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# IPSAS 21 & 26 Impairment of Non-cash and Cash generating assets – as adopted by the Maltese Government

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## Guidelines

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IPSAS Implementation  
Team

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## Introduction

### 1. IPSAS 21 and IPSAS 26 – as adopted by the Maltese Government

1.1 These guidelines refer to the **impairment accounting standards as adopted by the Maltese Government**. These versions are based on the original IPSAS 21 and IPSAS 26 developed by the International Public Sector Accounting Standards Board (IPSASB). Modifications were made to bring the IPSAS closer to the local context. An appendix to the standards '**Comparison with IPSAS 21 and IPSAS 26**' summarises the significant differences with the original IPSAS 21 and IPSAS 26.

### 2. Scope

2.1 These guidelines were prepared to enable the users to:

- 2.1.1 Develop a working-level knowledge of the IPSAS principles that guide the accounting and reporting for Impairment and
- 2.1.2 Understand the major changes, challenges and benefits as a result of the implementation of IPSAS 21 and IPSAS 26<sup>1</sup>.

### 3. Target Audience

3.1 These guidelines are designed for finance and non-finance employees employed in Ministries and Departments of the Government of Malta.

### 4. Guidelines Structure

4.1 These guidelines shall provide a detailed overview of the principles contained in IPSAS 21 and IPSAS 26 including the difference between cash-generating and non-cash-generating assets, identification of assets that may be impaired, the recognition and measurement of impairment losses, and the reporting and disclosure of impairment.

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<sup>1</sup> References to IPSAS 21 and IPSAS 26 or any other IPSAS shall be taken as meaning 'as adopted by the Maltese Government'

## A. What is Impairment?

1. As a result of the adoption of accrual accounting, financial reports shall include a Statement of Financial Position. As the carrying value of assets shall be reported on this Statement, more care should now be taken to ensure that the **carrying amounts reported are realistic and not overstated**.
2. During the useful life of an asset, some **unexpected** events may occur (such as accidents or obsolescence) that may cause a reduction in an asset's value beyond normal depreciation and amortization - a central government entity may become aware that its assets shall not provide the expected future economic benefit or service potential.
3. If an asset's value in the financial statements is **higher** than its realistic value, known as its 'recoverable amount', the asset is said to have suffered an **impairment loss**.
4. Impairment is in fact determined by comparing the **carrying amount** of the asset with its **recoverable amount**. When the carrying amount of an asset is greater than the recoverable amount, the value of the asset must be reduced to recognise this impairment loss so as to reflect the decline in the utility of the asset to the entity that controls it.
5. Note that IPSAS 21 refers to the **recoverable service amount**, and not simply recoverable amount (as in IPSAS 26) as the focus of IPSAS 21 is on non-cash generating assets held **primarily** for providing a **service**.
6. The main **accounting issues** to consider are as follows:
  - How is it possible to identify the occurrence of an impairment loss?
  - How should the recoverable amount of the asset be measured?
  - How should an impairment loss be accounted for and reported on the financial statements?
7. This guidance explains the **concept of impairment** and provides examples of different situations that may cause impairment of assets. It also describes how impairment should be measured and recorded in the accounts. It is supplemented with examples of different situations in the context of the Maltese Government.

*IPSAS 21 and 26 define impairment as 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.*

## B. Cash-generating and non-cash-generating assets

1. The aims of IPSAS 21 - *Impairment of non-cash generating assets*, and IPSAS 26 – *Impairment of cash-generating assets*, are to prescribe procedures to ensure that assets are carried in the financial statements at no more than their recoverable (service) amount.
2. They prescribe requirements for:
  - the identification of assets that may be impaired,
  - the impairment testing,
  - the accounting for impairment losses and
  - the reversal of those losses.
3. IPSAS 21 and 26 generally apply to **non-current assets**, including property, plant and equipment, intangible assets not measured at revalued amounts, as well as equity-accounted investments and investments in subsidiaries in stand-alone financial statements.
4. The following table lists some assets which are **excluded** from IPSAS 21 and 26. Note that this list is not comprehensive. For a full list refer to IPSAS 21 and 26.

Asset	Relevant Standard
Inventories	IPSAS 12
Assets arising from construction contracts	IPSAS 11
Financial assets within the scope of IPSAS 29	IPSAS 29
Investment property measured at fair value	IPSAS 16
Assets arising from employee benefits	IPSAS 25
Biological assets related to agricultural activity measured at fair value less costs to sell	IPSAS 27

5. Each central government entity needs to identify whether IPSAS 21 or IPSAS 26 is applicable in its circumstance.
6. **IPSAS 21** applies to what are referred to as **non-cash-generating assets**. Such assets are **primarily** held for **providing a public service**.
7. **IPSAS 26** applies to **cash-generating assets**. These are assets held with the **primary** objective of generating a **commercial return**. Holding an asset to generate a commercial return indicates that central government entity **intends** to:
  - a) generate positive cash inflows from the asset, and
  - b) earn a commercial return that reflects the risk involved in holding the asset.

Therefore, a cash-generating asset may be held with the primary objective of generating return even though it does not meet that objective during a particular reporting period. Alternatively, an asset may be a non-cash generating asset even though it may be generating a commercial return during a particular period.

8. At times judgement may be required in determining whether an asset is held primarily for providing a public service or for generating a commercial return. In most instances, however, due to the inherent character of their activities, **central government entities hold non-cash-generating assets**. The majority of the assets within central government entities are not used to generate a commercial return.
9. Consequently, this guidance will **direct its focus on IPSAS 21 - Impairment of non-cash-generating assets**. In case of doubt, ministries/departments should consult with Treasury in determining whether an asset or group of assets are cash generating or non-cash-generating.
10. The following examples are presented to help illustrate the difference between cash-generating and non-cash-generating assets.

### 11. Examples

#### 11.1 Example 1

The primary objective of a public school within the Education Department is to provide educational services to students with no fee. However, a **dedicated section** is used as a bookshop to sell educational books and materials at **current market prices with the intention to generate profits**.

Since the assets held by this bookshop are primarily employed to an activity that generates a **commercial return**, being cash inflows from the sale of educational books and materials at current market prices, **IPSAS 26** will apply to these assets of the dedicated section.

#### 11.2 Example 2

Mater Dei Hospital is **primarily used** by non-fee paying patients who use its wards, services and facilities. However, an MRI machine at Mater Dei can generate cash flows when used by non-EU resident patients since they need to pay for using such service.

