International Public Sector Accounting Standard 21
Impairment of Non-Cash-Generating Assets

IPSASB Basis for Conclusions – as per 2017 IPSASB Handbook

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Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 21.

Introduction

BC1. The IPSASB's IFRS Convergence Program is an important element in the IPSASB's work program. The IPSASB's policy is to converge the accrual basis IPSASs with IFRSs issued by the IASB where appropriate for public sector entities.

BC2. The accrual IPSASs are based on the IFRSs issued by the IASB, to the extent that the requirements of those Standards are applicable to the public sector. The requirements of this Standard have been developed consistent with 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 fair value less costs to sell of the asset. This Standard includes a similar definition.

BC3. IAS 36 applies to cash-generating assets and cash-generating units, while this Standard applies to individual non-cash-generating assets. This results in a number of differences between the two standards. The main differences are:

(a) The method of measurement of value in use of a non-cash-generating asset under this Standard is different from that applied to a cash-generating asset under IAS 36;

(b) This Standard does not require entities to apply an impairment test to property, plant, and equipment carried at revalued amounts; and

(c) This Standard does not include a decrease in market value significantly greater than would be expected as a result of the passage of time or normal use as a minimum indication of impairment. This indication is included as an additional indication that impairment may exist.

The IPSASB's reasons for making these departures from the requirements of IAS 36 are explained in the paragraphs below.

BC4. An Invitation to Comment (ITC), *Impairment of Assets*, issued in 2000 proposed an approach to accounting for impairment of the assets of public sector entities that applied IAS 36 to the extent that it was appropriate. ED 23, *Impairment of Assets*, was developed after consideration of responses to the ITC and issued in 2003. This Standard was developed after consideration of the responses to ED 23.

Cash-Generating Assets

BC5. IAS 36 requires an entity to determine value in use as the present value of estimated future cash flows expected to be derived (a) from the continuing use of the asset, or cash-generating unit, and (b) 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. IPSAS 26 is based on IAS 36. The requirements of IPSAS 26 are applicable to cash-generating assets held by public sector entities. This Standard requires entities to apply IPSAS 26 to account for impairment of cash-generating assets in the public sector.

BC5A. IPSAS 40, *Public Sector Combinations,* was issued in January 2017. IPSAS 40 includes requirements for recognizing and measuring goodwill. In developing IPSAS 40, the IPSASB considered the requirements for impairing goodwill. The IPSASB noted that goodwill does not generate economic benefits independently of other assets, and is therefore assessed for impairment as part of a group of assets. Goodwill can only be measured by reference to cash flows, whether positive cash inflows or reductions in net cash outflows. The IPSASB also noted that IPSAS 21 deals with the impairment of individual assets only, and assesses impairment by reference to the present value of the remaining service potential of the asset. The IPSASB therefore concluded that it would not be appropriate to apply IPSAS 21 to the impairment of goodwill. The IPSASB concluded that, for the purposes of impairment, goodwill should be considered a cash-generating asset irrespective of whether the operation to which it relates is a cash-generating operation. The IPSASB agreed to include additional guidance in IPSAS 21 and in IPSAS 26 that goodwill should be considered a cash-generating asset for the purposes of impairment.

Non-Cash-Generating Assets

BC6. In considering the principles underpinning a value in use concept applicable to non-cash-generating assets, the IPSASB 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

BC7. Determining value in use (present value of remaining service potential) of a non-cash-generating asset may be approached in a number of ways. One approach that replicates IAS 36 involves estimating and discounting cash inflows that would have arisen had the entity sold its services or other outputs in the market. However, the IPSASB is of the view that it is unlikely that this approach could be used in practice, due to the complexities involved in determining the appropriate prices at which to value the service or other output units and estimating the appropriate discount rate.

BC8. Other approaches reflect an implicit determination of value in use. In this respect, the IPSASB considered the market value approach, and approaches that measure depreciated replacement cost, and include consideration of restoration cost and service units.

