NCAP 4 Impairment of Non-Current Assets

OVERVIEW

This Non-Current Asset Policy (NCAP) discusses the principles underlying the impairment of non-current 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 and are rarely sold – rather they are typically 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) that have a sales market 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 all material asset classes. 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). Agencies only need to test an asset for impairment if there are indicators of impairment.
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.

Refer to Appendix 4.1 Flowchart 1 for an overview of the decision-making process around asset 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, at each reporting date, 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.

NCAP Tools Illustrative Example 4.3.1 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.

For assets to which impairment does not apply (i.e. specialised assets of not-for-profit agencies that are not held primarily for generating cash flows and are measured at fair value), there is no need to assess impairment indicators annually. Nevertheless, if the agency becomes aware of an impairment indicator, it is likely evidence of a significant change in the asset's fair value, which would warrant a specific appraisal to be performed in the current financial year in accordance with NCAP 3.6.

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.

Refer to NCAP Tools Illustrative Example 4.4.1.

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 fair value less costs of disposal (i.e. net selling price) and its value-in-use.

4.5.1. Fair Value less 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 Non-Current Assets for guidance on determining fair values.

4.5.2. 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.*

It is Treasury policy that 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.

4.5.3. Recoverable Amount and Not-for-Profit Considerations

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. 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 section.

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.

For non-specialised property, plant and equipment measured at 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.

Unused assets

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. An example would be a policy decision to cease delivering a particular service that renders the asset surplus to requirements. 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.)

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.

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). Refer to the decision tree in Appendix 4.1 Flowchart 2.

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.

4.6.1. 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.

4.6.2. Revaluations and Accumulated Impairment Losses

It is Treasury policy that 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 shall be eliminated at that date against the gross amount of the asset. This is consistent with Treasury's policy to account for accumulated depreciation using the 'net method' for assets revalued using a market or income approach (refer NCAP 5.5 Other Depreciation Issues).

Agencies are reminded that any impairment of assets measured at fair value is ordinarily already captured by the revaluation process, as outlined in NCAP 4.1 and NCAP 4.5.

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.

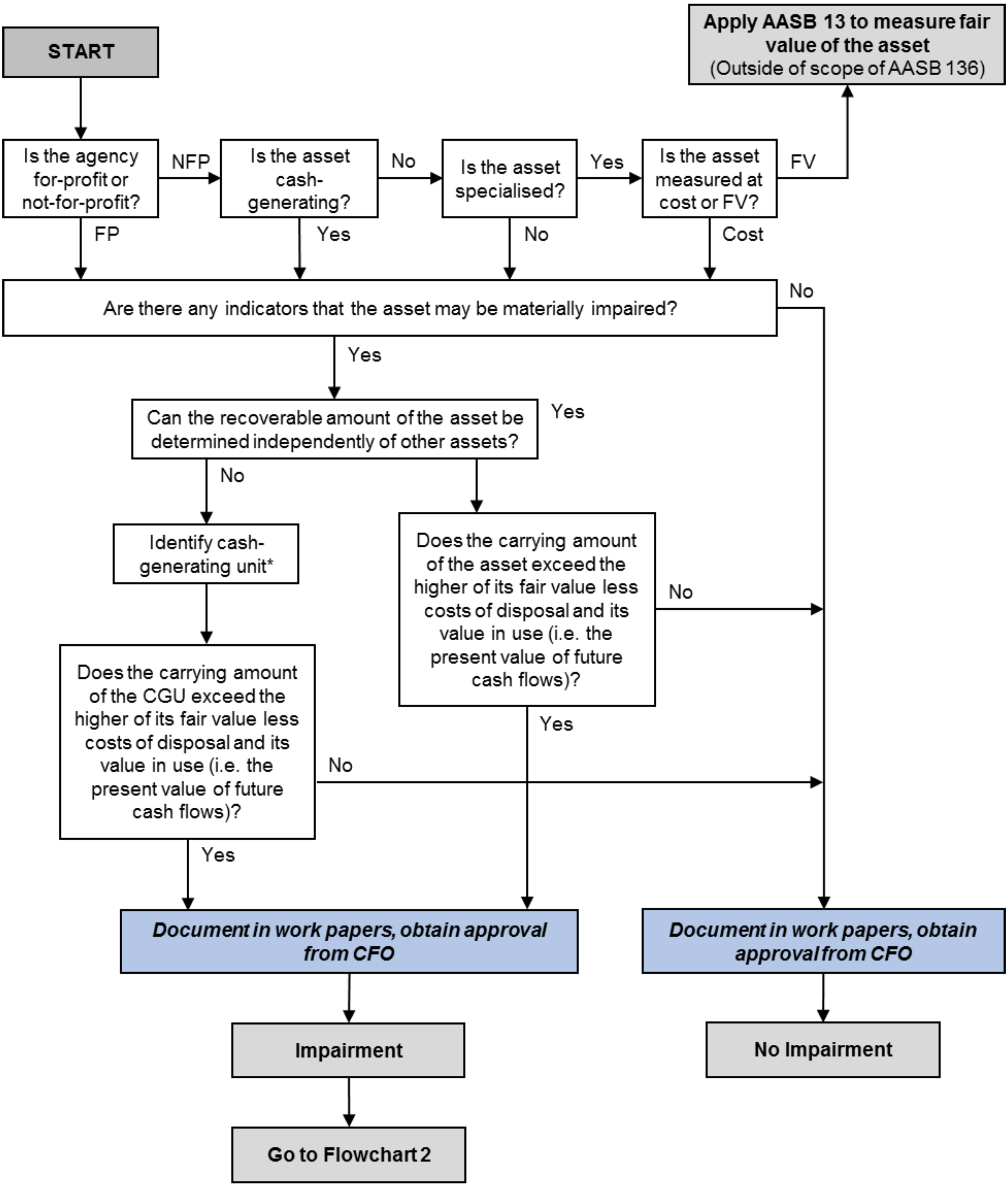
In relation to for-profit agencies, a reversal of an impairment loss on a revalued asset can only be offset against a prior decrement to the extent available for the same asset. In respect of not-for profit agencies, a reversal of an impairment loss on a revalued asset can only be offset against a prior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

APPENDIX 4.1 IMPAIRMENT DECISION MAKING

Flowchart 1 - Is an Asset Impaired?



* Would be rare to have cash-generating unit in a not-for-profit entity

Flowchart 2 - How is an Impairment Loss Recognised?