

**This Exposure Draft was approved by the Public Sector Committee of the International Federation of Accountants.**

***Acknowledgment***

This Exposure Draft of an International Public Sector Accounting Standard deals with the impairment of non-cash-generating assets in the public sector. Extracts from International Accounting Standard IAS 36 (1998) *Impairment of Assets* are reproduced in this publication of the Public Sector Committee of the International Federation of Accountants with the permission of the International Accounting Standards Board (IASB). IAS 36 was published by the International Accounting Standards Committee (IASC). The IASB and the International Accounting Standards Committee Foundation (IASCF) were established in 2001 to replace the IASC. The International Accounting Standards (IASs) issued by the IASC remain in force until they are amended or withdrawn by the IASB.

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## **Commenting on this Exposure Draft**

This Exposure Draft of the International Federation of Accountants was prepared by the Public Sector Committee. The proposals in this Exposure Draft may be modified in the final Standard in the light of comments received before being issued in the form of an International Public Sector Accounting Standard.

Comments should be submitted in writing so as to be received by xx Month 2003 (Date: 4 months after issue date). E-mail responses are preferred. All comments will be considered a matter of public record. Comments should be addressed to:

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# INTRODUCTION

## Accounting Standards for the Public Sector

The International Federation of Accountants — Public Sector Committee (the Committee) is developing recommended accounting standards for public sector entities referred to as International Public Sector Accounting Standards (IPSASs). The Committee recognizes the significant benefits of achieving consistent and comparable financial information across jurisdictions and it believes that the IPSASs play a key role in enabling these benefits to be realized.

The IPSASs are based on the International Financial Reporting Standards (IFRSs), formerly known as International Accounting Standards (IASs), issued by the International Accounting Standards Board (IASB), where the requirements of those Standards are applicable to the public sector. The Committee is also developing IPSASs that deal with accounting issues in the public sector that are not addressed in the IFRSs or IASs.

The adoption of IPSASs by governments will improve both the quality and comparability of financial information reported by public sector entities around the world. The Committee strongly encourages governments and national standard setters to engage in the development of its Standards by commenting on the proposals set out in these Exposure Drafts. The Committee recognizes the right of governments and national standard setters to establish accounting standards and guidelines for financial reporting in their jurisdictions. The Committee encourages the adoption of IPSASs and the harmonization of national requirements with IPSASs. Financial statements should be described as complying with IPSASs only if they comply with all the requirements of each applicable IPSAS.

## Due Process and Timetable

An important part of the process of developing IPSASs is for the Committee to receive comments on the proposals set out in these Exposure Drafts from governments, public sector entities, auditors, standard-setters and other parties with an interest in public sector financial reporting. Accordingly, each proposed IPSAS is first released as an Exposure Draft, inviting interested parties to provide their comments. Exposure Drafts will usually have a comment period of four months, although longer periods may be used for certain Exposure Drafts. Upon the closure of the comment period, the Committee will consider the

comments received on the Exposure Draft and may modify each proposed IPSASs in the light of the comments received before proceeding to issue a final Standard.

## **Background**

The Committee issued an Invitation to Comment (ITC) *Impairment of Assets* in July 2000. The ITC identified the PSC's tentative views on the principles that should be applied for the recognition and measurement of impairments to assets held by public sector entities. The ITC was the first step in the due process that led to the development of this exposure draft.

The submissions on the ITC reflected broad support for the general approach to impairment proposed by the Committee in that document. However, a number of respondents expressed concern about particular aspects of the impairment tests proposed. During 2001 and 2002, the Committee considered comments by the constituents and a number of staff papers addressing constituents' concerns and the key issues set out in the ITC. A subcommittee of the PSC also considered the principles underpinning the determination of "value in use" for non-cash -generating assets and reported to the PSC in late 2002.

## **Purpose of the Exposure Draft**

This Exposure Draft proposes requirements for the identification, recognition, measurement, reversal and disclosure of an impairment loss in respect of public sector non-cash flow assets.

## **Request for Comments**

Comments are invited on any proposals in this Exposure Draft by xx month 2003 [Date: 4 months after the issue date]. The Committee would prefer that respondents express a clear overall opinion on whether the Exposure Draft in general is supported and that this opinion be supplemented by detailed comments, whether supportive or critical, on the issues in the Exposure Draft. Respondents are also invited to provide detailed comments on any other aspect of the Exposure Draft (including materials and examples contained in appendices) indicating the specific paragraph number or groups of paragraphs to which they relate. It would be helpful to the PSC if these comments clearly explained the issue and suggested alternative wording, with supporting reasoning, where this is appropriate.

## Specific Matters for Comment

The Committee would particularly value comment on the proposal to:

- (a) include in the scope of the proposed Standard, agricultural assets, goodwill and all other identifiable intangible assets not explicitly excluded in paragraph 1 of the ED. Paragraph 1 excludes:
  - inventories;
  - assets arising from construction contracts;
  - financial assets included in the scope of IPSAS 15;
  - investment property that is measured at fair value under IPSAS 16, and property, plant and equipment measured at fair value under IPSAS 17; and
  - other assets in respect of which accounting requirements for impairment are included in another IPSAS.
- (b) define cash -generating assets as assets held by:
  - (i) Government Business Enterprises (GBEs); and
  - (ii) public sector entities other than GBEs to generate a commercial rate of return (paragraph 13).
- (c) assess at each reporting date whether there is an indicator that an asset may be impaired. Paragraph 20 identifies a minimum set of indicators, but the list is not exhaustive.
- (d) estimate an asset's recoverable service amount when an indicator of impairment is present at reporting date (paragraph 19).
- (e) exclude the change in market value from the list of minimum indicators set out in black letter in paragraph 20 but indicate in commentary that it may be an indicator (paragraph 21).
- (f) measure the value in use of a non-cash flow asset using the depreciated replacement cost, restoration cost and service units approaches as appropriate (paragraph 37).

- (g) recognize an impairment loss and reduce the carrying amount of the asset to its recoverable service amount, when the asset's recoverable service amount is less than its carrying amount (paragraphs 46 and 48).
- (h) assess at each reporting date whether there is an indicator that an impairment loss recognized for an asset in prior years may no longer exist or may have decreased. Paragraph 54 identifies a minimum set of indicators, but the list is not exhaustive.
- (i) estimate an asset's recoverable service amount when annual assessments indicate that a previous loss no longer exists or has decreased (paragraph 53).
- (j) recognize a reversal of an impairment loss if and only if there has been a change in estimates used to determine the asset's recoverable service amount since the last impairment loss was recognized and increase the asset's carrying amount to its recoverable service amount subject to the ceiling set in paragraph 61 (paragraphs 58, 61 and 62).
- (k) make disclosures as set out in paragraphs 65, and 68-70.

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**INTERNATIONAL PUBLIC SECTOR ACCOUNTING  
STANDARD IPSAS XX**

## **Impairment of Assets**

*The standards, which have been set in bold italic type, should be read in the context of the commentary paragraphs in this Standard, which are in plain type, and in the context of the “Preface to International Public Sector Accounting Standards”. International Public Sector Accounting Standards are not intended to apply to immaterial items.*

## **Objective**

The objective of this Standard is to prescribe the procedures that an entity applies to determine whether an asset is impaired and to ensure that impairment losses are recognized. The Standard also specifies when an entity should reverse an impairment loss and prescribes certain disclosures for impaired assets.