Market value approach

BC9. 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 the highest and best use of the asset for which market participants would be prepared to pay in the prevailing circumstances. The IPSASB noted that the use of the observable market value as a proxy for value in use was redundant, since market value differed from the fair value less costs to sell (the other arm of the recoverable service amount estimate) of the asset only by the amount of the costs of disposal. Therefore the market value would be effectively captured by the fair value less costs to sell arm of recoverable service amount.

Depreciated replacement cost approach

BC10. 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 specialized 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

BC11. This approach is usually used when impairment losses arise from damage. Under this approach, the value in use of the asset is determined by subtracting the estimated restoration cost of the asset from the depreciated replacement or reproduction cost of the asset before impairment.

Service units approach

BC12. This approach determines the value in use of the asset by reducing the depreciated replacement or reproduction 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

BC13. The IPSASB agreed that the value in use of a non-cash-generating asset will be measured using the depreciated replacement cost, the restoration cost, or the service units approaches cited above as appropriate.

Other Assets

BC14. IPSAS 21 contains specific requirements for testing intangible assets for impairment, and for recognizing and measuring impairment losses related to intangible assets. These requirements complement the requirements of IPSAS 31, *Intangible Assets*. Non-cash-generating intangible assets measured at cost are included in the scope of this Standard and should be tested for impairment according to the requirements of this Standard.

Group of Assets and Corporate Assets

BC15. Under IAS 36, where it is not possible to determine the recoverable amount for an individual asset, then the recoverable amount for the asset's cash-generating unit (CGU) will be determined. The CGU is the smallest identifiable group of assets (a) that generates cash inflows from continuing use, and (b) that is largely independent of the cash inflows from other assets or groups of assets. The IPSASB considered the concept of a service-generating unit in a non-cash-generating context. It noted that as the requirements in this Standard are applied to individual assets, the adoption of such a concept by analogy to the CGU concept in IAS 36 is unnecessary, because it is possible to identify the service potential of individual assets. Moreover, its adoption would introduce undue complexities in accounting for impairment of non-cash-generating assets.

BC16. 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 belong. The IPSASB observed that in a non-cash-generating context, the concept of a service-generating unit is not warranted, as noted in paragraph BC15 above. The IPSASB further noted that such assets are often an integral part of the service delivery function and their impairment is to be dealt with as for any other non-cash-generating assets of the entity.

Property, Plant, and Equipment and Intangible Assets

BC17. At the time this Standard was approved in December 2004, it did not require the application of an impairment test to non-cash-generating assets that are carried at revalued amounts under the revaluation model in IPSAS 17 and IPSAS 31. The IPSASB was of the view that under the revaluation model in IPSAS 17 and IPSAS 31, assets would 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 would be taken into account in the valuation. Therefore any difference between the asset's carrying amount and its fair value less costs to sell would be the disposal costs. The IPSASB was of the view that, in most cases, these would not be material and, from a practical viewpoint, it was not necessary to measure an asset's recoverable service amount and to recognize an impairment loss for the disposal costs of a non-cash-generating asset.

BC18. In contrast to this Standard, IAS 36 requires entities to test revalued assets for impairment after they have been revalued. The rationale for this difference was explained by reference to the factors set out in paragraphs BC19 and BC20 below.

BC19. Firstly, there are different methods of determining recoverable service amount under this Standard, and of determining recoverable amount under IAS 36. Recoverable service amount is defined in this Standard as the higher of a non-cash-generating asset's fair value less costs to sell and its value in use. Under this Standard, an entity determines an asset's value in use by determining the current cost to replace the asset's remaining service potential. The current cost to replace the asset's remaining service potential is determined using the depreciated replacement cost approach, and approaches described as the restoration cost approach and the service units approach. These approaches may also be adopted to measure fair value under IPSAS 17 and IPSAS 31 and therefore the value in use is a measure of fair value. Recoverable amount is defined in IAS 36 as the higher of an asset's fair value less costs to sell and its value in use. Value in use under IAS 36 is determined using the present value of the cash flows expected to be derived from continued use of the asset and its eventual disposal. IAS 36 states that the value in use may be different from the fair value of the asset.

