NCAP 4 Impairment of Assets

OVERVIEW
This Non-Current Asset Policy (NCAP) discusses the principles underlying the recognition of property, plant and equipment and intangible assets.

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4.1 APPLICATION OF AASB 136 AND NCAP 4 TO NOT-FOR-PROFIT AGENCIES

Under AASB 136 Impairment of Assets (paragraph Aus5.1), many assets of not-for-profit agencies are not held primarily for their ability to generate net cash inflows – rather they are specialised assets held for continuing use of their service capacity / service delivery.

Specialised assets will have very limited or no alternative use and/or be substantially customised to facilitate the delivery of particular public services. Specialised assets would ordinarily include various types of infrastructure, specialised buildings (e.g. prisons, hospitals, schools), and major plant and equipment that is substantially customised.

AASB 136 Impairment of Assets (paragraph Aus5.1) specifies that because such specialised assets of not-for-profit entities are rarely sold, their cost of disposal is typically negligible. Consequently, the recoverable amount of such specialised assets is expected to be materially the same as fair value, determined under AASB 13 Fair Value Measurement.

Consequently, in respect of not-for-profit agencies, AASB 136:

- **DOES NOT APPLY** to specialised assets measured **AT FAIR VALUE** under AASB 116 and AASB 138. However, not-for-profit agencies must continue to assess every year at reporting date whether there are any indicators that the service capacity of its assets have changed since the last revaluation was completed. Where indicators exist that the asset has experienced a material reduction in service capacity or remaining useful life since the effective date of the last valuation, the fair value of the asset should be reviewed and, if required, revalued downwards (refer to NCAP 3.5);

- **APPLIES** to specialised assets measured **AT COST** under AASB 116 and AASB 138; and

- **APPLIES** to all other non-specialised assets (including work-in-progress) and assets held for generating cash flows (in the rare circumstances cash-generating assets are held by not-for-profit agencies) under AASB 116 and AASB 138. For non-specialised assets measured at fair value (or an amount that approximates fair value), impairment would only arise in rare circumstances such as where the costs of disposal are material. Similar to specialised assets measured at fair value, any ‘impairment’ of these assets is also effectively captured through the revaluation process.

The requirements of AASB 136 Aus5.1 are not applicable to for-profit agencies. For-profit agencies must apply the relevant requirements of AASB 136 to all non-current assets, including work in progress assets (but excluding investment property measured at fair value).
4.2 IMPAIRMENT OVERVIEW

In general, an asset is impaired when its recoverable amount is less than its carrying amount (refer to NCAP 4.4 Recoverable Amount). If an asset is materially impaired, it must be written-down to its recoverable amount and an impairment loss recorded.

A review for impairment indicators must be performed and documented annually. For specialised assets of not-for-profit agencies measured at fair value (refer to NCAP 4.1), this review will form part of the annual revaluation process (refer to NCAP 3.5).

Where agencies are required to apply AASB 136 when testing for impairment, agencies only have to test an asset for impairment if there are indicators of impairment. Such indicators could be of a general nature e.g. floods, or more specific in nature such as a fire in a complex.

At reporting date, agencies should examine all work in progress (WIP) assets to determine the likelihood of the project continuing to completion in the original manner intended in order to assess the validity of expenditure capitalised into WIP to date. This is in addition to the original assessment of the ability to capitalise costs into WIP when the expenditure was first incurred.

The requirements of AASB 136 apply subject to the notion of materiality. For example, where the total value of an agency’s assets in a class is immaterial, compared to the total balance of Property, Plant and Equipment, that agency has discretion about whether or not to assess for impairment indicators for those assets. Also, where assets are tested for impairment and the total change in the written down value for the class of assets or the total impact on depreciation for the class of assets is material, then the impairment loss must be brought to account.

However, there may be circumstances where other adjustments may be more applicable than impairment adjustments or a revaluation decrement. For example, it may be more appropriate to derecognise an asset that is damaged so severely in a natural disaster that no future economic benefit will be derived from the asset. Another example is where management makes a decision to, and undertakes, a demolition during a reporting period – this is likely to reflect an asset write-off rather than an impairment.
4.3 INDICATORS OF IMPAIRMENT

Agencies must assess every year at reporting date whether there are any indicators that an asset may be impaired. The term ‘an asset’ applies equally to an individual asset or a cash generating unit. An entity is not required to make a formal estimate of recoverable amount of an asset if no indicators of impairment are identified.