Since the primary objective of Mater Dei is **not to generate profits**, in this case **IPSAS 21 will apply** in the case of the MRI machine even if a fee is charged to non-

EU resident patients.

### Example 3

The Ministry for Finance has a hall used for events organised by governmental departments. No fees are charged for using such venue. However, occasionally same hall is rented out to third parties for private events since they specifically request the use of such hall to enjoy its historical surroundings. In such case, the ministry charges a rental fee at a commercial rate for the use of this hall.

Given that this hall generates **a commercial return** in the form of rental income is **incidental** and it is **mainly used for administration purposes**, thus **IPSAS 21** will apply.

### 11.3 Example 4

The Government Printing Press meets all the printing requirements of Government, ministries, departments and other entities. Prices charged to customers for printing work are intended to **cover the costs** incurred by the press but **not to generate profits**.

Since the objective is **not** to earn a commercial return but to accommodate the printing needs of government ministries/departments, and since the prices charged are **not** at market rates, the assets of the government printing press are non-cash-generating assets. **IPSAS 21** will apply.

*A cash-generating asset is held with the primary objective of generating a commercial return. In such cases, IPSAS 26 shall apply.*

*A non-cash-generating asset is held primarily to provide a service. Government ministries and departments mainly hold non-cash-generating assets. IPSAS 21 shall apply to non-cash-generating assets.*

## C. Causes of Impairment

1. IPSAS 21 and 26 require central government entities to **assess** whether there is any indication that an asset may be impaired **at the end of each reporting period**. IPSAS 21 and IPSAS 26 identify the following external and internal sources of information that may indicate that an asset is impaired:

### 1.1 External sources of information:

1.1.1 Significant long-term adverse changes in the technological, legal or government policy environment.

1.1.2 Cessation or near cessation of demand for services provided by asset.

#### Examples:

- a) Medical diagnostic equipment rarely or never used because a more technologically advanced machine provides more accurate results.
- b) IT equipment is not compatible with the organization's new CFMS system and thus becomes obsolete before the end of its expected useful life.
- c) Vehicles and machinery which do not meet new emission standards.
- d) School premises that can no longer be used for instruction purposes due to new safety regulations.

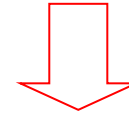
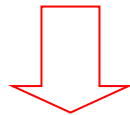
#### Examples:

- a) A school closed due to lack of demand for its services arising from a population shift in other areas.
- b) Machinery at Government Printing Press no longer used as books printed by this machine are no longer published by the Government.
- c) A fish tank used to cultivate specific species of fish is no longer used as the Fisheries Department has decided to stop cultivating this species of fish.



1.1.3 Asset's market value has declined significantly more than would be expected with the normal passage of time or normal use.

1.1.4 A significant long term decline in demand for services provided by asset.



**Examples:**

- a) A particular brand's equipment has suddenly declined in value following the introduction of a similar superior model by its closest competitor.

**Examples:**

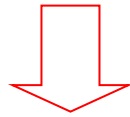
- a) Use of fax machines declined considerably with the increased use of email.
- b) Use of printing machine at the Government Printing Press declined significantly as Government publications are now available online.

**Note 1:** Another external source of information, applicable only to IPSAS 26 (and not IPSAS 21) is an increase in interest rates (such as market interest rates) as these changes will most likely affect the discount rate used in calculating the asset's value in use and decrease the asset's recoverable amount significantly.

**Note 2:** Knowledge with regards to these external sources of information may be obtained from suppliers, appraisers, manufacturer associations, classified advertising and internet searches.

## 1.2 Internal sources of information:

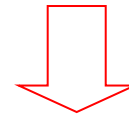
### 1.2.1 Evidence of physical damage.



#### Examples:

- a) A flood damages a road.
- b) A police car is damaged in a collision.
- c) Equipment that is damaged and can no longer be repaired, or for which repairs are not feasible.

### 1.2.2 Decision to halt construction of the asset before it is complete.



#### Examples:

- a) Excavation of a road stopped due to the identification of an archaeological discovery.
- b) Construction was stopped due to a decline in the economy.

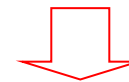
### 1.2.3 Significant changes with an adverse effect on the entity and the manner in which the asset is used.



#### Examples:

- a) A school building being used for storage rather than for educational purposes.
- b) A mainframe computer is underutilised because many applications have now been converted to operate on servers.

### 1.2.4 Internal reports indicate the service potential/economic performance is or will be significantly worse than expected.



#### Examples:

- a) Increased cost of operating or maintaining an asset than originally budgeted.
- b) Significantly lower output levels than expected.

2. These lists of indications are not exhaustive – there may be other indications of impairment. If an indication of impairment is present, the central government entity must perform an impairment test.

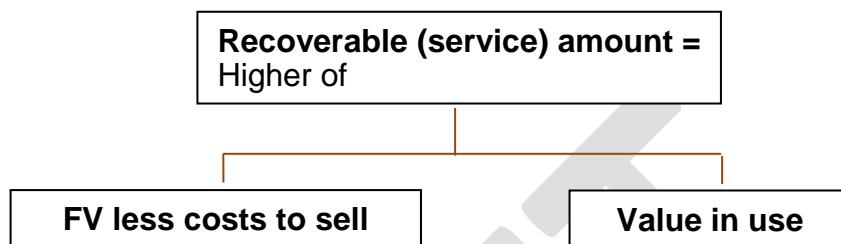
3. Annual impairment tests, irrespective of whether there are indications of impairment, are required for intangible assets with an indefinite useful life or not yet available for use.

*IPSAS 21 and IPSAS 26 state that 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 service amount of the asset.*

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## D. Testing for impairment

1. If an indication of impairment exists, the central government entity is required to carry out an **impairment test**, i.e. estimate the **recoverable (service) amount** of the asset, and compare it to the asset's **carrying amount**.
2. The **recoverable (service) amount** is the higher of an item's fair value less costs to sell and its value in use.