BC20. Secondly, the requirement under IAS 36 to combine non-cash-generating assets with cash-generating assets to form a cash-generating unit is not replicated in this Standard. Under IAS 36, where an asset does not produce cash inflows, it is combined with other assets to form a cash-generating unit, the value in use of which is then measured. The sum of the fair values of the assets that make up a cash-generating unit may be different to the value in use of the cash-generating unit.

Impairment of Revalued Assets (Amendments to IPSAS 21 and IPSAS 26)

BC20A. As a consequence of requests from jurisdictions that apply IPSASs, in 2015 the IPSASB revisited the original decision to exclude revalued property, plant and equipment and intangible assets from the scope of IPSAS 21.

BC20B. The IPSASB considered that the rationale in paragraphs BC19 and BC20 for the different requirements in IPSAS 21 and IAS 36 remained sound. The IPSASB acknowledged the view that impairments would be taken into account when carrying out revaluations of assets to ensure that their carrying amounts do not differ materially from fair value, as required by paragraph 44 of IPSAS 17 and paragraph 74 of IPSAS 31.

BC20C. The IPSASB also acknowledged that it was ambiguous whether impairment losses and reversals of impairment losses are revaluations, given that they are accounted for in a similar manner. Paragraph 51 of IPSAS 17 requires an entire class of assets to be revalued if an item of property, plant and equipment belonging to that class is revalued. Therefore, if impairment losses and reversals of impairment losses are interpreted as revaluations the consequences are onerous. The IPSASB considered that it should resolve this ambiguity.

BC20D. The IPSASB also considered it important that users are provided with the quantitative and qualitative information on impairments specified in paragraphs 77 and 78 of IPSAS 21.

BC20E. The IPSASB's objective in clarifying the ambiguity, was to ensure that impairment losses and reversals of impairment losses of a revalued asset did not require an entity to revalue the entire class of assets to which that item belongs in order to recognize an impairment loss in respect of that item.

BC20F. Although including property, plant and equipment and intangible assets that are measured at revalued amounts within the scope of IPSAS 21 means that an entity is required to assess annually whether there is any indication that an asset may be impaired, it is likely that an entity will be aware of any indicators of impairment. The IPSASB therefore concluded that bringing property, plant and equipment and intangible assets that are measured at revalued amounts within the scope of IPSAS 21 will not be overly onerous for the preparers of financial statements.

BC20G. As a result of these considerations the IPSASB approved ED 57, *Impairment of Revalued Assets,* in September 2015 and published the ED the following month.

Responses to ED 57

BC20H. The majority of the respondents to ED 57 supported the proposals and the IPSASB's rationale. The IPSASB considered a proposal that a clarification that impairment losses and reversals of impairment losses of a revalued asset do not require an entity to revalue the entire class of assets to which that item belongs could be achieved more economically through a simple statement in IPSAS 17.

BC20I. The IPSASB acknowledged this view but considered it inappropriate for two reasons. Firstly, such an approach did not sufficiently address the different methods of determining value in use for non-cash generating assets when evaluating an asset's recoverable service amount. Such methods are the depreciated replacement cost approach, the restoration cost approach and the service-units approach. Secondly, the approach does not provide the information needed for accountability and decision-making purposes by users that is provided by the disclosures in IPSAS 21 and IPSAS 26. The IPSASB therefore decided to effect the proposals in ED 57 in a final pronouncement.

BC20J. Following comments by respondents to the ED the IPSASB reassessed the assertion in the Basis for Conclusions of ED 57 that impairments are conceptually different from revaluation decreases. Because both impairments and revaluation decreases involve a diminution of service potential or the ability to generate economic benefits, the IPSASB concluded that they are conceptually the same. However, there is a practical difference. Impairments are events that affect individual assets, or groups of assets, rather than the result of periodic revaluations. This practical difference is reflected in the statement in paragraph 51A of IPSAS 17 that "impairment losses and reversals of impairment losses of an asset under IPSAS 21 and IPSAS 26, *Impairment of Cash-Generating Assets*, do not necessarily give rise to the need to revalue the class of assets to which that asset, or group of assets, belongs."