## **Scope**

1. *An entity which prepares and presents financial statements under the accrual basis of accounting should apply this Standard in accounting for impairment of all assets, except:*
  - (a) *inventories (see IPSAS 12 Inventories);*
  - (b) *assets arising from construction contracts (see IPSAS 11 Construction Contracts);*
  - (c) *financial assets that are included in the scope of IPSAS 15 Financial Instruments: Disclosure and Presentation;*
  - (d) *Investment property and property, plant and equipment that are measured at fair value (see IPSAS 16 Investment Property and IPSAS 17 Property, Plant and Equipment); and*
  - (e) *Other assets in respect of which accounting requirements for impairment are included in another International Public Sector Accounting Standard.*



2. ***This Standard applies to all public sector entities other than Government Business Enterprises.***
3. ***Public sector entities that hold cash-generating assets as defined in paragraph 13 should apply IAS 36 Impairment of Assets to such assets. Public sector entities that hold non-cash-generating assets should apply the requirements of this Standard to non-cash -generating assets.***
4. This Standard excludes from its scope the impairment of assets that are dealt with in another International Public Sector Accounting Standard. Government Business Enterprises (GBEs) apply IAS 36 and therefore are not subject to the provisions of this Standard. Public sector entities other than GBEs apply IAS 36 to their cash-generating assets and apply this Standard to their non-cash-generating assets. Paragraphs 5 to 12 explains the scope of the Standard in greater detail.

*Exclusions from the scope*

5. This Standard does not apply to inventories and assets arising from construction contracts because existing International Public Sector Accounting Standards applicable to these assets already contain specific requirements for recognising and measuring these assets.
6. This Standard does not require the application of an impairment test to an investment property that is carried at fair value under the International Public Sector Accounting Standard IPSAS 16 *Investment Property*. This is because under the fair value model in IPSAS 16, an investment property is carried at fair value at the reporting date and any impairment will be taken into account in the valuation.
7. Likewise, this Standard does not require the application of an impairment test to non-cash -generating assets that are carried at fair value under the allowed alternative treatment in International Public Sector Accounting Standard IPSAS 17 *Property, Plant and Equipment*. This is because under the allowed alternative treatment in IPSAS 17, assets will be revalued with sufficient regularity to ensure that they are carried at an amount that is not materially different from their fair value as at the reporting date and any impairment will be taken into account in the valuation.

8. Consistent with the requirements of paragraph 3 above, property, plant and equipment that are classified as cash-generating assets and are carried at fair value under the allowed alternative treatment in IPSAS 17 are dealt with under IAS 36.
9. This Standard does not apply to financial assets that are included in the scope of IPSAS 15 *Financial Instruments: Presentation and Disclosures*. Impairment of these assets will be dealt with in an International Public Sector Accounting Standard that the PSC intends to develop on the basis of IAS 39 to deal with the recognition and measurement of financial instruments.
10. Investments in:
  - (a) subsidiaries, as defined in IPSAS 6 *Consolidated Financial Statements and Accounting for Controlled Entities*;
  - (b) associates, as defined in IPSAS 7 *Accounting for Investments in Associates*; and
  - (c) joint ventures, as defined in IPSAS 8 *Financial Reporting of Interests in Joint Ventures*;

are financial assets that are excluded from the scope of IPSAS 15. Where such investments are classified as cash-generating assets they are dealt with under IAS 36. Where these assets are in the nature of non-cash-generating assets, they are dealt with under this Standard.

#### *Government Business Enterprises*

11. The *Preface to International Financial Reporting Standards* issued by the International Accounting Standards Board (IASB) explains that International Financial Reporting Standards (IFRSs) are designed to apply to the general purpose financial statements of all profit-oriented entities. Government Business Enterprises (GBEs) are defined in paragraph 13 below. They are profit-oriented entities. Accordingly, they are required to comply with IFRSs and International Accounting Standards (IASs).
12. The International Accounting Standards Board (IASB) was established in 2001 to replace the International Accounting Standards Committee (IASC). The IASs issued by the IASC

remain in force until they are amended or withdrawn by the IASB.

## Definitions

13. *The following terms are used in this Standard with the meanings specified:*

Cash comprises cash on hand and demand deposits.

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Cash flows are inflows and outflows of cash and cash equivalents.

Cash-generating assets are assets held by:

- (a) public sector Government Business Enterprises (GBEs); and
- (b) public sector entities other than GBEs to generate a commercial rate of return.

Carrying amount is the amount at which an asset is recognized in the statement of financial position after deduction of any accumulated depreciation and accumulated impairment losses.

Costs of disposal are incremental costs directly attributable to the disposal of an asset, excluding finance costs and income tax expense.

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Government Business Enterprise means an entity that has all the following characteristics:

- (a) is an entity with the power to contract in its own name;

- (b) *has been assigned the financial and operational authority to carry on a business;*
- (c) *sells goods and services, in the normal course of its business, to other entities at a profit or full cost recovery;*
- (d) *is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length); and*
- (e) *is controlled by a public sector entity.*

*An impairment* *is a loss in the future economic benefits or service potential of an asset, over and above the systematic recognition of the loss of an asset's future economic benefits or service potential through depreciation.*

*An impairment loss for a non-cash-generating asset* *is the amount by which the carrying amount of the asset exceeds its recoverable service amount.*

*Net selling price* *is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal. This is the fair value of the asset less the costs of selling.*

*Non-cash-generating assets* *are assets other than cash-generating assets.*

*Property plant and equipment* *are tangible assets that:*

- (a) *are held by an entity for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and*
- (b) *are expected to be used during more than one reporting period.*

*Recoverable service amount of a non-cash-generating asset* *is the higher of a non-cash-generating asset's net selling price and its value in use.*

*Useful life of property, plant and equipment* *is either:*

- (a) *the period of time over which an asset is expected to be used by the entity; or*
- (b) *the number of production or similar units expected to be obtained from the asset by the entity.*

**Value in use of a non-cash-generating asset is the present value of the asset's remaining service potential.**

**Value in use of a cash-generating asset is the present value of the 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.**

### **Government Business Enterprises**

14. Government Business Enterprises (GBEs) include both trading enterprises, such as utilities, and financial enterprises, such as financial institutions. GBEs are, in substance, no different from entities conducting similar activities in the private sector. GBEs generally operate to make a profit, although some may have limited community service obligations under which they are required to provide some individuals and organizations in the community with goods and services at either no charge or a significantly reduced charge.
15. Assets held by Government GBEs are cash-generating assets. Public sector entities other than GBEs may hold assets to generate a commercial rate of return. For the purposes of this Standard, an asset held by a non-GBE public sector entity is classified as a cash-generating asset if the asset (or unit of which the asset is a part) operates with the objective of generating a commercial rate of return through the provision of services to external parties.

### **Impairment**

16. This Standard defines an "impairment" as a loss in the future economic benefits or service potential of an asset, over and above the systematic recognition of the loss of an asset's future economic benefits or service potential through depreciation. Impairment, therefore, reflects a decline in the utility of an asset to the entity that controls it. For example, an entity may have a purpose-built military storage facility that it no longer uses. In addition, because of the specialized nature of the facility and its location, it is unlikely that it can be leased out or sold and therefore the entity is unable to generate cash flows from the leasing or disposal of the asset. The asset is regarded as impaired because it is no longer capable of providing the entity with service potential — it has little, or no, utility for the entity in contributing to the achievement of its objectives.

