INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS OF KENYA

ASSET VALUATION AND IMPAIRMENT WORKSHOP

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ASSET VALUATION AND IMPAIRMENT WORKSHOP

IPSAS 21 & IPSAS 26

SESSION OVERVIEW

IPSAS 21 & IPSAS 26

- Impairment identification
- Recognition and measurement
- Impairment reversals
- Disclosure requirements
- Practical application
- Questions and answers

IPSAS 21 Impairment of Non-Cash-Generating Assets

Effective date
Annual periods beginning on or after January 1, 2006.

Objective
To ensure that non cash-generating assets are carried at no more than their recoverable service amount, and to prescribe how recoverable service amount is calculated.

Summary
•IPSAS 21 applies to all non-cash-generating assets, except assets arising from construction contracts (see IPSAS 11), inventories (see IPSAS 12), financial assets that are included in the scope of IPSAS 29, investment property measured at fair value (see IPSAS 16), non-cash-generating property, plant and equipment that is measured at revalued amounts (see IPSAS 17), and other assets in respect of which accounting requirements for impairment are included in another IPSAS.

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IPSAS 21 Impairment of Non-Cash-Generating Assets

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KEY DEFINITIONS

1) Recoverable service amount - the higher of a NCG assets fair value less costs to sell and its value in use.
2) An impairment - a loss in the future economic benefits or service potential of an asset, over and above the systematic recognition of the loss of the assets future economic benefits or service potential through depreciation.
3) An impairment loss of a non-cash-generating asset -the amount by which the carrying amount of an asset exceeds its recoverable service amount
4) Value in use of a non-cash-generating asset – the present value of the assets remaining service potential.

IPSAS 21 Impairment of Non-Cash-Generating Assets

•Public sector entities that hold cash-generating assets shall apply IPSAS 26 to such assets.
•An impairment loss of a non-cash-generating asset is the amount by which the carrying amount of an asset exceeds its recoverable service amount.

An impairment loss shall be recognised immediately in surplus or deficit.

•After the recognition of an impairment loss, the depreciation (amortisation) charge for the asset shall 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.

IPSAS 21 Impairment of Non-Cash-Generating Assets

MEASURMENT

Recoverable service amount is the higher of a non-cash-generating asset's fair value, less costs to sell and its value in use.

Value in use of a non-cash-generating asset is the present value of the asset's remaining service potential. The present value of the remaining service potential of the asset is determined using any one of the following three approaches, and depends on the availability of data and the nature of the impairment:

IPSAS 21 Impairment of Non-Cash-Generating Assets

1) Depreciated replacement cost 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 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.

2) Restoration cost 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.

IPSAS 21 Impairment of Non-Cash-Generating Assets

3) Service units 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 before impairment, whichever is lower

At each reporting date, review assets to assess for any indication that an asset may be impaired. If impairment is indicated, the entity shall estimate recoverable service amount. Reversal of prior years' impairment losses allowed in certain instances.

IPSAS 21 Impairment of Non-Cash-Generating Assets

RECOGNITION

An entity shall disclose the following for each class of assets:
(a) The amount of impairment losses recognized in surplus or deficit during the period and the line item(s) of the statement of financial performance in which those impairment losses are included.
(b) The amount of reversals of impairment losses recognized in surplus or deficit during the period and the line item(s) of the statement of financial performance in which those impairment losses are reversed.

IPSAS 21 Impairment of Non-Cash-Generating Assets

DISCLOSURE

At each reporting date, review assets to assess for any indication that an asset may be impaired. If impairment is indicated, the entity shall estimate recoverable service amount. Reversal of prior years' impairment losses allowed in certain instances.