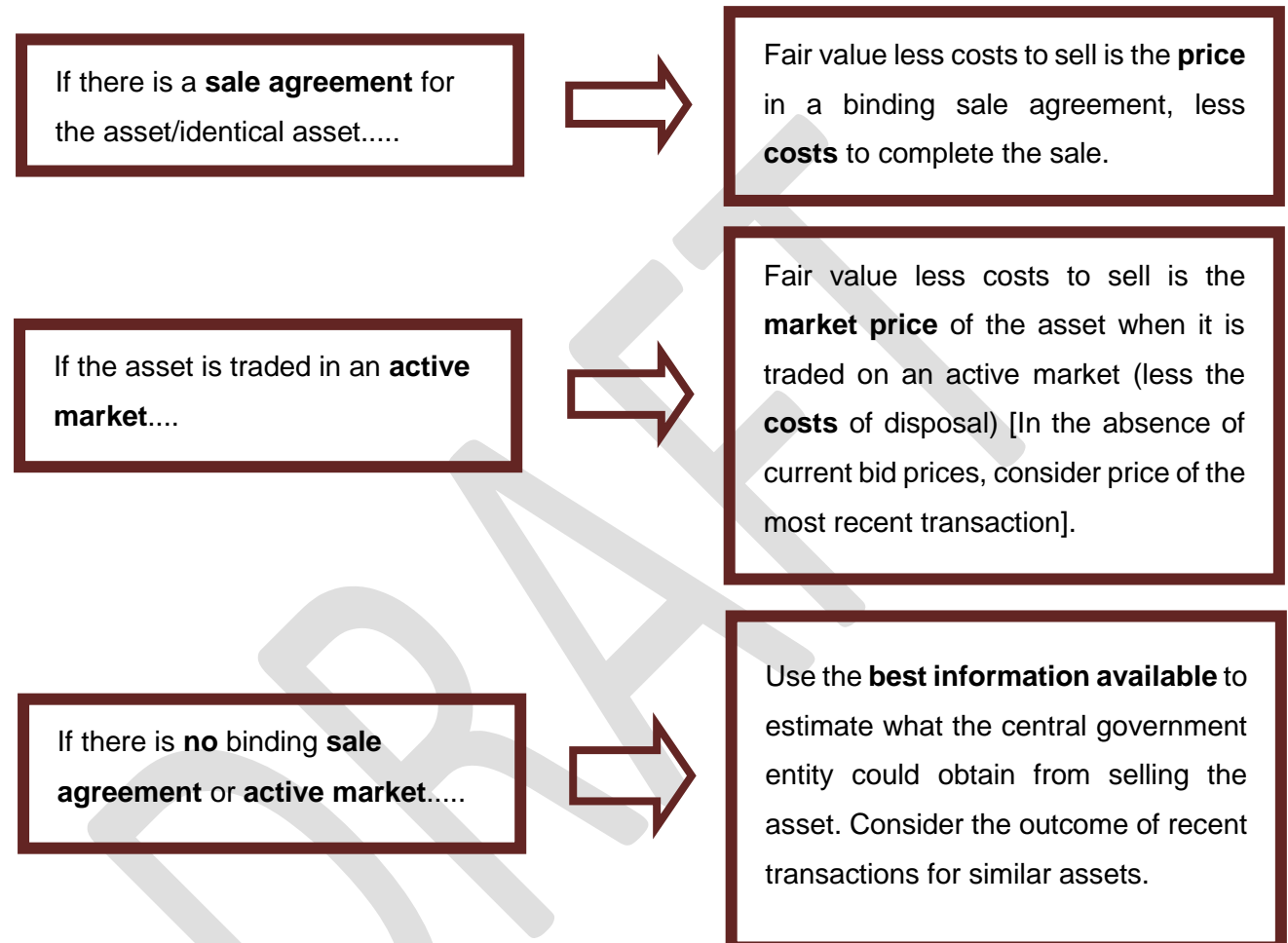
3. An asset is **impaired** when its **carrying amount exceeds its recoverable (service) amount**.
  - 3.1 For example, a machine is stated in the accounts at €4,000. Its fair value is €3,500 and costs to sell are €20. The value in use is €3,300. In this case the **fair value less costs to sell of €3,480 is higher than the value in use of €3,300**, therefore the fair value less costs to sell is taken as the recoverable service amount. Comparing the recoverable service amount of €3,480 to the carrying amount of €4,000, the machine has suffered an **impairment loss of €520**.
4. If the **fair value less costs to sell is higher**, the central government entity should consider **selling the asset**; if the **value in use is higher**, the central government entity should, if possible, **continue to use the asset**.
5. The above reasoning implies that if the entity estimates either of the two amounts (fair value less costs to sell or value in use) and that amount **exceeds** the asset's carrying amount, the asset is **not impaired** and there is no need to estimate the other amount.

### Requirements for recording impairment:

- The asset management officer shall assess at each reporting date whether there is an indication that an asset may be impaired.
- If an indication exists, then the recoverable (service) amount is calculated.
- If the carrying amount of the asset > Recoverable (service) amount, an impairment loss is recorded.
- $\text{Impairment loss} = \text{Carrying amount of asset} - \text{Recoverable (service) amount}$ .

## 6. Measuring Fair Value less costs to sell

6.1 Fair value less costs to sell is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, less the cost of disposal. In order to determine this amount, the central government entity should consider the following in descending order:



## 7. Examples

### 7.1 Example 1

A department owns equipment for which there is an active market. The equipment can be sold at a price of **€65,000**. However, it would first need to be inspected by a specialist to ensure that it conforms to health and safety regulations before being sold. The inspection would cost **€250**.

The **fair value less costs to sell** of the machine is **€64,750** (€65,000 - €250).

## 7.2 Example 2

A department owns a machine of a specialised nature which was custom built for the requirements of the department a number of years ago. There is no active market for such a machine. However, the department is aware that a neighbouring country has recently sold similar machines at a price of **€5,000**. These machines were of a similar age and in a similar condition as the one owned by the local department. The department does not envisage any costs related to selling such a machine.

The fair value less costs to sell of the machine is estimated by **reference to the similar machines** sold in the neighbouring country and could be set at **€5,000**.

## 8. Measuring value in use

8.1 For a **non-cash-generating asset**, value in use is the **present value** of an asset's remaining **service potential**.

8.2 For a **cash-generating asset**, value in use is the **present value** of the **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.

### 8.3 Value in use for non-cash-generating assets (IPSAS 21)

8.3.1. The **value in use** for non-cash-generating assets is determined using **one of the three approaches highlighted below**, as appropriate in the given circumstances. Note that for the purpose of most of the examples that follow hereunder, the fair value less costs to sell has not been provided, as in these examples it is assumed that the fair value less costs to sell is either not available or is lower than the value in use.

(a) **Depreciated  
replacement  
cost**

(b) **Restoration  
cost**

(c) **Service  
units**

a) **Depreciated replacement cost approach**

This is the current cost that will have to be incurred to **reproduce** or **replace** the gross service potential of an asset (whichever is lower), **depreciated** to reflect the asset's current age or condition.

