

8 Impairments

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8.1 Introduction

8.1.1 This chapter deals with accounting for impairments.

8.2 Accounting standards

8.2.1 The following accounting standard deals with accounting for impairments:
IAS 36 Impairment of Assets.

IAS 36 Impairment of Assets

Applicability

8.2.2 IAS 36 applies in full, as adapted and as interpreted, to all reporting entities covered by this Manual.

Objective of IAS 36

8.2.3 The objective of IAS 36 Impairment of Assets is to ensure that assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and the Standard requires the recognition of an impairment loss. In other words, an impairment reflects a permanent diminution in the value of an asset as a result of a clear consumption of economic benefits or service potential. Downward revaluations resulting from changes in market value do not necessarily result in an impairment.

Adaptation of IAS 36 for the public sector context

8.2.4 The following adaptation of IAS 36 for the public sector context applies.

Recognition

a) References in IAS 36 to the recognition of an impairment loss of a revalued asset being treated as a revaluation decrease to the extent that that impairment does not exceed the amount in the revaluation surplus for the same asset, are adapted such that only those impairment losses that do not result from a loss of economic value or service potential should be taken to the revaluation reserve. Impairment losses that arise from a clear consumption of economic benefit should be taken to the Statement of Comprehensive Net Expenditure. However, to ensure that the outcome as reflected in the reserves figure on the Statement of Financial Position is consistent with the requirements of IAS 36 had this adaptation not been applied, the balance on any revaluation reserve (up to the level of the impairment) to which the impairment would have been charged under IAS 36 should be transferred to the general fund.

Interpretation of IAS 36 for the public sector context

8.2.5 The following interpretations of IAS 36 for the public sector context apply.

Scope

- a) Heritage Assets is within the scope of IAS 36 to the extent specified in chapter 6, paragraph 6.2.35.

Recognition and measurement

- b) Where an asset is not held for the purpose of generating cash flows, value in use is assumed to equal the cost of replacing the service potential provided by the asset, unless there has been a reduction in service potential.

Other relevant factors

8.2.6 In budgetary terms, certain impairments will score as DEL and others as AME, and departments will enter the type of impairment onto COINS using the relevant account code. The Consolidated Budgeting Guidance (CBG) contains more detail. The budgeting treatment does not influence the accounting treatment, but entities might wish to consider whether information about the type and cause of impairment could usefully be included in the relevant notes to the accounts. Impairment categories are defined below.

8.2.7 Capitalised development expenditure that is directly linked to a tangible non-current asset should be impaired only where the tangible non-current asset becomes impaired. Where the intangible asset relates to a group of tangible non-current assets, any impairment will be charged only where the entire group is impaired and will be proportionate to the impairment of the group of tangible assets. For example, development expenditure related to a fleet of aircraft will be impaired only where the entire fleet is impaired and not if less than the whole fleet is impaired.

Definitions: impairments that score as DEL

8.2.8 The following types of impairment will score as DEL.

Loss or Damage resulting from normal business operations

8.2.9 All losses of, and damage to, tangible non-current assets that reduce the recoverable amount to below the book value other than those caused by a catastrophe (see below). Normal business operations covers all loss and damage to assets that result from management and staff action (or inaction), and the actions of third parties. This category includes theft.

Abandonment of assets in the course of construction

8.2.10 The impairment of assets in the course of construction as a result of a management decision to abandon the construction process, i.e. management decides that it no longer requires the facility under construction and the construction costs to date are completely written off or substantially written off to reflect reduced utility. This category includes the abandonment of software assets in the course of construction.

Over Specification of Assets (Gold Plating)

- 8.2.11 Gold plating is the unnecessary over-specification of assets at the point at which the asset is first constructed or purchased. This category should be used where the gold plating of assets leads to an impairment either because the asset is valued at its utility value to the business, or because the gold plating cannot be reflected in the recoverable amount.
- 8.2.12 Care should be taken not to impair assets as being gold plated where they are of a high specification by necessity. For example, the high specification of embassies is in part a result of security and other factors relating to location and the needs of a representational building. The higher specification due to justified security and operational considerations should not lead to an impairment down to the value of ordinary office accommodation. The key is that the higher specification must be justifiable: if it is not an impairment should be taken.

Definitions: impairments that score as AME

- 8.2.13 The following types of impairment will score as AME (with the agreement of the relevant authority (through sponsoring bodies where appropriate)).

Loss as the result of a catastrophe

- 8.2.14 Damage to tangible non-current assets as a result of a catastrophe. The System of National Accounts (SNA93) which forms the basis of recording transactions in the National Accounts defines a catastrophe as: 'such events as will be generally easy to identify. They include major earthquakes, volcanic eruptions, tidal waves, exceptionally severe hurricanes, droughts and other natural disasters; acts of war, riots and other political events; and technological accidents such as major toxic spills or release of radioactive particles into the air'.
- 8.2.15 Such events are very rare in global terms and exceptionally rare in the UK. Where a department believes an impairment should be scored as a Catastrophic Loss rather than 'Loss or Damage resulting from normal business operations' it should first contact the relevant authority.
- 8.2.16 For the avoidance of doubt, the following are not catastrophes within the meaning of this definition: prison or street riots; loss or damage due, for example, to an ingress of water that could have been avoided by better maintenance or that resulted from relocation to a site where flooding was likely. These are all examples of losses resulting from management action or inaction.

Unforeseen Obsolescence

- 8.2.17 All assets are subject to obsolescence. However, the rate of obsolescence tends to be category specific: e.g. IT assets suffer a faster rate of obsolescence than do buildings. Departments will take account of foreseeable obsolescence when establishing asset lives. Unforeseen obsolescence will generally only occur either as the result of the introduction of a completely new technology or a change in legislation rendering use of the asset illegal. As such events are exceptionally rare, the relevant authority should be contacted prior to the use of this category.

Other Impairments

8.2.18 This category includes impairments that cannot be scored to another impairment category.

- Write Down to Depreciated Replacement Cost – This occurs where specialised building assets or enhancements (e.g. the construction of a new wing) to such assets are written down to depreciated replacement cost (DRC) following the first professional valuation.
- Write Downs of Development Land – This occurs where land is purchased for some form of social development. The cost of the land and any clean up cost can be greater than the disposal value resulting in an impairment.
- Changes in Use – This usually occurs where specialised assets no longer required for their original purpose are put to a non specialised use (e.g. a hardened aircraft hangar used as a store) or where an asset becomes permanently underused. However, impairment can result from the change of use of any asset including non-specialised assets.
- Disposals – Impairments can occur where assets are moved from ‘in use’ to ‘available for sale’.
- Uncompensated Seizures – The seizure of assets by governments or institutional units, other than for the settlement of fines or taxes, for which full compensation is not provided.
- Other impairments not detailed – Please contact the relevant authority for advice.

Revaluations

8.2.19 Downward revaluations result in an impairment only where an asset is revalued below its historical cost carrying amount. In these cases, the accounting treatment is as for any other impairment. All other downward movements (for example, as a result of market fluctuations) should be accounted for through the revaluation (or donated asset or government grant) reserve to the extent that there is a credit in that reserve that relates to the revalued asset or portfolio of assets.