## Identifying an Asset that may be Impaired

17. Paragraphs 18 to 26 specify when recoverable service amount should be determined.
18. An asset is impaired when the carrying amount of the asset exceeds its recoverable service amount. Paragraphs 20 to 24 identify key indicators that an impairment loss may have occurred: if any of those indications is present, an entity is required to make a formal estimate of recoverable service amount. If no indication of a potential impairment loss is present, this Standard does not require an entity to make a formal estimate of recoverable service amount.
19. *An entity should assess at each reporting date whether there is any indication that an asset may be impaired. If any such indication exists, the entity should estimate the recoverable service amount of the asset.*
20. *In assessing whether there is any indication that an asset may be impaired, an entity should consider, as a minimum, the following indications:*

### External sources of information

- (a) *cessation of the demand or need for services provided by the asset;*
- (b) *significant long term changes with an adverse effect on the entity have taken place during the period or will take place in the near future, in the technological, legal or government policy environment in which the entity operates;*

### Internal sources of information

- (c) *evidence is available of physical damage of an asset;*
- (d) *significant long term changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include plans to discontinue or restructure the operation to which an asset belongs or plans to dispose of an asset before the previously expected date;*

- e) *a decision to halt the construction of the asset before it is complete or in a usable condition; and*
  - f) *evidence is available from internal reporting that indicates that the service performance of an asset is, or will be, worse than expected.*
21. The list in paragraph 20 is not exhaustive. There may be other indicators that an asset may be impaired. The existence of other indicators would also require the entity to estimate the asset's recoverable service amount. For example, any of the following may be an indicator of impairment:
- (i) a significant decline in an asset's market value; or
  - (ii) a significant long term decline (but not necessarily cessation) in the demand for or need for services provided by the asset.
22. The events or circumstances that may indicate an impairment of an asset are significant will often have prompted discussion by the governing board, management, or media. A change in a parameter such as demand for the service, extent or manner of use, legal environment or government policy environment would indicate impairment only if such a change was significant and had a long-term adverse effect. A change in the use of an asset during the period may also be an indicator of impairment. This may occur when, for example, a building used as a school may undergo a change in use and be used for storage. In assessing whether an impairment has occurred the entity need to assess changes in service potential over the long term. This underlines the fact that the changes are seen within the context of the anticipated long-term use of the asset. However, the expectations of long-term use can change and the entity's assessments at each reporting date would reflect that. Appendix A sets out examples of impairment indicators referred to in paragraph 20.
23. In assessing whether there is a halt in construction for the purposes of triggering an impairment test, the entity would consider whether construction has simply been delayed, whether there is an intention to resume the construction in near future, or whether the circumstances are such that the construction work is not to be completed in the foreseeable future. Where the construction is delayed or postponed to a specific, foreseeable

future date, the project could still be treated as work in progress and is not considered as halted.

24. Evidence from internal reporting that indicates that an asset may be impaired includes the existence of:
- (a) significantly higher costs of operating or maintaining the asset, compared with those originally budgeted; and
  - (b) significantly lower service or output levels provided by the asset compared with those originally expected.

A significant increase in operating costs of an asset may indicate that the asset is not as efficient or productive as initially anticipated in output standards set by the manufacturer, in accordance to which the operating budget was drawn up. Similarly, a significant increase in maintenance costs may indicate that, higher costs need to be incurred to maintain the asset's performance at a level indicated by its most recently assessed standard of performance. In other cases, direct quantitative evidence of an impairment may be indicated by a significant long term fall in the expected service or output levels provided by the asset.

25. The concept of materiality applies in identifying whether the recoverable service amount of an asset needs to be estimated. For example, if previous assessments show that an asset's recoverable service amount is significantly greater than its carrying amount, the entity need not re-estimate the asset's recoverable service amount if no events have occurred that would eliminate that difference. Similarly, previous analysis may show that an asset's recoverable service amount is not sensitive to one (or more) of the indications listed in paragraph 20.
26. If there is an indication that an asset may be impaired, this may indicate that the remaining useful life, the depreciation (amortisation) method or the residual value for the asset need to be reviewed and adjusted under the International Public Sector Accounting Standard applicable to the asset, even if no impairment loss is recognised for the asset.



## Measurement of Recoverable Service Amount

27. This Standard defines recoverable service amount as the higher of an asset's net selling price and its value in use. Paragraphs 28 to 44 set out the requirements for measuring recoverable service amount.
28. It is not always necessary to determine both an asset's net selling price and its value in use. For example, if either of these amounts exceeds the asset's carrying amount, the asset is not impaired and it is not necessary to estimate the other amount.
29. It may be possible to determine an asset's net selling price, even if the asset is not traded in an active market. Paragraphs 34 and 35 set out possible alternative bases for estimating net selling price when an active market for the asset does not exist. However, in some circumstances it will not be possible to determine net selling price because there is no basis for making a reliable estimate of the amount obtainable from the sale of the asset in an arm's length transaction between knowledgeable and willing parties. In this case, the recoverable service amount of the asset may be taken to be its value in use.
30. If there is no reason to believe that an asset's value in use materially exceeds its net selling price, the asset's recoverable service amount may be taken to be its net selling price. This will often be the case for an asset that is held for disposal. This is because the value in use of an asset held for disposal will consist mainly of its net disposal proceeds. However, for many public sector non-cash -generating assets which are held on an ongoing basis to provide specialized services or public goods to the community, the value in use of the asset is likely to be greater than its net selling price.
31. Recoverable service amount is determined for an individual asset. However, in some cases, governments or government entities may recognise assets on a group basis rather than an individual basis. For example, some may recognize infrastructure at the network or subsystem level, rather than recognizing individual assets within a network or subsystem. In such cases, the recoverable service amount may be determined on an "asset group" basis. Professional judgment is used to determine the level at which the Standard is to be applied.

32. In some cases, estimates, averages and computational shortcuts may provide a reasonable approximation of the detailed computations illustrated in this Standard for determining net selling price or value in use.

## Net Selling Price

33. The best evidence of an asset's net selling price is a price in a binding sale agreement in an arm's length transaction, adjusted for incremental costs that would be directly attributable to the disposal of the asset.
34. If there is no binding sale agreement but an asset is traded in an active market, net selling price is the asset's market price less the costs of disposal. The appropriate market price is usually the current bid price. When current bid prices are unavailable, the price of the most recent transaction may provide a basis from which to estimate net selling price, provided that there has not been a significant change in economic circumstances between the transaction date and the date at which the estimate is made.
35. If there is no binding sale agreement or active market for an asset, net selling price is based on the best information available to reflect the amount that an entity could obtain, at the reporting date, for the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the costs of disposal. In determining this amount, an entity considers the outcome of recent transactions for similar assets within the same industry. Net selling price does not reflect a forced sale, unless management or the governing body is compelled to sell immediately.
36. Costs of disposal, other than those that have already been recognised as liabilities, are deducted in determining net selling price. Examples of such costs are legal costs, stamp duty and similar transaction taxes, costs of removing the asset, and direct incremental costs to bring an asset into condition for its sale. However, termination benefits (as defined in IAS 19, *Employee Benefits*<sup>1</sup>) and costs associated with reducing or reorganising a business following the disposal of an asset are not direct incremental costs to dispose of the asset.

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<sup>1</sup> The PSC has included the development of an IPSAS on "employee benefits" in its work program. It is expected that the project be activated in the last quarter of 2003.

