset's cash-generating unit)."

"66. As defined in paragraph 4, an asset's cash-generating unit is the smallest group of assets that includes the asset and that generates cash inflows from continuing use that are largely independent of the cash inflows from

other assets or groups of assets. Identification of an asset's cash-generating unit involves judgement. If recoverable amount cannot be determined for an individual asset, an enterprise identifies the lowest aggregation of assets that generate largely independent cash inflows from continuing use.

67. Cash inflows from continuing use are inflows of cash and cash equivalents received from parties outside the reporting enterprise. In identifying whether cash inflows from an asset (or group of assets) are largely independent of the cash inflows from other assets (or groups of assets), an enterprise considers various factors including how management monitors the enterprise's operations (such as by product lines, businesses, individual locations, districts or regional areas or in some other way) or how management makes decisions about continuing or disposing of the enterprise's assets and operations. Example 1 in the Appendix gives examples of identification of a cash-generating unit.

68. ***If an active market exists for the output produced by an asset or a group of assets, this asset or group of assets should be identified as a separate cash-generating unit, even if some or all of the output is used internally. If this is the case, management's best estimate of future mar-***

ket prices for the output should be used:

(a) ***in determining the value in use of this cash-generating unit, when estimating the future cash inflows that relate to the internal use of the output; and***

(b) ***in determining the value in use of other cash-generating units of the reporting enterprise, when estimating the future cash outflows that relate to the internal use of the output.***

69. Even if part or all of the output produced by an asset or a group of assets is used by other units of the reporting enterprise (for example, products at an intermediate stage of a production process), this asset or group of assets forms a separate cash-generating unit if the enterprise could sell this output in an active market. This is because this asset or group of assets could generate cash inflows from continuing use that would be largely independent of the cash inflows from other assets or groups of assets. In using information based on financial budgets/forecasts that relates to such a cash-generating unit, an enterprise adjusts this information if internal transfer prices do not reflect management's best estimate of future market prices for the cash-generating unit's output."

9. On the basis of the above, the Committee is of the view that as stated in paragraph 64 of AS 28, the company should first determine whether there are certain individual assets that may be impaired in the light of indicators stated in paragraph 8 of AS 28. For example, an asset might be damaged beyond repair or might have outlived its utility [paragraph 8(e) of AS 28]. Thereafter, or in case it is not possible to identify individual assets for impairment, the CGUs need to be identified. Identification of CGUs in a large organisation requires intensive detailed exercise involving consideration of various factors, including those illustrated in AS 28, so as to meet the definition of the 'cash-generating unit' reproduced in paragraph 7 above. As stated in paragraph 66 of AS 28 reproduced above, 'identification of an asset's cash-generating unit involves judgement' to be exercised by the management and the auditors on the basis of the aforesaid exercise and, therefore, depends on consideration of various factors. The Committee is of the view that in case, it is not possible for an enterprise, to identify separate cash-generating units, the enterprise as a whole should be considered as the cash-generating unit.

10. With regard to whether an exchange can be considered as a CGU, the Committee is of the view that the exchange may be considered as a CGU if the enterprise monitors its operations exchange-wise as indicated in paragraph 67 of AS 28 reproduced above. The Committee notes that gener-

ally the entire exchange may need to be modernised when it becomes obsolete. In view of this, the exchange may be considered as a CGU and its cash flows can be worked out on the basis of the 'value in use'.

11. The Committee is further of the view that the mere fact that the sale price in case of disposal of assets is negligible and the fact that the assets are enterprise-specific and are subject to fast obsolescence does not mean that AS 28 cannot be applied. This is because as per the definition of the term 'recoverable amount' reproduced above, it is the *higher* of the net selling price and the value in use that is to be compared with the carrying amount of the asset(s). Apparently, in the case of this company, the 'value in use' may be higher than the net selling price. If it is so, the value in use may be considered as the recoverable amount.

D. Opinion

12. On the basis of the above, the opinion of the Committee on the issues raised by the querist in paragraph 5 above, is as below:

- (i) The telecom industry is not exempted from AS 28. Accordingly, AS 28 is applicable to the company in question.
- (ii) The assets/CGUs of the enterprise should be identified on the basis of a detailed and in-depth study of the assets of the enterprise keeping in view various factors, including those stated in AS 28. In case it is not possible to determine CGUs of the enterprise, then the whole enterprise will be considered as the CGU. □

Notes:

1. *The Opinion is only that of the Expert Advisory Committee and does not necessarily represent the Opinion of the Council of the Institute.*
2. *The Compendium of Opinions containing the Opinions of Expert Advisory Committee has been published in twenty three volumes which are available for sale at the Institute's office at New Delhi and its regional council offices at Mumbai, Chennai, Kolkata and Kanpur.*