

PROPOSED STATUTORY BOARD FINANCIAL REPORTING STANDARD GUIDANCE NOTE 8

Impairment of Non-Cash Generating Assets

SB-FRS Guidance Note 8 Impairment of Non-Cash Generating Assets applies to Statutory Boards from annual periods beginning on or after 1 April 2017. Earlier application is permitted.

Comments to be received by 26 August 2016

This exposure draft *Accounting and Disclosure for Donations* is issued by the Accountant-General's Department Financial & Management Reporting Directorate for comments only and does not necessarily represent the views of the Directorate. The proposals may be modified in the light of the comments received before being issued as a Statutory Board Financial Reporting Standard (SB-FRS).

Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, clearly explaining the problem and providing a suggestion for alternative wording with supporting reasoning.

Comments should be submitted in writing, so as to be received by 26 **August 2016** preferably by email to AGD_ASSB_Feedback@agd.gov.sg or addressed to:

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Statutory Board Financial Reporting Standard Guidance Note 8 Impairment of Non-Cash Generating Assets is set out in paragraphs 1- 23 and Annex. All the paragraphs have equal authority. SB-FRS Guidance Notes are issued to standardise the accounting and disclosure requirements of Statutory Boards in specific areas and are to be complied with by Statutory Boards. These Guidance Notes rank behind SB-FRS and INT SB-FRS in terms of importance.

The principles in SB-FRS Guidance Note 8 have been adapted from International Public Sector Accounting Standards IPSAS 21 Impairment of Non-Cash-Generating Assets.

This SB-FRS includes select text and extracts from the *Handbook of International Public Sector Accounting Pronouncements, 2016 Edition*, *Handbook of International Public Sector Accounting Pronouncements, 2017 Edition*, and *Handbook of International Public Sector Accounting Pronouncements, 2018 Edition* of the International Public Sector Accounting Standards Board, published by IFAC and is used with permission of IFAC.

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Proposed Statutory Board Financial Reporting Standard (SB-FRS) Guidance Note 8

Impairment for Non-Cash Generating Assets

Introduction

1. SB-FRS 36 *Impairment of Assets* prescribes how Statutory Boards should identify, measure and account for the impairment of assets. SB-FRS 36 is identical to the Accounting Standards Council's FRS 36 *Impairment of Assets* which was developed primarily with "for-profit" entities in mind. The concept of cash generating assets/units is central to SB-FRS 36. The assessment of cash inflows and outflows is therefore important in assessing impairment of assets under SB-FRS 36.

2. Statutory Boards are autonomous bodies set up by Acts of Parliament and are directly accountable to the Parliament. They are set up to fulfil public functions and are not bottom-line driven. In fulfilling their public functions, Statutory Boards may have some assets that are not meant to generate financial returns (i.e. non-cash generating assets). These assets are often not actively traded in the market and may be funded separately by government grants. In some cases, Statutory Boards are expected to fund expenditure to operate or replace these assets in future, using the surpluses accumulated from other activities. As such, the concepts of cash generating assets and assessment of cash inflows and outflows under SB-FRS 36 are at times, not applicable to these assets.

3. An asset is impaired when its carrying amount exceeds its recoverable amount. In other words, impairment is a loss in the future economic benefits or service potential¹ of an asset, over and above the systematic recognition of the loss of the asset's future economic benefits or service potential through depreciation.

Scope

4. The recognition, measurement and disclosure principles for impairment loss and reversal of impairment loss should follow that prescribed in SB-FRS 36.

5. This Guidance Note provides guidance to Statutory Boards on the definition of non-cash generating assets, how to identify impairment in non-cash generating assets, and measure the amount of recoverable amount for value in use. This Guidance Note does not apply to the assets excluded from the scope of SB-FRS 36 as indicated in paragraphs 2 – 5 of SB-FRS 36.

Definition of Non-Cash Generating Assets

6. Cash-generating assets are assets that are held with the primary objective of generating commercial returns². An asset generates commercial returns when it is deployed in a manner consistent with that adopted by a profit-oriented entity. This means that the entity intends to generate positive cash inflows from the asset and earn a commercial return that reflects the risk involved in holding the asset.

¹ Service potential indicates the capacity of an asset to provide goods and services in accordance with an entity's objectives, without necessarily generating any net cash in-flows.

² Definition in International Public Sector Accounting Standards (IPSAS) 21 *Impairment of Non-Cash Generating Assets*

7. Corporate assets are assets other than goodwill that contribute to the future cash flows of both the cash-generating unit under review and other cash-generating units³. Examples of corporate assets are head office assets.

8. Non-cash generating assets are assets other than cash-generating assets and corporate assets. Therefore, an asset may be a non-cash generating asset even though some cash is generated from its use.

9. Non-cash generating assets are held by Statutory Boards to fulfil social objectives and / or for national interests, rather than generate commercial returns. Public parks, accommodation rented out to the needy at rates below cost-recovery and toll-free roads are examples of non-cash generating assets.

Identifying Impairment in Non-Cash Generating Assets

10. As non-cash generating assets are held not for commercial returns, they often would not generate cash inflows that would exceed their carrying amounts. The primary objective of Statutory Boards is also not to generate commercial returns for Government. Therefore, it would not be appropriate to assess for impairment for these assets in the same way as it is done for cash-generating assets.