**Examples: Depreciated replacement cost approach**

- i. Example 1: Significant long-term change in **the technological environment** with an adverse effect on the central government entity – **underutilised mainframe computer**

10 years ago a department purchased a **new mainframe computer** at a cost of **€12,000,000**. The department estimated that the useful life of the computer would be 14 years and that it would use **90%** of its central processing capacity.

Within a few months after acquisition, the mainframe reached its targeted usage of 90% but during the current year usage declined to **30%**. The decline is attributed to the introduction of desktop computers which contain a large processing capacity and therefore do not require the capacity of the mainframe.

A computer is available on the market at a price of **€600,000** that can provide the remaining service potential of the mainframe computer. Calculate the impairment loss.

**Solution**

The long term change in the technological environment resulting from the introduction of desktop computers, having larger capacities, is an indication of impairment.

Impairment is calculated as follows:

**Step 1 – Calculation of mainframe's carrying amount**

<b>Cost at acquisition</b>	€12,000,000
<b>Accumulated depreciation (€12,000,000/14*10)</b>	€ 8,571,429
<b>Carrying amount</b>	€ 3,428,571

**Step 2 – Calculation of recoverable service amount**

<b>Cost of replacement</b>	€ 600,000
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<b>Accumulated depreciation (€600,000/14*10)</b>	€ 428,571
<b>Recoverable service amount</b>	€ 171,429

**Step 3 – Calculation of impairment loss**

Impairment	=	<b>carrying amount - recoverable amount</b>
	=	€3,428,571 - €171,429
	=	<b>€3,257,142</b>

ii. Example 2: Significant long-term change with **adverse effect on the central government entity**

Two years ago, the Department for Education constructed a new school. The furniture and other equipment cost €1,500,000. It was estimated that the furniture and equipment would be used for 10 years. During the current period, enrolment declined from 1,000 to 200 students as a result of a new privately owned school opening in the area. The Department decided to close the two top floors of the 3 storey school building and there is no expectation that enrolments will increase in the future such that the upper storeys would be re-opened. The **current replacement cost** of the **one-storey** furniture and equipment is estimated at **€900,000**. Calculate the impairment loss.

**Solution**

The extent of use of the school has changed from three floors to one as a result of the reduction in the number of students. The reduction in the extent of use is significant (from 1,000 to 200) and enrolment is expected to remain at this reduced level for the foreseeable future. This is an indication of impairment.

The impairment is calculated as follows:

**Step 1 – Calculation of furniture & equipment's carrying amount**

<b>Cost at acquisition</b>	€1,500,000
<b>Accumulated depreciation (€1,500,000/10*2)</b>	€ 300,000
<b>Carrying amount</b>	€1,200,000

**Step 2 – Calculation of recoverable service amount**

<b>Cost of replacement</b>	€ 900,000
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<b>Accumulated depreciation (€900,000/10*2)</b>	€ 180,000
<b>Recoverable service amount</b>	€ 720,000

**Step 3 – Calculation of impairment loss**

$$\begin{aligned}\text{Impairment} &= \text{carrying amount} - \text{recoverable amount} \\ &= \text{€1,200,000} - \text{€720,000} \\ &= \text{€480,000}\end{aligned}$$

b) **Restoration cost approach**

This is the **depreciated replacement cost** (before impairment) less the estimated **cost required to repair a damaged asset**.

**Present value of remaining Service Potential =**

Depreciated Replacement Cost less Estimated Cost to restore the asset

**Examples: Restoration cost approach**

i. Example 1: Physical damage – ambulance damaged on the road

Four years ago Mater Dei Hospital acquired a new ambulance at a cost of **€300,000**. It estimated a useful life of **10 years** for the ambulance, however, during the current year the ambulance sustained damage in a road accident, requiring **€50,000** to be restored to the same condition before the accident. The restoration will not affect its remaining useful life. The cost of buying a new ambulance is currently **€375,000**. Calculate the impairment loss.



### Solution

Impairment is indicated because the ambulance has sustained **physical damage** in the road accident.

The impairment is calculated as follows:

#### *Step 1 – Calculation of the ambulance's carrying amount*

Cost at acquisition	€300,000
Accumulated depreciation (€300,000/10*4)	€120,000
Carrying amount	€180,000

#### *Step 2 – Calculation of recoverable service amount*

Cost of replacement	€375,000
Accumulated depreciation (€375,000/10*4)	€150,000
Depreciated replacement cost (undamaged state)	€225,000
Less restoration cost	€ 50,000
Recoverable service amount	€175,000

#### *Step 3 – Calculation of impairment loss*

Impairment	=	carrying amount	-	recoverable amount
	=	€180,000	-	€175,000
	=	<b>€5,000</b>		

#### ii. Example 2: Physical damage – furniture damaged by fire road

Two years ago a department refurbished its premises and bought new furniture which cost **€10,000**. The furniture had an expected useful life of **15 years**. During the current year, the furniture was damaged in a fire. Repairs of **€1,500** are required in order to restore the furniture to the same condition before the fire. The cost of buying new furniture is **€13,000**. Calculate the impairment loss.

### Solution

Impairment is indicated because the furniture has sustained physical damage due to the fire.

The impairment is calculated as follows:

**Step 1 – Calculation of the furniture's carrying amount**

<b>Cost at acquisition</b>	€10,000
<b>Accumulated depreciation (€10,000/15*2)</b>	€ 1,333
<b>Carrying amount</b>	€ 8,667

**Step 2 – Calculation of recoverable service amount**

<b>Cost of replacement</b>	€13,000
<b>Accumulated depreciation (€13,000/15*2)</b>	€ 1,733
<b>Depreciated replacement cost (undamaged state)</b>	€11,267
<b>Less restoration cost</b>	€ 1,500
<b>Recoverable service amount</b>	€ 9,767

**Step 3 – Calculation of impairment loss**

Impairment	=	<b>carrying amount</b>	-	<b>recoverable amount</b>
	=	€8,667	-	€9,767
	=	0		

This asset is **not impaired** as the carrying amount is **lower** than its recoverable service amount.

c) **Service units approach**

Under this approach, the value of the remaining service potential of the asset is determined by **reducing the current cost** to take into account the **decline** in the service potential of the asset. The depreciated replacement cost (before impairment) is reduced to the number of service units expected from the impaired asset.