## Value in Use

37. This Standard defines the value in use of a non-cash-generating asset as the present value of the asset's remaining service potential. The present value of the remaining service potential of the asset is determined using the following approaches identified in paragraphs 38 to 42, as appropriate:

### *Depreciated replacement cost approach*

38. Under this approach, the present value of the remaining service potential of an asset is determined as the depreciated replacement cost of the asset. The replacement cost of an asset is the current cost to replace the asset's gross service potential. This cost is depreciated to reflect the asset in its used condition. An asset may be replaced either through reproduction (replication) of the existing asset or through replacement of its gross service potential. The depreciated replacement cost is measured as the reproduction or replacement cost of the asset, whichever is lower, less accumulated depreciation calculated on the basis of such cost to reflect the already consumed or expired service potential of the asset.
39. The replacement cost and reproduction cost of an asset are determined on an "optimised" basis. The rationale is that the entity would not replace the asset with a like asset if the asset to be replaced is an overdesigned or overcapacity asset. Overdesigned assets contain features which are unnecessary for the goods or services the asset provides. Overcapacity assets are assets that have a greater capacity than is necessary to meet the demand for goods or services the asset provides. The optimised determination of the replacement cost or reproduction cost of an asset thus reflects the service potential required of the asset.
40. In certain cases, standby or surplus capacity is held for safety reasons. This arises from the need to ensure that adequate service capacity is available in the particular circumstances of the entity. For example, the fire department need to have fire engines on standby to deliver services in emergencies. Such surplus or standby capacity is part of the required service potential of the asset.

***Restoration cost approach***

41. Restoration cost is the cost of restoring the service potential of an asset to its pre-impaired level. Under this approach, the present value of the remaining service potential of the asset is determined by subtracting the estimated restoration cost of the asset from the current cost of replacing the remaining service potential of the asset before impairment. The latter cost is usually determined as the depreciated reproduction or replacement cost of the asset, whichever is lower. Paragraphs 38 and 39 include additional guidance on determining the replacement cost or reproduction cost of an asset.

***Service units approach***

42. Under this approach, the present value of the remaining service potential of the asset is determined by reducing the current cost of the remaining service potential of the asset before impairment to conform with the reduced number of service units expected from the asset in its impaired state. As in the restoration cost approach, the current cost of replacing the remaining service potential of the asset before impairment is usually determined as the depreciated reproduction or replacement cost of the asset, whichever is lower.

**Application of approaches**

43. The choice of the most appropriate approach to measuring value in use depends on the availability of data and the nature of the impairment:
  - (a) impairments identified from significant long-term changes in the technological, legal or government policy environment are generally measurable using a depreciated replacement cost approach or a service units approach;
  - (b) impairments identified from a significant long-term change in the extent or manner of use, including that identified from the cessation of demand, are generally measurable using a depreciated replacement cost or a service units approach; and
  - (c) impairments identified from physical damage are generally measurable using a restoration cost approach.

44. Appendix B sets out examples of various approaches that may be used to determine the value in use of a non-cash generating asset.

## **Recognition and Measurement of an Impairment Loss**

45. Paragraphs 46 to 51 set out the requirements for recognising and measuring impairment losses for an asset.
46. *If, and only if, the recoverable service amount of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable service amount. That reduction is an impairment loss.*
47. As noted in paragraph 19, this Standard requires an entity to make a formal estimate of recoverable service amount only if an indication of a potential impairment loss is present. Paragraphs 20 to 24 identify key indicators that an impairment loss may have occurred.
48. *An impairment loss should be recognised as an expense in the statement of financial performance immediately.*
49. *When the amount estimated for an impairment loss is greater than the carrying amount of the asset to which it relates, an entity should recognise a liability if, and only if, required by another International Public Sector Accounting Standard.*
50. Where the estimated impairment loss is greater than the carrying amount of the asset, the carrying amount of the asset is reduced to zero with a corresponding expense recognised. A liability would be recognised only if another International Public Sector Accounting Standard so requires. An example is when a purpose-built military installation is no longer used and the entity is required by law to remove such installations if not usable. The entity may need to make a provision for dismantling costs if required by the International Public Sector Accounting Standard IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*.
51. *After the recognition of an impairment loss, the depreciation (amortisation) charge for the asset should be adjusted in future periods to allocate the asset's revised carrying amount,*

*less its residual value (if any), on a systematic basis over its remaining useful life.*

## **Reversal of an Impairment Loss**

52. Paragraphs 53 to 63 set out the requirements for reversing an impairment loss recognised for an asset in prior years.
53. *An entity should assess at each reporting date whether there is any indication that an impairment loss recognised for an asset in prior years may no longer exist or may have decreased. If any such indication exists, the entity should estimate the recoverable service amount of that asset.*
54. *In assessing whether there is any indication that an impairment loss recognised for an asset in prior years may no longer exist or may have decreased, an entity should consider, as a minimum, the following indications:*

### **External sources of information**

- (a) *resurgence of the demand or need for services provided by the asset;*
- (b) *significant long term changes with a favourable effect on the entity have taken place during the period, or will take place in the near future, in the technological, legal or government policy environment in which the entity operates;*

### **Internal sources of information**

- (c) *significant long-term changes with a favourable effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, the asset is used or is expected to be used. These changes include capital expenditure incurred during the period to improve or enhance an asset in excess of its most recently assessed standard of performance or a commitment to discontinue or restructure the operation to which the asset belongs;*
- (d) *a decision to resume construction of the asset that was previously halted before it was complete or in a usable condition; and*

- (e) *evidence is available from internal reporting that indicates that the service performance of the asset is, or will be, better than expected.*
55. Indications of a potential decrease in an impairment loss in paragraph 54 mirror the indications of a potential impairment loss in paragraph 20. The concept of materiality applies in identifying whether an impairment loss recognised for an asset in prior years may need to be reversed and the recoverable service amount of the asset determined.
56. The list in paragraph 54 is not exhaustive. An entity may identify other indications of reversal in impairment loss that would also require the entity to re-estimate the asset's recoverable service amount. For example, any of the following may be an indicator that the impairment loss may have reversed:
- (i) a significant rise in an asset's market value; or
  - (ii) a significant long-term increase in the demand or need for the services provided by the asset.
57. If there is an indication that an impairment loss recognised for an asset may no longer exist or may have decreased, this may indicate that the remaining useful life, the depreciation (amortisation) method or the residual value may need to be reviewed and adjusted in accordance with the International Public Sector Accounting Standard applicable to the asset, even if no impairment loss is reversed for the asset.
58. *An impairment loss recognised for an asset in prior periods should be reversed if, and only if, there has been a change in the estimates used to determine the asset's recoverable service amount since the last impairment loss was recognised. If this is the case, the carrying amount of the asset should, except as described in paragraph 61, be increased to its recoverable service amount. That increase is a reversal of an impairment loss.*
59. This Standard requires an entity to make a formal estimate of recoverable service amount only if an indication of a reversal of an impairment loss is present. Paragraphs 54 to 56 identify key indicators that an impairment loss recognised for an asset in prior years may no longer exist or may have decreased.

60. A reversal of an impairment loss reflects an increase in the estimated service potential of an asset, either from use or sale, since the date when an entity last recognised an impairment loss for that asset. An entity identifies the change in estimates that causes the increase in estimated service potential. Examples of changes in estimates include:
- (a) a change in the basis for recoverable service amount (i.e., whether recoverable service amount is based on net selling price or value in use);
  - (b) if recoverable service amount was based on value in use, a change in estimate of the components of value in use; or
  - (c) if recoverable service amount was based on net selling price, a change in estimate of the components of net selling price.
61. *The increased carrying amount of an asset due to a reversal of an impairment loss should not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years.*
62. *A reversal of an impairment loss for an asset should be recognised as revenue in the statement of financial performance immediately.*
63. *After a reversal of an impairment loss is recognised, the depreciation (amortisation) charge for the asset should be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.*

## Redesignation of Assets

64. The redesignation of assets from cash-generating assets to non-cash-generating assets or from non-cash-generating assets to cash-generating assets, only occurs when there is clear evidence that such a redesignation is appropriate. A redesignation, by itself, does not necessarily trigger an impairment test or a reversal of an impairment loss. Instead the indication for an impairment test or a reversal of an impairment loss comes from,



as a minimum, the listed indicators applicable to the asset after redesignation.