Entity is required to disclose the criteria applied to distinguish following classes of assets [IPSAS 21.72A]:

- cash generating assets
- non-cash-generating assets

Disclosures by class of assets [IPSAS 21.73]:

- impairment losses recognized in surplus or deficit
- impairment losses reversed in surplus or deficit
- line item(s) of the statement of statement of financial performance affected

If an impairment loss (reversal) is individually material the following should be disclosed [IPSAS 21.77]

- events and circumstances resulting in the (reversal) impairment loss
- amount of the loss or reversal

IPSAS 26 Impairment of Cash-Generating Assets (IAS 36)

Effective date

Periods beginning on or after April 1, 2009. Earlier application is encouraged.

Objective

To prescribe the procedures that an entity applies to determine whether a cash-generating asset is impaired and to ensure that impairment losses are recognised. This standard also specifies when an entity shall reverse an impairment loss and prescribes disclosures.

IPSAS 26 Impairment of Cash-Generating Assets

Summary

•IPSAS 26 applies to the accounting for the impairment of all cash-generating assets except inventories (see IPSAS 12), assets arising from construction contracts (see IPSAS 11), financial assets that are within the scope of IPSAS 29, investment property measured at fair value (see IPSAS 16), cash-generating property, plant, and equipment that is measured at revalued amounts (see IPSAS 17), deferred tax assets, assets arising from employee benefits (see IPSAS 25), intangible assets that are regularly revalued to fair value, goodwill, biological assets related to agricultural activity measured at fair value less estimated point-of-sale costs, deferred acquisition costs and intangible assets arising from an insurer's contractual rights under insurance contracts, noncurrent assets classified as held for sale and discontinued operations, and other cash-generating assets in respect of which accounting requirements for impairment are included in another IPSAS.

•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 the asset 's future economic benefits or service potential through depreciation.

IPSAS 26 Impairment of Cash-Generating Assets

MEASUREMENT AND RECOGNITION

The recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use.

•An impairment loss of a cash-generating asset is the amount by which the carrying amount of an asset exceeds its recoverable amount.

•An entity shall assess at each reporting date whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset.

•An entity shall test an intangible asset with an indefinite useful life or an intangible asset not yet available for use for impairment annually by comparing its carrying amount with its recoverable amount. This impairment test may be performed at any time during the reporting period, provided it is performed at the same time every year.

•If, and only if, the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset shall be reduced to its recoverable amount. That reduction is an impairment loss.

IPSAS 26 Impairment of Cash-Generating Assets

MEASUREMENT AND RECOGNITION

•An impairment loss shall be recognised immediately in surplus or deficit. When the amount estimated for an impairment loss exceeds the carrying amount of the asset to which it relates, an entity shall recognise a liability if, and only if, that is required by another IPSAS.

•After the recognition of an impairment loss, the depreciation (amortisation) charge for the asset shall 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.

•Value in use of a cash-generating asset is the present value of estimated future cash flows expected to be derived from the continuing use of an asset, and from its disposal at the end of its useful life.

IPSAS 26 Impairment of Cash-Generating Assets

MEASUREMENT AND RECOGNITION

Discount rate is the pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the asset. The discount rate shall not reflect risks for which future cash flows have been adjusted and shall equal the rate of return that investors would require if they were to choose an investment that would generate cash flows equivalent to those expected from the asset.

If it is not possible to determine the recoverable amount for the individual cash-generating asset, then determine recoverable amount for the asset's cash-generating unit.

IPSAS 26 Impairment of Cash-Generating Assets

MEASUREMENT AND RECOGNITION

If an active market exists for the output produced by an asset or group of assets, that asset or group of assets shall be identified as a cash-generating unit, even if some or all of the output is used internally. If the cash inflows generated by an asset or cash-generating unit are affected by internal transfer pricing, an entity shall use management's best estimate of future prices that could be achieved in arm's length transactions in estimating:

−The future cash outflows used to determine the value in use of any other assets or cash-generating units that are affected by the internal transfer pricing.