**Examples: Service units approach**

- i. Example 1: Evidence from internal reporting – higher cost of operating a printing machine.

Two years ago, the Government Printing Press bought a highly specialised printing machine for **€1,500,000** that was expected to print **50 million** pages over its estimated **15-year** useful life. During the current year, it was reported that a feature of the machine does not function as expected. This resulted in a revision of the estimated pages to **35 million** over the coming **13 years**. The machine had

printed **6 million** copies in the first **two years**. The replacement cost of a new printing machine is **€1,800,000**. Calculate the impairment loss. The machine is depreciated using the straight line method.

**Solution**

Evidence from internal reporting indicates that the printing machine may be impaired since its service potential is worse than expected.

The impairment is calculated as follows:

**Step 1 – Calculation of the machine's carrying amount**

Cost at acquisition	€1,500,000
Accumulated depreciation ( $€1,500,000/15*2$ )	€ 200,000
Carrying amount	€1,300,000

**Step 2 – Calculation of revised remaining service units' percentage**

Original expected total number of printouts	50,000,000
Actual total number of printouts to date	6,000,000
Original expected number of remaining printouts	44,000,000
Revised expected number of printouts	35,000,000
Revised percentage of remaining service units	79.454%

**Step 3 – Calculation of recoverable service amount**

Cost of replacement	€1,800,000
Accumulated depreciation ( $€1,800,000/15*2$ )	€ 240,000
Depreciated replacement cost	€1,560,000
Recoverable service amount ( $€1,560,000 \times 79.545\%$ )	€1,240,902

**Step 4 – Calculation of impairment loss**

Impairment = carrying amount - recoverable service amount	
=	€1,300,000 - €1,240,902
=	<b>€59,098</b>

- ii. Example 2: Significant long-term change with an adverse effect on the entity in the legal environment.

Mater Dei Hospital bought new equipment at a cost of **€250,000** last year which was expected to treat 100,000 patients over its 5-year useful life. This year, new health regulations came into force which required such equipment to be used to help treat a maximum of 75,000 patients. 20,000 patients have been treated up to date. The equipment had a fair value less costs to sell of **€190,000** after the regulations came into force. The current replacement cost of such equipment is **€255,000**. Calculate the impairment loss. The equipment is depreciated using the straight line method.



### **Solution**

The indication of impairment is the significant long-term change in the legal environment, requiring the equipment to be used for a maximum of 75,000 patients rather than 100,000.

The impairment is calculated as follows:

#### ***Step 1 – Calculation of the equipment's carrying amount***

<b>Cost at acquisition</b>	€250,000
<b>Accumulated depreciation (<math>€250,000/5*1</math>)</b>	€ 50,000
<b>Carrying amount</b>	€200,000

#### ***Step 2 – Calculation of revised remaining service units' percentage***

<b>Original expected total number of patients</b>	100,000
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<b>Actual total number of patients to date</b>	20,000
<b>Original expected number of remaining patients</b>	80,000
<b>Revised expected number of patients (75,000-20,000)</b>	55,000
<b>Revised percentage of remaining service units</b>	68.75%

***Step 3 – Calculation of recoverable service amount***

<b>Cost of replacement</b>	€255,000
<b>Accumulated depreciation (€255,000/5*1)</b>	€ 51,000
<b>Depreciated replacement cost</b>	€204,000
<b>Value in use after introduction of new regulation (€204,000 x 68.75%)</b>	€140,250
<b>Fair value less costs to sell after introduction of new regulation</b>	€190,000

Therefore, recoverable service amount = fair value less costs to sell = €190,000 (as fair value less costs to sell is greater than value in use)

***Step 4 – Calculation of impairment loss***

$$\begin{aligned}\text{Impairment} &= \text{carrying amount} - \text{recoverable amount} \\ &= \quad \quad \quad \text{€200,000} - \text{€190,000} \\ &= \quad \quad \quad \text{€10,000}\end{aligned}$$

### IPSAS team note:

The choice of an approach depends on the *availability of information* and the *nature of the impairment*:

- The *restoration* or *depreciated replacement cost* approaches are used when impairment is due to *physical damage* of the asset.
- The *service units* or *depreciated replacement cost* approaches are used when there is a long term change in the use of the asset or when impairment is due to *external indicators*.

Central Government Entities should adopt the Depreciated Replacement Cost approach. If another approach is being considered, kindly consult with the Treasury before adoption.

### 8.4 Value in use for cash-generating assets (IPSAS 26)

8.4.1. For a **cash-generating asset**, value in use is the **present value of the estimated future cash flows**, derived from the **continuing use of the asset** and its **sale** at the end of its useful life.

8.4.2. The following steps need to be taken to **calculate** the **value in use** for a cash generating asset:

a) **Estimate the future cash flows from the continuing use of the asset and its ultimate disposal**

b) **Determine the discount rate to be used to calculate the present value of the estimated future cash flows**

### a) **Estimating the future cash flows**

The estimates of future cash flows are to be based on the most recent financial budgets and forecasts which should cover a maximum period of 5 years. Beyond the period covered by the budgets and forecasts, cash flow projections are estimated by extrapolating the projections using a steady or declining growth rate. Cash flow projections should also be based on reasonable and supportable assumptions that represent the best estimate of the economic conditions that will exist.

### b) **Determining the discount rate<sup>2</sup>**

The appropriate discount rate to be used should be a **pre-tax rate** that reflects the current market assessments of:

- The **time value** of money; and
- The **risks** specific to the asset.

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<sup>2</sup> The discount rate shall be established with the assistance of the pertinent Government authority.



## E. Recognising the impairment loss

1. When the **recoverable (service) amount** of the asset is **less** than the **carrying amount**, the carrying amount should be reduced to the **recoverable (service) amount**. The difference is the **impairment loss** which is recognised immediately in the Statement of Financial Performance.

$$\text{Impairment Loss} = \text{Carrying Amount less Recoverable Service Amount}$$

2. **After** the recognition of an impairment loss, the **depreciable amount** for the impaired asset will be reduced, due to the impairment. The impaired asset's remaining **useful life** may also be different. The **new depreciable amount** and **remaining useful life** will need to be determined in order to calculate the **depreciation expense** for future years.
3. **Comprehensive example: vehicles damaged in flood**

At the end of 2014 heavy rainfall caused a flooding at the garage of the Police Department, damaging a number of police vehicles which were parked in the garage at that time. The cars, which had a **carrying amount of €66,000** at the beginning of 2014, cannot be used in their current state. They can be either

- Sold on the **market** for €40,000, or
- Sold at an **auction** for €38,000 but they will incur **auction costs** of **€1,500**, or
- Repaired at a cost of **€15,000**.