Agencies are to have a framework in place to ensure that any impairment indicators are identified and if material impairment of an asset exists, that this is reflected in an agency’s asset records and financial statements (refer to process in Appendix 4.1, Flowchart 2).

For intangible assets with an indefinite useful life or an intangible asset not yet available for use, the agency must test for impairment annually (testing to ensure carrying amounts of assets do not exceed recoverable amounts), irrespective of whether there are any indicators of impairment, and whenever there is an indication that the intangible asset may be impaired.

The events or circumstances that may indicate the impairment of an asset will generally be significant and will often have prompted discussion by a management group or similar, or the media. Agencies should use judgement in identifying indicators of impairment.

Agencies should refer to AASB 136 (paragraph 12) for a list of minimum considerations for indicators of impairment. The list in the Standard is not exhaustive. Appendix 4.2 provides some examples of indicators of impairment or changes in service potential which may be applicable in the public sector.

An indicator of impairment will not always lead to an impairment loss being recorded. 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 needs to be reviewed and adjusted in accordance with the Standard applicable to the asset, even if no impairment loss is recognised for the asset. Judgement must be used to determine whether it is more appropriate to record an impairment loss, or make other adjustments. Reasons for these decisions must be included in supporting documentation.
4.4 CASH-GENERATING UNITS

Cash-generating units will generally only be applicable to for-profit agencies.

In some instances, it may not be possible for a for-profit agency to determine the recoverable amount of an individual asset as they do not generate cash flows independent from other assets. The cash-generating unit concept is only used when it is not possible to estimate the recoverable amount of an individual asset.

A cash-generating unit is the smallest identifiable group of assets which generates independent cash inflows. Therefore, agencies should start with individual assets, and identify the lowest aggregate of assets that generate largely independent cash inflows.

Example

In relation to power lines, an electricity distributor may find it difficult to determine the fair value of a single power line, or the present value of the line’s cash flows. If this occurs, the electricity distributor would group together assets to determine recoverable amount. For this example, the smallest number of assets within a power distribution network which generates its own cash inflow would need to be grouped together and the recoverable amount applied to the group.

Another example may be ports. It may be difficult to determine the recoverable amount of a single wharf, so the agency may group together the entire wharf facility, including such assets as the wharves, channels, loading equipment and the private access roads. Again, this must be the smallest grouping of assets which generates its own cash inflow.

Identification of a cash-generating unit to which an asset may belong involves professional judgement by management and ideally should be formally endorsed by a senior level of management.

Once the cash-generating units have been identified, these are to be consistently applied from year to year, unless a change is justified.

The recoverable amount of a cash-generating unit is determined in the same manner as for a single asset of a for-profit agency, i.e. the higher of fair value less costs of disposal and the value in use (i.e. present value of future cash flows expected to be derived from the unit).

A cash-generating unit is not a separate asset for reporting purposes. A cash-generating unit is used solely for the determination of impairment losses. Refer to AASB 136, paragraphs 100-102 for the treatment of impairment of corporate assets that relate to cash-generating units.
4.5 RECOVERABLE AMOUNT

Recoverable amount is determined under AASB 136 as the higher of an asset’s net selling price (fair value less costs of disposal) and its value-in-use.

**Fair Value less Costs of Disposal**

Fair value less costs of disposal is the amount that would be received to sell the asset in an orderly transaction between market participants at the measurement date, less the costs of disposal.

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

Refer to NCAP 3 Valuation of Assets for guidance on determining fair values.

**Value-in-use**

Value-in-use is the present value of the future cash flows expected to be derived from an asset. Value-in-use is calculated applying the requirements of paragraphs 30-57 of AASB 136 Impairment of Assets.

Where a for-profit agency receives Community Service Obligations (CSOs), these are to be included in the calculation to determine value-in-use.

When the carrying amount of an asset does not yet include all the cash outflows to be incurred before it is ready for use or sale, the estimate of future cash outflows includes an estimate of any further cash outflow that is expected to be incurred before the asset is ready for use or sale.

**Recoverable Amount and Not-for-Profit Agencies**

As outlined in NCAP 4.1, many assets of not-for-profit entities not held primarily for their ability to generate net cash inflows and are specialised assets held for continuing use of their service capacity. Where such specialised assets are measured at fair value, the recoverable amount of these assets is expected to be materially the same as fair value determined under AASB 13 Fair Value Measurement. Consequently, AASB 136 does not apply to those assets as any impairment losses are effectively captured through the revaluation process.