## Disclosure

**65. *For each class of assets, the financial statements should disclose:***

- (a) *the amount of impairment losses recognised in the statement of financial performance during the period and the line item(s) of the statement of financial performance in which those impairment losses are included; and***
- (b) *the amount of reversals of impairment losses recognised in the statement of financial performance during the period and the line item(s) of the statement of financial performance in which those impairment losses are reversed.***

**66.** A class of assets is a grouping of assets of similar nature and use in an entity's operations.

**67.** The information required in paragraph 65 may be presented with other information disclosed for the class of assets. For example, this information may be included in a reconciliation of the carrying amount of property, plant and equipment, at the beginning and end of the period, as required under IPSAS 17 *Property, Plant and Equipment*.

**68. *An entity that applies IPSAS 18 Segment Reporting, should disclose the following for each service and/or the geographical segment reported by the entity:***

- (a) *the amount of impairment losses recognised in the statement of financial performance; and***
- (b) *the amount of reversals of impairment losses recognised in the statement of financial performance.***

**69. *If an impairment loss for an asset is recognised or reversed during the period and is material to the financial statements of the reporting entity as a whole, an entity should disclose:***

- (a) *the events and circumstances that led to the recognition or reversal of the impairment loss;***

- (b) *the amount of the impairment loss or reversal of impairment loss recognised;*
  - (c) *the nature of the asset;*
  - (d) *the service and/or geographical segment to which the asset belongs if the entity applies IPSAS 18;*
  - (e) *whether the recoverable service amount of the asset is its net selling price or its value in use;*
  - (f) *if the recoverable service amount is net selling price, the basis used to determine net selling price (such as whether selling price was determined by reference to an active market or in some other way); and*
  - (g) *if the recoverable service amount is value in use, the approach used to determine value in use.*
70. *If impairment losses recognised (reversed) during the period are material in aggregate to the financial statements of the reporting entity as a whole, an entity should disclose a brief description of the following:*
- (a) *the main classes of assets affected by impairment losses (reversals of impairment losses) for which no information is disclosed under paragraph 69; and*
  - (b) *the main events and circumstances that led to the recognition (reversal) of these impairment losses for which no information is disclosed under paragraph 69.*
71. An entity is encouraged to disclose key assumptions used to determine the recoverable service amount of assets during the period.

## Transitional Provisions

72. *This Standard should be applied on a prospective basis only. Impairment losses (reversals of impairment losses) that result from adoption of this International Public Sector Accounting Standard should be recognised in accordance with this Standard (i.e., in the statement of financial performance).*

73. Before the adoption of this Standard, entities may have adopted accounting policies for the recognition and reversal of impairment losses. On adoption of this Standard a change in accounting policy may arise. It would be difficult to determine the amount of adjustments resulting from a retrospective application of the change in accounting policy. Therefore, on adoption of this Standard, an entity does not apply the benchmark or the allowed alternative treatment for other changes in accounting policies in IPSAS 3, Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies.

## Effective Date

74. *This International Public Sector Accounting Standard becomes effective for annual financial statements covering periods beginning on or after XX Month Year. Earlier application is encouraged.*
75. When an entity adopts the accrual basis of accounting, as defined by International Public Sector Accounting Standards, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

## Appendix A:

### Indicators of Impairment— Examples

*This appendix sets out examples of impairment indicators discussed in the Standard to assist in clarifying their meaning. It does not form part of the standards.*

#### External sources of information

##### **(a) Cessation of the demand or need for services provided by the asset**

The asset still maintains the same service potential, but demand for that service has ceased. Examples of assets impaired in this manner include:

- (i) A school closed because of a lack of demand for school services arising from population shift to other areas and it is not anticipated that this demographic trend affecting the demand for the school services will reverse in the foreseeable future;
- (ii) A railway line closed due to lack of patronage (for example, the population in a rural area has substantially moved to the city due to successive years of drought and those that have stayed behind use the cheaper bus service); and
- (iii) A convention center or stadium whose principal lessee does not renew its lease with the result that the underutilization of the facility is expected to lead to its closure.

##### **(b) significant long term changes in the technological environment with an adverse effect on the entity**

The service utility of an asset may be reduced if technology has advanced to produce alternatives that provide better or more efficient service. Examples of assets impaired in this manner are:

- (i) Medical diagnostic equipment that is rarely or never used because a newer machine embodying more advanced technology provides more accurate results (would also meet indicator (a) above);

- (ii) Software that is no longer being supported by the external supplier and the entity does not have the personnel to maintain the software; and
- (iii) Computer hardware that has become obsolete as the result of technological development.
- (c) **Significant long term changes in the legal or government policy environment.**

An asset's service potential may be reduced as a result of a change in a law or regulation. Examples of impairments identified by this indicator include:

- (i) An automobile that does not meet emission standards or a plane that does not meet noise standards;
- (ii) A school that can no longer be used for instruction purposes due to new safety regulations regarding its building materials or emergency exit procedure; and
- (iii) A drinking water plant that cannot be used because it does not meet new environmental standards.

## **Internal sources of information**

- (d) **Evidence is available of physical damage of an asset.**

Physical damage would likely result in the asset being unable to provide the level of service that it once was able to provide. Examples of assets impaired in this way include:

- (i) Equipment that is damaged and can no longer be repaired or for which repairs are not economically feasible;
- (ii) A building damaged by fire or flood or other factors;
- (iii) A building that is closed due to identification of structural deficiencies;
- (iv) Sections of an elevated roadway that have sagged, indicating that that segment of roadway will need to be replaced in 15 years rather than the original design life of 30 years;
- (v) A dam whose spillway has been reduced as a result of a structural assessment;

- (vi) A water treatment plant whose capacity has been reduced by intake blockage and the removal of the blockage is not economical;
- (vii) A bridge that is weight-restricted due to identification of structural deficiencies; and
- (viii) A navy destroyer damaged in a collision.
- (e) **Significant long term changes in the extent to which an asset is used, or is expected to be used, with an adverse effect on the entity.**

If an asset is not being used to the same degree as it was when originally put into service or the expected useful life of the asset is shorter than originally estimated, the asset may be impaired. An example of an asset that might be identified as potentially being impaired by this indicator is a mainframe computer that is underutilized because many applications have been converted or developed to operate on servers or PC platforms. A significant long-term decline in the demand for an asset's services may translate itself into a significant long-term change in the extent to which the asset is used.

- (f) **Significant long term changes in the manner in which an asset is used, or is expected to be used, with an adverse effect on the entity.**

If the asset is not being used in the same way as it was when originally put into service, the asset may be impaired. An example of an impaired asset that might be identified by this indicator is a school building that is being used for storage rather than for educational purposes.

- (g) **A decision to halt the construction of the asset before it is complete or is in a usable condition.**

An asset that will not be completed cannot provide the service intended. Examples of assets impaired in this manner include:

- (i) Construction stopped due to identification of an archaeological discovery or environmental condition such as nesting ground for a threatened or endangered species, and
- (ii) Construction stopped due to a decline in the economy.