The **current replacement cost** of such vehicles is **€80,000**. The cars had been bought in 2013 for €77,000 with a useful life of 7 years. Calculate the impairment loss for the year 2014.



Impairment is calculated as follows:

**Step 1 – Calculation of the vehicles' carrying amount at the end of 2014**

Cost at acquisition	€77,000
Depreciation per annum (€77,000/7)	€11,000
<b>Carrying amount at the end of 2014</b> <b>(2 years' depreciation)</b>	<b>€55,000</b>
(€77,000 - €11,000 - €11,000)	

**Step 2 – Calculation of recoverable service amount**

**Value in use:**

Cost of replacement	€80,000
Accumulated depreciation (€80,000/7*2)	(€22,857)
Depreciated replacement cost)	€57,143
Less repair cost	(€15,000)
Recoverable service amount	€42,143

**Fair value less costs to sell:**

This is the **higher** of the market price for vehicles i.e. €40,000 and the **auction price less costs** of the auction i.e. €38,000 - €1,500 = €36,500. The fair value less costs to sell is €40,000.

Since the **value in use** (€42,143) is **higher** than the fair value less costs to sell (€40,000), the value in use of **€42,143** is taken as the **recoverable service amount**.

**Step 3 – Calculation of impairment loss**

Impairment = carrying amount - recoverable service amount	
= €55,000 - €42,143	
= <b>€12,857</b>	

Therefore, in 2014, the following entries would be made in the accounts with respect to these vehicles:

Debit Depreciation <b>expense</b>	<b>€11,000</b>
Credit <b>Accumulated depreciation</b>	<b>€11,000</b>
Being the <b>Depreciation Charge</b> for the year <b>before</b> impairment	

## IPSAS 21 & 26 Impairment - as adopted by the Maltese Government

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The above entry reduces the carrying amount of the vehicles to €55,000 (€66,000 after one year, less €11,000 = €55,000 after 2 years).

Debit <b>Impairment loss</b>	<b>€12,857</b>
Credit <b>Accumulated depreciation</b>	<b>€12,857</b>
Being <b>impairment loss on damaged vehicles</b>	

The above entry records the **impairment loss** and reduces the carrying amount of the vehicles further to the **recoverable service amount of €42,143**.

Cost at acquisition was **€77,000** less 2 years' depreciation **€22,000** less impairment loss **€12,857** = **carrying amount of €42,143 at the end of 2014**.

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## IPSAS 21 & 26 Impairment - as adopted by the Maltese Government

The **Statement of Financial Performance** for the year ended 2014 will disclose the depreciation and impairment loss as follows:

<i>Statement of Financial Performance</i>				
<i>for the year ended</i>				
<i>31<sup>st</sup> December 2014 (extract)</i>				
	<i>Notes</i>	<i>2014</i> <i>(€)</i>	<i>2013</i> <i>(€)</i>	
<i>Expenditure</i>				<i>IPSAS</i> <i>1.109 - 112</i>
<i>Wages, salaries &amp; employee benefits</i>		x	x	
<i>Water &amp; electricity</i>		x	x	
<i>Depreciation and amortisation expense</i>		11,000	11,000	
<i>General expenses</i>		x	x	
<i>Total expenditure</i>		x	x	
<i>Other gains/(losses)</i>				
<i>Impairment loss</i>	<i>26</i>	<i>12,857</i>	x	<i>IPSAS</i> <i>1.107 (a)</i>

## IPSAS 21 & 26 Impairment - as adopted by the Maltese Government

The following extract illustrates how **PP&E** should be reported on the face of the **Statement of Financial Position**:

Statement of Financial Position as at 31 <sup>st</sup> December 2014 (extract)				
	Notes	2014 (€)	2013 (€)	
Assets		X	X	
Non-current assets		X	X	
Property, plant and equipment	40	42,143	66,000	IPSAS 1.88 (a)
Intangible assets		X	X	IPSAS 1.88 (c)

The **Notes to the Financial Statements** would disclose the following:

Notes to the financial statements (extract)			
26. Impairment loss			
	2014 (€)	2013 (€)	
Property, plant and equipment	12,857	X	
Intangible assets	X	X	
Total impairment loss	X	X	

During the year ended 31 December 2014, a number of police cars suffered damage due to a flooding at the Police Department garage. The recoverable service amount of the cars was based on their value in use. Value in use was determined using the restoration cost approach, based on the depreciated cost to replace the cars less repair costs.

## IPSAS 21 & 26 Impairment - as adopted by the Maltese Government

Notes to the financial statements (extract)		
40. Property, plant and equipment		
	Vehicles (€)	
Cost		
At 1 January 2013	-	
Additions	77,000	
Disposals	-	
Transfers/adjustment	-	
At 31 December 2013	77,000	
Additions	-	
Disposals	-	
Transfers/adjustments	-	
At 31 December 2014	77,000	
Depreciation & Impairment		
At 1 January 2013	-	
Depreciation	11,000	
Impairment	-	
At 31 December 2013	11,000	
Depreciation	11,000	
Disposals	-	
Impairment	12,857	IPSAS 21.73
Transfers/adjustment	-	
At 31 December 2014	23,857	
Net book values		
At 31 December 2014	42,143	
At 31 December 2013	66,000	

## IPSAS 21 & 26 Impairment - as adopted by the Maltese Government

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In the above example, if the cars were sold by auction in 2015:

The cars were sold in the auction at the price initially estimated of €38,000. Auction costs were higher than expected and totalled €2,500.