Where such assets are measured at cost, and indicators of impairment exist, the recoverable amount must be determined under AASB 136 as the higher of the fair value less costs of disposal (i.e. net fair value) and its
value-in-use. Since the value in use of a primarily non-cash generating asset would ordinarily be zero (or close to zero), the recoverable amount should be first assessed by considering the asset’s fair value under AASB 13. In these circumstances, not-for-profit agencies should firstly consider the current replacement cost or market value approaches before concluding the income method is the appropriate fair value determination of recoverable amount. This is because the income approach is likely to result in a fair value similar to the value-in-use calculation in the previous paragraph.

For non-specialised property, plant and equipment measured at fair value (or an amount that approximates fair value), impairment will only arise in rare circumstances such as where the costs of disposal are material. Similar to specialised assets measured at fair value, any ‘impairment’ of these assets is also effectively captured through the revaluation process.

Where an agency is not using an asset and a formal decision has been made not to re-use or replace the service potential/capacity of the asset (either in its current location, another location or with another agency), then the recoverable amount would ordinarily be equal to the present value of the net disposal proceeds. In this scenario, the fair value may correlate with the market value or the scrap value on disposal. (Agencies should also refer to NCAP 3.10 on the subject of assets withdrawn permanently from use.)

**Example**

This would occur where a policy decision has been made to withdraw from delivering a particular service or delivering it in another way, that renders the assets surplus to requirements.

Where the agency is not using an asset but the service potential/capacity of the asset will be replaced (including in another location or with another agency), the recoverable amount would ordinarily be the asset’s fair value determined by a current replacement cost approach or market value approach under AASB 13. (Agencies should also refer to NCAP 3.10 on the subject of temporary idle assets intended to be re-employed.)

Where the agency is not using the asset and no decision has made regarding re-use, replacement or redeployment of the service potential/capacity of the asset, agencies will need to assess the appropriate fair value/recoverable amount applicable in those circumstances.

By way of illustration, if the asset had severely limited / restricted service capacity/potential due to physical damage, or required substantial repairs to return to service, or the prospects for alternate use by another agency or third party are minimal/remote, it may be determined that the fair value under AASB 13 is zero until such time as a formal decision is made. Alternatively, if the asset had no indicators of reduced service capacity and the potential to be re-used (including by another agency), then it may be treated in the same manner as a temporarily idle asset (as identified above). Consequently, the fair value determined by a current replacement cost approach or market value approach under AASB 13 reflecting its highest and best use to market participants may be more appropriate.
In the rare instance that a not-for-profit agency holds an asset for its ability to generate a commercial return, the value-in-use will be the present value of the future cash flows expected to be derived from the asset.

### 4.6 RECORDING AN IMPAIRMENT LOSS

An impairment loss is recognised immediately in the Statement of Comprehensive Income, unless the asset is carried at a revalued amount.

When an asset is measured at a revalued amount, the impairment loss is to be treated in the same way as a revaluation decrement, i.e. offset against the asset revaluation surplus to the extent available for that same asset (for-profit agencies) or same class of assets (not-for-profit agencies).

Following the recognition of an impairment loss, the depreciation/amortisation charge for the asset is to 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.

**Cash Generating Unit – allocating an impairment loss**

While the impairment loss is determined for a cash-generating unit, the loss is allocated against individual assets. The impairment loss is allocated firstly to reduce the carrying amount of any goodwill and then on a pro-rata basis against the carrying amount of each asset in the unit. These reductions in carrying amounts are treated and recognised as impairment losses on individual assets.

In allocating an impairment loss of a cash-generating unit across all assets in the unit, an agency must not reduce the carrying amount of an asset below the highest of:

(a) its fair value less costs of disposal (if determinable);
(b) its value-in-use (if determinable); and
(c) zero.

If the entire amount of an impairment loss cannot be allocated to an individual asset due to the rules above, the remaining impairment loss that would otherwise have been allocated to the asset is allocated pro rata to the other assets of the cash-generating unit.