The circumstances that led to the halting of construction should also be considered. If construction is deferred, that is, postponed to a specific,

foreseeable future date, the project could still be treated as work in progress and is not considered as halted.

- (h) **Evidence is available from internal reporting that indicates that the service performance of an asset is, or will be, worse than expected.**

Internal reports may indicate that an asset is not performing as expected or its performance is deteriorating over time. For example an internal health department report on a rural clinic may indicate that due to changes in the demographics of the area, the demand for the clinic services has sharply declined.

## **Appendix B: Measurement of Impairment Loss — Examples**

*This appendix illustrates the application of the provisions of the Standard to assist in clarifying their meaning. It does not form part of the Standard. The facts assumed in these examples are illustrative only and are not intended to modify or limit the requirements of the Standard or to indicate the Committee's endorsement of the situations or methods illustrated. Application of the provisions of this Standard may require assessment of facts and circumstances other than those illustrated here.*

***Note: In the following examples, unless a net selling price is indicated, it is assumed that the net selling price of the asset tested for impairment is less than its value in use or is not determinable. Therefore, the asset's recoverable service amount is equal to its value in use.***



## Example 1 — Depreciated Replacement Cost Approach

### Significant Long-term Change with Adverse Effect on the Entity in the Technological Environment —Underutilized mainframe computer

In 1999, the City of Kermann purchased a new mainframe computer at a cost of 10 million currency units. Kermann estimated that the useful life of the computer would be seven years and that on average 80 percent of central processing unit (CPU) capacity would be used by the various departments. A buffer of excess CPU time of 20 percent was expected and needed to accommodate scheduling jobs to meet peak period deadlines. Within a few months after acquisition, CPU usage reached 80 percent, but declined to 20 percent in 2003 because many applications of the departments were converted to run on desktop computers or servers. A computer is available on the market at the price of 500,000 currency units that can provide the remaining service potential of the mainframe computer using the remaining applications.

#### *Evaluation of Impairment*

The indicator of impairment is the significant long term change in technological environment resulting in conversion of applications from the mainframe to other platforms and therefore decreased usage of the mainframe computer. (Alternatively it can be argued that a significant decline in the extent of use of the mainframe indicates impairment.) Impairment loss is determined using the depreciated replacement cost approach as follows:

<b>a</b>	<b>Acquisition cost, 1999</b>	<b>10,000,000</b>
	<b>Accumulated depreciation, 2003 (a x 4 / 7 )</b>	<b><u>5,714,286</u></b>
<b>b</b>	<b>Carrying amount, 2003</b>	<b><u><u>4,285,714</u></u></b>
<b>c</b>	<b>Replacement cost</b>	<b>500,000</b>
	<b>Accumulated depreciation(d x 4 / 7)</b>	<b><u>285,714</u></b>
<b>d</b>	<b>Depreciated replacement cost</b>	<b><u><u>214, 286</u></u></b>
	<b>Impairment loss (d – b)</b>	<b><u><u>4,071,428</u></u></b>

## Example 2— Depreciated Replacement Cost Approach

### Significant Long-term Change with Adverse Effect on the Entity in the Manner of Use—School used as warehouse

#### *Assumptions*

In 1997, Lunden School District constructed an elementary school at a cost of 10 million currency units. The estimated useful life of the school is fifty years. In 2003, the school is closed because enrolments in the district declined unexpectedly due to a population shift caused by the bankruptcy of the major employer in the area. The school is converted to use as a storage warehouse, and Lunden School District has no evidence that enrolments will increase in the future such that the building would be reopened for use as a school. The current replacement cost for a warehouse of the same size as the school is 4.2 million currency units.

#### *Evaluation of Impairment*

Impairment is indicated because the purpose for which the building is used has changed significantly from a place for instructing students to a storage facility and this is not anticipated to change for the foreseeable future. An impairment loss using depreciated replacement cost approach would be determined as follows:

<b>a</b>	<b>Historical cost, 1997</b>	<b>10,000,000</b>
	<b>Accumulated depreciation (a x 6 / 50)</b>	<b>1,200,000</b>
<b>b</b>	<b>Carrying amount, 2003</b>	<b>8,800,000</b>
<b>c</b>	<b>Replacement cost of warehouse, 2003</b>	<b>4,200,000</b>
	<b>accumulated depreciation (c x 6 / 50 )</b>	<b>504,000</b>
<b>d</b>	<b>Depreciated replacement cost</b>	<b>3,696,000</b>
	<b>Impairment loss (d - b)</b>	<b>5,104,000</b>

## Example 3 — Depreciated Replacement Cost Approach

### Significant Long-term Change with Adverse Effect on the Entity in the Extent of Use—School partially closed due to decline in enrolment

In 1983, the Lutton School District constructed a school at the cost of 2.5 million currency units. The entity estimated the school would be used for 40 years. In 2003, the enrolment declined from 1000 to 200 students as the result of population shift caused by the bankruptcy of a major employer in the area. The management decided to close the top two floors of the three story school building. The current replacement cost of the one storey school is estimated at 1.3 million currency units.

#### *Evaluation of Impairment*

Impairment is indicated because the extent of use of the school has changed from three floors to one floor as the result of reduction in the number of students from 1000 to 200 students. The reduction in the extent of use is significant and the enrolment is expected to remain at the reduced level for the foreseeable future. Impairment loss using service units approach would be determined as follows:

<b>a</b>	<b>Acquisition cost, 1983</b>	<b>2,500,000</b>
	<b>Accumulated depreciation 2003 (a x 20/40)</b>	<b>1,250,000</b>
<b>b</b>	<b>Carrying amount 2003</b>	<b>1,250,000</b>
<b>c</b>	<b>Replacement cost</b>	<b>1,300,000</b>
	<b>Accumulated depreciation (c x 20/40)</b>	<b>650,000</b>
<b>d</b>	<b>Depreciated replacement cost</b>	<b>650,000</b>
<b>e - b</b>	<b>Impairment loss (d - b)</b>	<b>600,000</b>

## Example 4 — Restoration Cost Approach

### Physical Damage — School bus damaged in road accident

In 1998, North District Primary School acquired a bus at the cost of 200,000 currency units to help students from a nearby village with commuting free of charge. The school estimated a useful life of 10 years for the bus. In 2003, the bus sustained damage in a road accident requiring 40,000 currency units to be restored to a usable condition. The restoration will not affect the useful life of the asset. The cost of a new bus to deliver a similar service is 250,000 currency units in 2003.

### *Evaluation of Impairment*

Impairment is indicated because the bus has sustained physical damage in the road accident. Impairment loss using restoration cost approach would be determined as follows:

<b>a</b>	<b>Acquisition cost, 1998</b>	<b>200,000</b>
	<b>Accumulated depreciation (a / 10 X 5)</b>	<b>100,000</b>
<b>b</b>	<b>Carrying Amount, 2003</b>	<b>100,000</b>
<b>c</b>	<b>Current replacement cost</b>	<b>250,000</b>
	<b>Accumulated depreciation (c /10 X 5)</b>	<b>125,000</b>
<b>d</b>	<b>Depreciated replacement cost (undamaged state)</b>	<b>125,000</b>
	<b>Less: restoration cost</b>	<b>40,000</b>
<b>e</b>	<b>Depreciated replacement cost (damaged state)</b>	<b>85,000</b>
	<b>Impairment loss (b - e)</b>	<b>15,000</b>

## Example 5— Restoration Cost Approach

### Physical Damage—Building damaged by fire

In 1984, the City of Moreland built an office building at a cost of 50 million currency units. The building was expected to provide service for 40 years. In 2003, after 19 years of use, fire caused severe structural problems. Due to safety reasons, the office building is closed and structural repairs costing 35 million currency units are to be made to restore the office building to an occupiable condition. Assume that all the restoration costs are capitalizable. The replacement cost of a new office building is 100 million currency units.