Calculation of gain or loss on disposal:

Carrying amount	€42,143
Sales proceeds (€38,000 - €2,500)	€35,500
Loss on disposal	€ 6,643

Debit <b>Accumulated depreciation*</b>	<b>€34,857</b>	
Debit <b>Loss on disposal</b>	<b>€ 6,643</b>	
Debit <b>Cash</b>	<b>€35,500</b>	
		<b>Credit PP&amp;E (Vehicles) €77,000</b>

Being **de-recognition** of vehicles, and recording of **sales proceeds** and **loss on disposal**

*\*(€22,000 depreciation [2 years] plus impairment loss)*

## F. Reversing impairment losses

1. At each reporting date, central government entities should assess whether there is an **indication** that the impairment loss recognised in prior periods no longer exists.
2. Such indicators may include:
  - A decision to resume the construction of an asset that was previously halted before it was completed;
  - A resurgence in the demand or need for the services provided by the asset.
3. The indications of a potential reversal of an impairment loss mirror the indications of a potential impairment loss highlighted under section C of this guidance. When a **reversal** of impairment is required, the remaining useful life, depreciation method, or residual value will need to be adjusted.
4. The reversal should **not** lead to an asset's carrying amount which exceeds the net carrying amount that would have been obtained (following the systematic amortisation or depreciation plan for the asset) if no impairment loss had been recognised in prior periods.
5. The **reversal of an impairment loss is recognised in the statement of financial performance.**

### 5.1 Example:

A health centre had an x-ray machine which was bought in 2013 for **€50,000**. Its estimated useful life was 10 years. At the end 2014, the health department set up a centralised Medical Imaging Department at Mater Dei Hospital. The x-ray machine at the health centre was almost redundant as patients were now screened at the new centralised department. The **recoverable service amount** of the machine at the end of 2014 was estimated at **€32,000**. At the end of 2014, the fair value was €38,000. In 2014 the following **impairment loss** is recognised based on the following calculations:

Cost of machine	€50,000
Accumulated depreciation at end of 2014 ( $€50,000 \div 10 \times 2$ )	€10,000
<b>Carrying amount at end of 2014 (before impairment)</b>	<b>€40,000</b>
Recoverable service amount	€32,000
Fair Value	€38,000
Impairment loss ( $€40,000 - €38,000$ )*	€ 2,000
<b>Carrying amount at end of 2014 (after impairment)</b>	<b>€38,000</b>

(\*Since fair value is higher than the recoverable service amount; the impairment loss should be taken as the difference between fair value and carrying amount.)



## IPSAS 21 & 26 Impairment - as adopted by the Maltese Government

In **2015**, the depreciation is calculated on the **new** carrying amount of €38,000 and the **remaining** useful life of 8 years. The depreciation per annum is therefore €4,750 ( $€38,000 \div 8$ ). By the end of 2015, the new centralised department was experiencing a high demand for x-rays such that it could not cope with the patients on the waiting lists. It was decided that the **redundant** machine be transferred to the centralised unit to speed up the services. This is an **indication** that the impairment loss **may no longer exist** or may have decreased and consequently the department should re-estimate the recoverable service amount. Assuming that the **recoverable service amount** is **€45,000** and the fair value at the end of 2015 was €41,000. The relevant calculations are as follows:

<b><i>Carrying amount before reversal of impairment:</i></b>	
Carrying amount at end of 2014 (after impairment)	€38,000
Depreciation charge for 2015	€ 4,750
<b>Carrying amount at end of 2015 (before reversal of impairment)</b>	<b>€33,250</b>
<b><i>Carrying amount had no impairment been recognised:</i></b>	
Carrying amount at end of 2014 (before impairment)	€40,000
Depreciation had no impairment been recognised	€ 5,000
<b>Carrying amount at end of 2015 had no impairment been recognised</b>	<b>€35,000</b>
<b><i>Calculation of total increase in value:</i></b>	
Carrying amount at end of 2015 (before reversal of impairment)	€33,250
New recoverable service amount (at end of 2015)	€45,000
Fair value (at end of 2015)*	€41,000
<b>Total increase in value</b>	<b>€11,750</b>
<b><i>Calculation of reversed impairment loss:</i></b>	
Carrying amount at end of 2015 had no impairment been recognised	€35,000
Carrying amount at end of 2015 (before reversal of impairment)	€33,250
<b>Reversed impairment loss</b>	<b>€ 1,750</b>

(\*Since fair value is lower than the recoverable service amount; the impairment loss should be taken as the difference between recoverable service amount and carrying amount.)

## IPSAS 21 & 26 Impairment - as adopted by the Maltese Government

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The recoverable amount of €45,000 is higher than the carrying amount of €33,250; therefore, the impairment loss is to be reversed. However, it is important to note that not all of the €11,750 will be reversed. The reversal will be limited to what the carrying amount would have been **had no impairment loss** been recognised i.e. €35,000. Therefore, an amount of €1,750 (€35,000 - €33,250) will be reversed through the following accounting entry:

Debit <b>Accumulated depreciation</b>	<b>€1,750</b>
<b>Credit Impairment loss</b>	<b>€1,750</b>
<b>Being the reversal of impairment loss following the change in use of asset</b>	

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## G. Re-designation of assets

1. The **reclassification** from **non-cash-generating assets** to **cash-generating assets** or **vice-versa** is possible and allowed **only** when facts are clearly supporting this re-designation.
2. A **re-designation**, by itself, does not necessarily trigger an impairment test or a reversal of an impairment loss. The net book value of the asset at the time of the re-designation is considered as the basis of accounting going forward. However, an entity should consider the indications of impairment at the next reporting date after the re-designation.
3. The following is an example of **non-cash generating assets re-designated to cash-generating assets**:

Over the years, the mission of the **Government Printing Press** was to meet the printing needs of Government departments and as such, prices charged were never at market rates. The assets held by the press were correctly classified as non-cash generating assets.

During the current year, the government decides to exploit the revenue that could be earned by the press. The press was **restructured** to make it competitive with other privately owned printers, new market-based prices were set, and the press made its **services available to the market**. It was planned that the press would be able to generate a **profit** by the end of the year.

The assets held by the Government Printing Press will be **re-designated** as cash-generating assets and IPSAS 26 will apply.

## H. Disclosure

### 1. IPSAS 21 requires the following:

- a) The disclosure of the **criteria** developed by central government entities to distinguish non-cash-generating assets from cash generating assets.
- b) An entity shall disclose the following for each class of assets:
  - i) The **amount of impairment loss recognised** 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; and
  - ii) The **amount of reversals of impairment losses recognised** in surplus or deficit during the period, and the line items(s) of the statement of financial performance in which those impairment losses are reversed.
- c) An entity that reports segment information in accordance with IPSAS 18, Segment Reporting, shall disclose the following for each for each segment reported by the entity:
  - i) The **amount of impairment loss recognised** in surplus or deficit during the period; and
  - ii) The **amount of reversals of impairment losses recognised** in surplus or deficit during the period.
- d) A central government entity shall disclose the following for each **material** impairment loss recognised or reversed during the period:
  - i) The **events and circumstances** that led to the recognition or reversal of the impairment loss;
  - ii) The **amount** of the impairment loss recognised or reversed;
  - iii) The **nature** of the asset;
  - iv) The **segment** to which the asset belongs, if the entity reports segment information in accordance with IPSAS 18;
  - v) Whether the **recoverable service amount** of the asset is its **fair value less costs to sell** or its **value in use**;
  - vi) If the recoverable service amount of the asset is fair value less costs to sell, the **basis** used to determine fair value less costs to sell; and
  - vii) If the recoverable service amount is value in use, the **approach** used to determine value in use.
- e) A central government entity shall disclose the following information for the **aggregate of impairment losses** and **aggregate reversals of impairment**

**losses** recognised during the period for which no information is disclosed in accordance with point c) above:

- i) The **main classes** of assets affected by impairment losses and by reversals of impairment losses; and
- ii) The **main events and circumstances** that led to the recognition of these impairment losses and reversals of impairment losses.