**Revaluations and Accumulated Impairment Losses**

When an asset is revalued using either a market or income valuation approach, the balance of accumulated impairment losses at the date of recognition of the revaluation should be eliminated at that date against the gross amount of the asset, consistent with the accounting treatment for accumulated depreciation under the ‘net method’ (refer also to NCAP 5.6 Other Depreciation Issues, including the examples within that section).
4.7 REVERSING AN IMPAIRMENT LOSS

An impairment loss recognised under AASB 136 can be reversed for all assets other than goodwill.

At each reporting date, an agency must assess whether there is any indication that a previously recognised impairment loss may no longer exist or may have decreased. If an indication exists, the agency must again determine recoverable amount. The indicators for potential reversal of prior year impairment are outlined in paragraph 111 of AASB 136. To the extent that such indicators exist, agencies are to consider adjustments to the asset’s remaining useful life, the depreciation/amortisation method or the residual value (if any), even if no impairment reversal is recognised.

An impairment loss can only be reversed if there has been a change in the estimates used to determine the asset’s recoverable amount since the last impairment loss was recognised. AASB 136 provides examples of changes in estimates in paragraph 115. In reversing an impairment loss, the same rules apply as to those when impairment losses are initially recognised, in that the reversal is recognised immediately in the Statement of Comprehensive Income, unless the asset is carried at a revalued amount, in which case the reversal is treated as a revaluation increase.

In relation to for-profit agencies, a reversal of an impairment loss on a revalued asset can only be offset against a prior decrement to the extent available for the same asset. In respect of not-for profit agencies, a reversal of an impairment loss on a revalued asset can only be offset against a prior decrement for the same class of asset.

When reversing the impairment loss of a (completed) asset that was impaired when the asset was work in progress, the reversal is to go through the Statement of Comprehensive Income. This is because the reversal relates to that particular asset, of which the initial impairment would have been recognised immediately in the Statement of Comprehensive Income (WIP assets are carried at cost).

When reversing the impairment loss of an individual asset, the increased carrying amount must not exceed the carrying amount that would have been determined had no impairment loss been recognised. As a result, agencies must ensure that they maintain a record of the value of the asset exclusive of the impairment loss. A reversal of an impairment loss for a CGU is to be allocated on a pro rata basis according to the relative carrying amounts of the assets of the unit (apart from goodwill). In allocating a reversal of an impairment loss for a cash-generating unit, the carrying amount of an asset must not be increased above the lower of:

(a) its recoverable amount (if determinable); and
(b) the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior periods.

Any amount of a reversal of an impairment loss that cannot be allocated to an individual asset due to the rules above is to be allocated pro rata to the other assets of the unit. Goodwill is not to be included in the allocation process.

### 4.8 DISCLOSURE REQUIREMENTS

Agencies are to make the relevant disclosures in relation to impairment in accordance with paragraphs 126, 129, 130, 131, 133, 134 and 135 of AASB 136. Further, to ensure transparent reporting, an additional line of disclosure is to be included in the notes to the financial statements so that Accumulated Impairment Losses is disclosed separately from Accumulated Depreciation.
APPENDIX 4.1 IMPAIRMENT DECISION MAKING

Flowchart 1 - Is an Asset Impaired?

START

1. Is the agency for-profit or not-for-profit?
   - FP
   - NFP

2. Is the asset cash-generating?
   - Yes
   - No

3. Is the asset specialised?
   - Yes
   - No

4. Is the asset measured at cost or FV?
   - Cost
   - FV

5. Are there any indicators that the asset may be materially impaired?
   - Yes
   - No

6. Can the recoverable amount of the asset be determined independently of other assets?
   - Yes
   - No

7. Identify cash-generating unit *

8. Does the carrying amount of the CGU exceed the higher of its fair value less costs of disposal and its value in use (i.e. the present value of future cash flows)?
   - Yes
   - No

9. Document in work papers, obtain approval from CFO

10. Impairment

11. Go to Flowchart 2

12. Document in work papers, obtain approval from CFO

13. No Impairment

* Would be rare to have cash-generating unit in a not-for-profit entity
Flowchart 2 - How is an Impairment Loss Recognised?

Once an asset has been identified as being impaired (refer to Flowchart 1), calculate the impaired loss.

Is the asset carried at fair value?

Are you a for-profit agency?

Yes

Has a previous increment been recognised for the individual asset?

Yes

Recognise the impairment loss in the Statement of Comprehensive Income

No

Recognise the impairment loss in the Statement of Comprehensive Income

Has a previous increment been recognised for the class of assets?