•In allocating an impairment loss, an entity shall not reduce the carrying amount of an asset below the highest of:

−Its fair value less costs to sell (if determinable)

−Its fair value in use (if determinable) Zero

IPSAS 26 Impairment of Cash-Generating Assets

MEASUREMENT AND RECOGNITION

Where a non-cash-generating asset contributes to a cash-generating unit a proportion of the carrying amount of that non-cash-generating asset shall be allocated to the carrying amount of the cash-generating unit prior to estimation of the recoverable amount of the cash-generating unit. The carrying amount of the non-cash-generating asset shall reflect any impairment losses at the reporting date which have been determined under the requirements of IPSAS 21.

•An impairment loss recognised in prior periods for an asset shall be reversed if, and only if, there has been a change in the estimates used to determine the asset’s recoverable amount since the last impairment loss was recognised. If this is the case, the carrying amount of the asset shall be increased to its recoverable amount. That increase is a reversal of an impairment loss.

IPSAS 26 Impairment of Cash-Generating Assets

MEASUREMENT AND RECOGNITION

- The redesignation of an asset from a cash-generating asset to a non-cash-generating asset or from a non-cash-generating asset to a cash-generating asset shall only occur 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 arises from, as a minimum, the listed indications applicable to the asset after redesignation.
- An entity shall disclose the criteria developed by the entity to distinguish cash-generating assets from non-cash-generating assets. Other disclosure requirements are applicable.

IPSAS 26 Impairment of Cash-Generating Assets

DISCLOSURE

An entity shall disclose the criteria developed by the entity to distinguish cash-generating assets from non-cash-generating assets.

An entity shall disclose the following for each class of assets:

(a) The amount of impairment losses recognized in surplus or deficit during the period, and the line item(s) of the statement of financial performance in which those impairment losses are included

(b) The amount of reversals of impairment losses recognized in surplus or deficit during the period, and the line item(s) of the statement of financial performance in which those impairment losses are reversed.

IPSAS 26 Impairment of Cash-Generating Assets

DISCLOSURE

An entity is required to disclose the criteria applied to distinguish following classes of assets [IPSAS 26.114]:

- cash generating assets
- non-cash-generating assets

Disclosures by class of assets [IPSAS 26.115]:

- impairment losses recognized in surplus or deficit
- impairment losses reversed in surplus or deficit
- line item(s) of the statement of statement of financial performance affected

Disclosure by reported segment [IPSAS 26.119]

- impairment losses recognized
- impairment losses reversed

IPSAS 26 Impairment of Cash-Generating Assets

DISCLOSURE

If an impairment loss (reversal) is individually material the following should be disclosed [IPSAS 26.120]

- events and circumstances resulting in the (reversal) impairment loss
- amount of the loss or reversal
- for an individual asset:
  - o nature of the asset
  - o the segment to which the asset belongs
- cash generating unit
  - o description of the CGU and amount of impairment loss (reversal) by class of assets and segment
  - o if the method for aggregating assets to a CGU has changed, a description of the change and the current and previous method
- whether the recoverable service amounts is (i) fair value less cost to sell or (ii) value in use
- when recoverable amounts is <u>fair value less cost to sell</u>: the basis used to determine fair value less disposal cost (active market, recent prices,…)

Practical Sessions

A public hospital has ten wards, nine of which are used for fee-paying patients on a commercial basis, and the other is used for non-fee-paying patients. Patients from both wards jointly use other hospital facilities (for example, operating facilities). The extent to which the asset is held with the objective of providing a commercial return needs to be considered to determine whether the entity should apply the provisions of this Standard or IPSAS 21. If, as in this example, the non-cash-generating component is an insignificant component of the arrangement as a whole, the entity applies this Standard, rather than IPSAS 21.

Source: IPSAS 26

Practical Sessions

An entity may have municipal parking garage that is currently being used at 25 percent of capacity. It is held for commercial purposes and management has estimated that it generates a commercial rate of return when usage is at 75 percent of capacity and above. The decline in usage has not been accompanied by a significant increase in parking charges. The asset is regarded as impaired because its carrying amount exceeds its recoverable amount.

Source: IPSAS 26

QUESTIONS AND ANSWERS