11. Statutory Boards should consider, as a minimum, the following indicators⁴ of impairment for non-cash generating assets:

- Demand or expectations of demand for the services provided by the non-cash generating assets have ceased or significantly declined;
- Significant long-term changes with an adverse effect on the Statutory Board have taken place or will take place in the near future, in the technological, legal or government policy environment in which the Statutory Board operates;
- Significant long-term changes with an adverse effect on the Statutory Board have taken place, 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 by the Statutory Board. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, or plans to dispose of an asset before the previously expected date; or
- Evidence is available of obsolescence or physical damage of an asset.

12. The list of indicators provided in paragraph 11 is not exhaustive, and there may be other indications that an asset may be impaired.

13. If there is evidence that a non-cash generating asset may be impaired, Statutory Boards should refer to paragraphs 19-21 for the methods to compute the impairment amount of the non-cash generating assets and then write down the carrying amount to the recoverable amount of the assets.

14. If there is no indication of a potential impairment loss, there is no requirement to make a formal estimate of the recoverable amount of the assets.

Computing the Impairment Amount in Non-Cash Generating Assets

³ Definition in SB-FRS 36

⁴ Concept of indicators are adapted from those indicated in International Public Sector Accounting Standards (IPSAS) 21 *Impairment of Non-Cash Generating Assets*

15. If, and only if, the recoverable amount of a non-cash generating asset is less than its carrying amount, the carrying amount of the asset shall be reduced to its recoverable amount. This reduction is an impairment loss.

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

17. Statutory Boards *may consider, but are not limited to*, adopting the 3 methods⁵ of determining the value in use:

- a. Depreciated Replacement Cost Approach;
- b. Restoration Cost Approach; and
- c. Service Units Approach.

18. The choice of the most appropriate approach to measuring value in use depends on the availability of data and the nature of impairment.

Depreciated Replacement Cost Approach

19. 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 assets 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.

Restoration Cost Approach

20. 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.

Service Units Approach

21. 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 to 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.

22. Illustrative examples on measurement of impairment loss on non-cash generating assets are provided in **Annex**.

Effective Date

23. This Guidance Note is operative for financial statements covering periods beginning on or after 1 April 2017. Earlier application if permitted.

⁵ These are suggested by International Public Sector Accounting Standards (IPSAS) 21 *Impairment of Non-Cash Generating Assets* issued by the International Public Sector Accounting Standards Board (IPSASB)

Method 1: Depreciated Replacement Cost Approach

An office building was constructed at a cost of \$12 million. The estimated useful life of the factory building is 50 years. The office is closed 10 years later due to a change in development plans in the area. The office is converted to be used as a school. The current replacement cost for a school similar to the capacity of the office is \$ 8 million.

Analysis

As the purpose of the building has changed significantly and this change of use is not anticipated to change in the foreseeable future, impairment is indicated. The impairment loss using the depreciated replacement cost approach is determined as follows:

Carrying value of the building before change of use:

		\$
	Cost	12,000,000
	Accumulated depreciation (\$12 m x 10/50 years)	2,400,000
a	Carrying amount	9,600,000

Replacement cost of a school of similar capacity:

		\$
	Cost of school	8,000,000
	Accumulated depreciation (\$8 m x 10/50 years)	1,600,000
b	Recoverable Service amount	6,400,000

		\$
	Impairment loss (a-b)	3,200,000

Method 2: Restoration Cost Approach

A school building was damaged in a fire 10 years after it was constructed at a cost of \$10 million. The school building has a useful life of 50 years. The restoration cost is estimated as \$500,000 and there is no change to the useful life after the restoration. The cost of a new school building with the same capacity is \$8 million.

Analysis

Indication of impairment exists due to the physical damage to the building. Impairment loss using the restoration cost approach is determined as follows:

Carrying value of the school building:

		\$
	Cost	10,000,000
	Accumulated depreciation (\$10 m x 10/50 years)	2,000,000
a	Carrying amount	8,000,000

Replacement cost of a school of similar capacity:

		\$
	Replacement Cost	8,000,000
	Accumulated depreciation (\$8 m x 10/50 years)	1,600,000
	Depreciated replacement cost (undamaged)	6,400,000
	Less: restoration cost	500,000
b	Recoverable Service amount	5,900,000

		\$
	Impairment loss (a-b)	2,100,000

Method 3: Service Units Approach

A water treatment plant was constructed at a cost of \$4 million in 20X0. The plant is estimated to treat water over its useful life 10 years. In 20X5, a change in technology for water treatment resulted in a reduction of 25% of its annual output over the remaining 5 years of its useful life. The replacement cost of a new water treatment plant is \$5 million in 20X5.

Analysis

Indication of impairment exists due to the obsolescence of the water treatment technology. Impairment loss using the service units approach is determined as follows:

Carrying value of water treatment plant:

		\$
	Cost	4,000,000
	Accumulated depreciation (\$4 m x 5/10 years)	2,000,000
a	Carrying amount	2,000,000

Replacement cost of a water treatment plant:

		\$
	Replacement Cost	5,000,000
	Accumulated depreciation (\$5 m x 5/10 years)	2,500,000
b	Depreciated replacement cost before adjustment for remaining service units	2,500,000
c	Recoverable Service amount (b x 75%)	1,875,000

		\$
	Impairment loss (a-c)	125,000