No

To the extent available, offset the impairment loss against the Asset Revaluation Surplus (ARS) for the asset

Any amount over the ARS is to be recognised in the Statement of Comprehensive Income

Yes

To the extent available, offset the impairment loss against the Asset Revaluation Surplus (ARS) for the class

Any amount over the ARS is to be recognised in the Statement of Comprehensive Income
APPENDIX 4.2  EXAMPLES OF INDICATORS OF IMPAIRMENT OR CHANGE IN THE SERVICE POTENTIAL OF AN ASSET

Note:

As noted in NCAP 3.5 and 4.1, changes in service potential of assets measured at fair value are typically accounted for through the asset valuation process and via the asset revaluation reserve (or revaluation decrement/increment in the operating result if applicable).

NCAP 3.5 and 4.1 also identify that, depending on the agency’s classification (i.e. not-for-profit vs for-profit) and the asset’s measurement base (fair value vs cost), an indicator of impairment may also describe a change in service potential in the asset. Agencies should apply appropriate judgement when assessing indicators of impairment and indicators of change in service potential.

Agencies should ensure that a proper distinction is made between impairments accounted for under AASB 136 and revaluation adjustments accounted for under AASB 116 (including ‘impairments’ of assets measured at fair value which are accounted for as revaluation adjustments under AASB 116).

Some of the following examples have been taken from IPSAS 21 – *Impairment of Non-Cash Generating-Assets.*

(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*

- A school closed because of a lack of demand for school services arising from a population shift to other areas. It is not anticipated that this demographic trend affecting the demand for the school services will reverse in the foreseeable future.
- 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 who have stayed behind use the cheaper bus service).
- A convention centre or stadium’s principal lessee does not renew its lease with the result that the facility is expected to close.

(b)  Significant long-term changes in the technological environment with an adverse effect on the agency

The service utility of an asset may be reduced if technology has advanced to produce alternatives that provide better or more efficient service.

*Examples*

- Medical diagnostic equipment is rarely or never used because a newer machine embodying more advanced technology provides more accurate results.
• Software is no longer being supported by the external supplier because of technological advances and the agency does not have the personnel to maintain the software.

• Computer hardware 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*

• An automobile does not meet new emission standards or a plane that does not meet new noise standards.

• A school can no longer be used for instruction purposes due to new safety regulations regarding its building materials or emergency exit procedure.

• A water treatment plant cannot be used because it does not meet new environmental standards.

(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*

• A building is damaged by fire or flood or other factors.

• A building is closed due to identification of structural deficiencies.

• 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.

• A dam’s spillway has been reduced as a result of a structural assessment.

• A water treatment plant’s capacity has been reduced by intake blockage and the removal of the blockage is not economical.

• A bridge is weight-restricted due to identification of structural deficiencies.

• Equipment is damaged and can no longer be repaired or for which repairs are not economically feasible.

• Cracked water pipes are unable to supply the same amount of water due to leaks.

(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 agency**

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. 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.
Example

- A mainframe computer that is underutilized because many applications have been converted or developed to operate on servers or PC platforms.
- The design specifications of a computer software system under development change part way through the build phase. As a result, certain modules already designed and developed (and forming part of capital work-in-progress) are no longer required.

(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 agency.

If the asset is not being used in the same way as it was when originally put into service, the asset may be impaired.

N.B. When determining the fair value of the asset under AASB 13, the agency would ignore entity-specific factors and would also consider ‘highest and best use’. Therefore, an internal change in the manner in which an asset is used may not automatically result in an asset's recoverable amount being materially less than its carrying amount (despite the apparent indicator of impairment or change in service potential to the agency).

Example

- A school building that is being used for storage rather than for educational purposes.
- Park fountains no longer being used due to water restrictions and is filled in as a garden bed

(g) Evidence is available from internal reporting that indicates that the service performance of an asset is, or will be, significantly worse than expected

Internal reports may indicate that an asset is not performing as expected or its performance is deteriorating over time.

Example

- An internal health department report on operations of a rural clinic may indicate that an x-ray machine used by the clinic is impaired because the cost of maintaining the machine has significantly exceeded that originally budgeted.

(h) Market for the asset under construction declines

If the market in which the work in progress asset operates declines, the asset would be impaired

Example

- The market for investment property may decline. This may indicate that a property under construction is impaired because of the decline in value as a result of the market decline.