***Evaluation of Impairment***

Impairment is indicated because the office building has sustained physical damage due to fire at the premises. Impairment loss using restoration cost approach would be determined as follows:

<b>a</b>	<b>Acquisition cost, 1984</b>	<b>50,000,000</b>
<b>b</b>	<b>Accumulated depreciation 2003 (ax19/ 40)</b>	<b><u>23,750,000</u></b>
<b>c</b>	<b>Carrying amount, 2003</b>	<b><u>26,250,000</u></b>
<b>d</b>	<b>Replacement cost ( of a new building)</b>	<b>100,000,000</b>
<b>e</b>	<b>Accumulated depreciation (dx19/ 40 )</b>	<b><u>47,500,000</u></b>
<b>f</b>	<b>Depreciated replacement cost (undamaged)</b>	<b>52,500,000</b>
<b>g</b>	<b>Less: restoration cost</b>	<b><u>35,000,000</u></b>
<b>h</b>	<b>Depreciated replacement cost (in damaged state)</b>	<b><u>17,000,000</u></b>
<b>i</b>	<b>Impairment loss (c– i)</b>	<b><u>9,250,000</u></b>

**Example 6 — Service Units Approach****Significant Long-term Change with Adverse Effect on the Entity in the Extent of Use—High rise building partially unoccupied for the foreseeable future**

In 1989, Ornog City Council constructed a 20 storey office building for use by the Council in downtown Ornog at the cost of 80 million currency units. The Building is expected to have a useful life of 40 years. In 2003, Federal Safety Regulations required that the top 4 stories of high rise buildings should be left unoccupied for foreseeable future. The building has a net selling price of 45 million currency units in 2003 after regulations came into force. The current replacement cost of a similar 20 storey building is 85 million currency units.

***Evaluation of Impairment***

Impairment is indicated because the extent of use of the office building has changed from 20 floors to 16 floors as the result of new Federal Safety Regulations. The reduction in the extent of use is significant and the occupation of the building is expected to remain at the reduced level (16 floors) for the foreseeable future. Impairment loss using service approach would be determined as follows:

<b>a</b>	<b>Acquisition cost 1989</b>	<b>80,000,000</b>
	<b>Accumulated depreciation 2003 (a /40 X 15)</b>	<b>30,000,000</b>
<b>b</b>	<b>Carrying Amount 2003</b>	<b>50,000,000</b>
<b>c</b>	<b>Replacement cost (20 storey)</b>	<b>85,000,000</b>
	<b>Accumulated depreciation (a /40 X 15)</b>	<b>31,875,000</b>
<b>d</b>	<b>Depreciated replacement cost</b>	<b>53,125,000</b>
<b>e</b>	<b>Value in Use = Depreciated replacement cost of a 16 storey building (d / 20 x 16)</b>	<b>42,500,000</b>
<b>f</b>	<b>Net selling price of the building after regulation came into force</b>	<b>45,000,000</b>
<b>g</b>	<b>Recoverable service amount (higher of e and f)</b>	<b>45,000,000</b>
	<b>Impairment loss (g - b)</b>	<b>5,000,000</b>

## Example 7: Service Units Approach

### Evidence from Internal Reporting— Higher cost of operating the printing machine

In 1998 Country X Education Department purchased a new printing machine at a cost of 40 million currency units. The Department estimated that the useful life of the machine would be 40 million copies of books to be printed over 10 years for use by elementary school students. In 2003, it was reported that an automated feature of the machine's function does not operate as expected resulting in a 25 percent reduction in the machine's annual output level over the remaining 5 years of the useful life of the asset. The replacement cost of a new printing machine is 45 million currency units in 2003.

### *Evaluation of Impairment*

Impairment is indicated by evidence from internal reporting that the service performance of the printing machine is worse than it was expected. Circumstances suggest that the decline in the service potential

of the asset is significant and of long-term nature. Impairment loss using service units approach is determined as follows:

<b>a</b>	<b>Acquisition cost, 1998</b>	<b>40,000,000</b>
	<b>Accumulated depreciation (a / 10 x 5)</b>	<b><u>20,000,000</u></b>
<b>b</b>	<b>Carrying amount, 2003</b>	<b><u>20,000,000</u></b>
<b>c</b>	<b>Replacement cost</b>	<b>45,000,000</b>
	<b>Accumulated depreciation (c / 10 x 5)</b>	<b><u>22,500,000</u></b>
<b>d</b>	<b>Depreciated replacement cost</b>	<b><u>22,500,000</u></b>
<b>e</b>	<b>Depreciated replacement cost of the remaining service potential (d x 75%)</b>	<b><u>16,875,000</u></b>
	<b>Impairment loss (e - b)</b>	<b><u>3,125,000</u></b>

## Appendix C: Basis for Conclusions

*This appendix gives reasons for supporting certain solutions related to the accounting for impairment of assets.*

### Measurement of Recoverable Service Amount

- C1. The core accrual International Public Accounting Standards (IPSASs) are based on the International Financial Reporting Standards (IFRSs), formerly known as International Accounting Standards (IASs), issued by the International Accounting Standards Board (IASB) to the extent that the requirements of those Standards are applicable to the public sector. The proposals in this ED reflect that policy. IAS 36 requires entities to determine the recoverable amount of an asset if there are indications that the asset is impaired. The recoverable amount of an asset is defined as the higher of value in use and net selling price of the asset.
- C2. As a prelude to this Exposure Draft, the Invitation to Comment *Impairment of Assets* (ITC) issued in 2000 proposed an approach to accounting for impairment of the assets of public sector entities that applied IAS 36 *Impairment of Assets* to the extent that it was appropriate. This ED has been developed after consideration of responses to the ITC

### Cash-Generating Assets

- C3. IAS 36 requires an entity to determine value in use as the present value of estimated future cash flows expected to arise from the continuing use of the asset and from its disposal at the end of its useful life. The service potential of cash-generating assets is reflected by their ability to generate future cash flows. This requirement is applicable to cash-generating assets held by public sector and the ED proposes the application of IAS 36 to account for impairment of cash-generating assets in the public sector.

### Non-cash-Generating Assets

- C4. In considering the principles underpinning a value in use concept applicable to non-cash-generating assets, the Committee agreed that the value in use of a non-cash-generating asset



should be measured by reference to the present value of the remaining service potential of the asset. This replicates the approach taken by IAS 36.

### **Determination of Value in Use**

- C5. The determination of the present value of the remaining service potential may be approached in a number of ways. One approach is the explicit determination requiring the discounting of the service units valued at an appropriate price using an appropriate discount rate (this is referred to as surrogate cash flow approach and clearly replicates IAS 36). Other approaches reflect an implicit determination of value in use and are based on measurements such as market value and current replacement cost.
- C6. The use of the surrogate cash flows approach involves estimation by the entity of cash inflows that would have arisen had the entity sold its services or other outputs on the market. However, services provided by many public sector assets are provided free of charge or at a nominal charge to the community. The Committee observed that (i) it is not clear whether this approach is appropriate for these assets and (ii) it is unlikely that this approach could be used in practice due to the complexities involved in the determination of surrogate cash flows and the appropriate discount rate to be used in a non-cash-generating context.
- C7. The Committee considered the following approaches involving an implicit determination of value in use:

#### ***Market value approach***

- C8. Under this approach, where an active market exists for the asset, the value in use of the non-cash-generating asset is measured at the observable market value of the asset. Where an active market for the asset is not available, the entity uses the best available market evidence of the price at which the asset could be exchanged between knowledgeable willing parties in an arm's length transaction, having regard to highest and best use of the asset for which market participants would be prepared to pay in the prevailing circumstances.