Impairment of Non-Cash-Generating Assets Held by GBEs

BC21. When this Standard was issued, this Standard required that the impairment of all assets held by [GBEs] (the term in square brackets is no longer used following the issue of *The Applicability of IPSASs* in April 2016) be accounted for under IAS 36. When this Standard was issued GBEs were profit-oriented entities, and the assets employed by them were primarily cash-generating assets. When this Standard was issued, The *Preface to International Public Sector Accounting Standards* made it clear that GBEs were profit-oriented entities, and were therefore required to comply with IFRSs and IASs. When this Standard was issued, individual IPSASs made it explicit that IFRSs apply to GBEs. Accordingly, non-cash-generating assets were expected to be appropriately grouped with cash-generating assets of GBEs to form a cash-generating unit to be tested for impairment in accordance with IAS 36.

Indications of Impairment—Changes in Market Value

BC22. IAS 36 includes as a minimum indication of impairment that an asset's market value has declined significantly more than would be expected as a result of the passage of time or normal use. The IPSASB has included this as an additional indication of impairment, but not as a minimum indication of impairment. The IPSASB is of the view that these changes in market value do not necessarily indicate that a non-cash-generating asset is impaired. This is because non-cash-generating assets are held for reasons other than generating a commercial return; therefore, a change in market value may not reflect a change in the amount of service that the entity will recover from continued use of the asset.

Reversal of Impairment

BC23. Paragraph 60(a) includes resurgence of demand or need for services provided by the asset as a minimum indication of reversal of impairment, while paragraph 62(b) includes a significant long-term increase in demand or need for the services provided by the asset as an additional indication of possible reversal of impairment. The wording of these two indications is similar; however, they can be distinguished from each other because paragraph 60(a) refers to a resurgence of the demand that had declined and resulted in the recognition of an impairment loss. Paragraph 62(b) refers to new demand, and may be unrelated to the reason an impairment loss was recognized in respect of the asset.

BC24. Paragraph 62(a) includes a significant rise in an asset's market value as an additional indication of reversal of impairment. This does not mirror the indication of impairment in paragraph 27(a), which requires that the decline in market value be significantly more than would be expected as a result of the passage of time or normal use. This difference means that the increase in market value may be expected or unexpected.

BC25. Paragraph 27(c) includes "Evidence is available of physical damage of an asset" as a minimum indication of impairment. Paragraph 60 does not include an indication of reversal of impairment that mirrors this indication of impairment. The IPSASB has not included repair of an asset as an indication of reversal, because IPSAS 17 requires entities to add subsequent expenditure to the carrying amount of an item of property, plant, and equipment when it is probable that future economic benefits or service potential over the total life of the asset, in excess of the most recently assessed standard of performance of the existing asset, will flow to the entity. This requirement also applies to investment property that is measured using the cost model under IPSAS 16. The IPSASB is of the view that these requirements negate the need for an indication of reversal of impairment that mirrors the physical damage indication of impairment. The IPSASB also noted that restoration or repair of damage does not constitute a change in the estimate of the asset's recoverable service amount after impairment as specified by paragraph 65 of this IPSAS.

Revision of IPSAS 21 as a result of the IPSASB's *The Applicability of IPSASs*, issued in April 2016

BC26. The IPSASB issued *The Applicability of IPSASs* in April 2016. This pronouncement amends references in all IPSASs as follows:

(a) Removes the standard paragraphs about the applicability of IPSASs to "public sector entities other than GBEs" from the scope section of each Standard;

(b) Replaces the term "GBE" with the term "commercial public sector entities", where appropriate; and

(c) Amends paragraph 10 of the *Preface to International Public Sector Accounting Standards* by providing a positive description of public sector entities for which IPSASs are designed.

The reasons for these changes are set out in the Basis for Conclusions to IPSAS 1.