***Depreciated replacement cost approach***

- C9. Under this approach, the value in use of the asset is determined as the lowest cost at which the gross service potential embodied in the asset could be obtained in the normal course of operations less the value of the service potential already consumed. This approach assumes that the entity replaces the remaining service potential of the asset if it is deprived of it. An asset may be replaced either through reproduction (such as specialised assets) or through replacement of its gross service potential. Therefore, value in use is measured as the reproduction or replacement cost of the asset, whichever is lower, less accumulated depreciation calculated on the basis of such cost to reflect the already consumed or expired service potential of the asset.

***Restoration cost approach***

- C10. Under this approach, the value in use of the asset is determined by subtracting the estimated restoration cost of the asset from the market value or the replacement cost of the asset before impairment. This approach is usually used when impairments arise from physical damage.

***Service units approach***

- C11. This approach determines the value in use of the asset by reducing the market value or the replacement cost of the asset before impairment to conform to the reduced number of service units expected from the asset in its impaired state.

***Approaches adopted***

- C12. The Committee observed that the use of the observable market value as a proxy for value in use was redundant since market value differed from the net selling price (the other arm of recoverable service amount) only by the amount of selling costs involved and thus the market value would be effectively captured by the net selling price arm of impairment measurement. Accordingly, the Committee agreed that the value in use of a non-cash-generating asset should be measured using the other approaches cited above as appropriate.

## Goodwill and Other Intangibles

- C.13. Currently there are no IPSASs dealing with goodwill and other intangible assets. IAS 22 deals with the goodwill that arises in a business combination and IAS 38 deals with intangible assets. IAS 36 deals with impairment of goodwill and other intangible assets in a cash-generating context.
- C14. This Standard has not excluded goodwill and other intangible assets from its scope. The Committee, however, observed that goodwill as conventionally defined is not expected to arise in a non-cash generating context. Moreover, public sector intangible assets such as those reflecting the entity's ability to issue licences often arise in a cash flow context, and non-cash-generating intangible assets are envisaged to be of rare occurrence.

## Group of Assets and Corporate Assets

- C15. Under IAS 36, where it is not possible to determine the recoverable amount for an individual asset, then recoverable amount for the asset's cash-generating unit (CGU) should be determined. The CGU is the smallest identifiable group of assets that generates cash inflows from continuing use, and that is largely independent of the cash inflows from other assets or groups of assets. The Committee considered the concept of service generating unit in a non-cash-generating context and noted that as the proposed requirements in the ED are applied to individual assets, the adoption of such a concept by analogy to the CGU concept in IAS 36 is unnecessary. Moreover, its adoption would introduce undue complexities in accounting for impairment of non-cash-generating assets. However, the Committee observed that in some circumstances, governments or government entities may recognise assets on a group basis rather than on an individual basis. In such cases, professional judgment need to be used to determine the level at which the Standard is to be applied.
- C16. Under IAS 36, assets other than goodwill that contribute to the future cash flows of two or more CGUs are regarded as "corporate assets". In a cash generating context, because corporate assets do not generate separate cash inflows, the impairment of corporate assets are dealt with as part of the

impairment of the cash generating unit to which the corporate assets belongs. The Committee observed that in a non-cash-generating context, the identification of such assets necessitates the adoption of the concept of service generating unit which is not warranted as noted in paragraph C15 above. The Committee further noted that such assets are often an integral part of the service delivery function and their impairment are to be dealt with as for any other non-cash-generating assets of the entity.

## **Impairment of Non-Cash-Generating Assets Held by Government Business Enterprises (GBEs)**

C17. This Standard requires that the impairment of all assets held by GBEs be accounted for under IAS 36. GBEs are profit oriented entities and the assets employed by them are primarily cash generating assets. The Committee believes it is more appropriate to account for the impairment of non-cash-generating assets held by GBEs under IAS 36 for the following reasons:

- (a) Those GBE's that hold non-cash generating assets do so to dispose of their community service obligations as required by regulations. The acceptance of such obligations often acts as a precondition for engaging in profit making operations. Accordingly, non-cash generating assets are regarded as an integral part of cash generating operations. An analogy may be drawn with additional expenditure that a private sector entity is required to incur for the installation of equipments to reduce the emission of harmful gases. Such expenditure is required under the safety regulations and cannot be avoided if the entity is to carry out its operations. As such, such expenditure is a precondition for the performance of activities and an integral part of the costs of operations.
- (b) Non-cash-generating assets held by GBEs to carry out their community service obligations are often not material compared with the cash-generating assets. In such cases, in addition to the reason noted in (a) above, cost benefit considerations may not warrant accounting

for impairment of non-cash generating assets separately.

- (c) The preface to International Financial Reporting Standards (2002) has made it clear that IASB Standards can be applied by GBEs. Individual IPSASs make it explicit that IASB Standards should be applied to GBEs

Accordingly, non-cash flow assets are expected to be appropriately grouped with cash flow assets of GBEs to form a cash generating unit to be tested for impairment in accordance with IAS 36.

## Comparison with IAS 36

International Public Sector Accounting Standard IPSAS XX *Impairment of Assets* deals with the impairment of non-cash-generating assets. The main differences between IPSAS XX and IAS 36 *Impairment of Assets* are as follows:

- IPSAS XX deals with the impairment of non-cash generating assets of the public sector entities while IAS 36 deals with the impairment of cash-generating assets of private sector enterprises. IPSAS XX, however, requires that the impairment of cash generating assets of public sector entities including those of Government Business Enterprises be accounted for under IAS 36.
- The measurement of value in use under IPSAS XX is different from that under IAS 36 in that IPSAS XX measures the value in use of a non-cash generating asset using a number of different approaches while IAS 36 measures value in use as the present value of future cash flows from the asset.
- IPSAS XX does not give prominence to the change in the market value of the asset as an indicator of impairment. The change in market value appears in black letter in IAS 36 as part of the minimum set of indicators while IPSAS XX refers to it in commentary.
- IPSAS XX includes a decision to halt the construction of an asset before completion as an indicator of impairment and the resumption of the construction of the asset as an indicator of reversal of the impairment loss. There are no equivalents in IAS 36.
- IPSAS XX deals with the impairment of individual assets. There is no equivalent in IPSAS XX for cash-generating unit defined in IAS 36.
- IPSAS XX deals with “corporate assets” in the same manner as other non-cash-generating assets while IAS 36 deals with them as part of related cash-generating units.
- IPSAS XX uses different terminology, in certain instances, from IAS 36. The most significant examples are the use of the terms “entity”, “revenue”, “recoverable service amount” “statement of financial performance”, and “statement of financial position” in IPSAS XX. The equivalent terms in IAS 36 are “enterprise”, “income”, “recoverable amount”, “income statement”, and “balance sheet”.
- IPSAS XX contains many of the definitions of technical terms used in IAS 36 and an additional glossary of other defined terms.