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Example – extract from the Notes to the Financial Statements:

### 2.2 Summary of significant accounting policies

#### a) Impairment of non-financial assets: Impairment of non-cash generating assets

Non-cash-generating assets are those assets which are not held with the primary objective of generating a commercial return but are held for service delivery purposes. If any cash flows generated from the use of an asset are incidental to the objective of the delivery of services or insignificant in relation to the services provided, the asset is classified as a non-cash-generating asset.

At each reporting date, the Central Government entities assess whether there is an indication that a non-cash-generating asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Central Government entities estimate the asset's recoverable service amount. An asset's recoverable service amount is the higher of the asset's fair value less costs to sell and its value in use.

Where the carrying amount of an asset exceeds its recoverable service amount, the asset is considered impaired and is written down to its recoverable service amount. An impairment loss is recognised immediately in surplus or deficit.

In assessing value in use, the Central Government entities have adopted the depreciated replacement cost approach. Under this approach, the present value of the remaining service potential of an asset is determined as the depreciated replacement cost of the asset. 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.

Example – extract from the Notes to the Financial Statements:

### 2.2 Summary of significant accounting policies

#### a) Impairment of non-financial assets: Impairment of non-cash generating assets (contd.)

In determining fair value less costs to sell, the price of the assets in a binding sale agreement in an orderly transaction between market participants at the measurement date, adjusted for incremental costs that would be directly attributed to the disposal of the asset is used. If there is no binding agreement, but the asset is traded on an active market, fair value less cost to sell is the asset's market price less cost of disposal. If there is no binding sale agreement or active market for an asset, the Central Government entities determine fair value less cost to sell based on the best available information.

For each asset, an assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the Central Government entities estimate the recoverable service amount and reverse the impairment loss. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable service amount, nor exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognized in surplus or deficit.

## I. Summary of requirements

A central government entity needs to:

1. Review the relevant assets (i.e. within the scope) for indications of impairment at least annually;
2. If there are indications that assets may be impaired, test assets for impairment by determining their recoverable service amounts and recognising any impairment losses;
3. Test for impairment intangible assets that have indefinite useful lives or intangible assets that are not yet available for use, at least annually;
4. Assess whether or not an impairment loss recognised in a prior period should be reversed and recognise any reversed impairment losses (if any);
5. Consider whether the remaining useful life, the depreciation/amortisation method or the residual value for the asset need to be reviewed and adjusted;
6. Gather information required to comply with the disclosure requirements; and
7. Document the (i) review of assets for indications of impairment, (ii) impairment testing carried out and (iii) information gathered in support of the disclosure requirements, as part of the working papers supporting the annual financial statements for review by the entity's auditors.



## Glossary

**“Accruals-based accounting”** Accruals-based accounting is a system of accounting based on the accrual principle, under which revenue is recognised (recorded) when earned, and expenses are recognised when incurred.

**“Active market”** An active market is a market in which all the following conditions exist:

- (a) the items traded within the market are homogenous;
- (b) willing buyers and sellers can normally be found at any time; and
- (c) prices are available to the public

**“Amortisation”** Amortisation is the systematic allocation of the amortisable amount of an asset over its useful life.

**“Asset”** An asset is a resource presently controlled by the entity as a result of a past event and from which future economic benefits or service potential are expected to flow to the entity.

**“Asset Management”** Asset management is a process that directs the procuring, use and disposal of assets to obtain their full potential throughout their lifespan and manages and maintains any costs and risks associated with the assets.

**“Carrying amount (aka Net Book Value)”** Carrying amount is the amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment losses.

**“Cash-based accounting”** Cash-based accounting is an accounting method in which income is recorded when cash is received, and expenses are recorded when cash is paid out.

**“Cash-generating assets”** Cash-generating assets are assets held with the primary objective of generating a commercial return.

**“Cash-generating unit”** A cash-generating unit is the smallest identifiable group of assets held with the primary objective of generating a commercial return that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets.

**“Central Government Entities (CGEs)”** The term CGEs refers only to ministries and departments of the Government of Malta.

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

**“Fair Value less costs to sell”** Fair Value less costs to sell is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, less the costs of disposal.

**“Impairment”** Impairment is the 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. Impairment reflects a decline in the utility of an asset to the entity that controls it.

**“International Public Sector Accounting Standards (IPSASs)”** IPSASs are a set of accrual-based accounting standards issued by the IPSAS Board for use by public sector entities around the world in the preparation of financial statements.

**“Net Book Value (aka Carrying amount)”** Net Book Value is the amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment losses.

**“Non-cash-generating assets”** Non-cash-generating assets are assets other than cash-generating assets.

**“Recoverable amount”** The recoverable amount is the higher of an asset’s or cash-generating unit’s fair value less costs to sell and its value in use.

**“Recoverable service amount”** The recoverable service amount is the higher of a non-cash-generating asset’s fair value less costs to sell and its value in use.

**“Residual value”** Residual value is the estimated amount that an entity would currently receive from disposal of an asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

**“Service Potential”** Service potential is the capacity to provide services that contribute to achieving the entity’s objectives. Service potential enables an entity to achieve its objectives without necessarily generating net cash inflows.

**“Useful life”** Useful Life is either:

- the period over which an asset is expected to be available for use by an entity; or
- the number of production or similar units expected to be obtained from the asset by an entity.

**“Value in use of a cash-generating asset”** Value in use of a cash-generating asset is the present value of the 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.

**“Value in use of a non-cash-generating asset”** Value in use of a non-cash-generating asset is the present value of the asset’s remaining service potential.

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## **Amendments to draft Guidelines**

Amendments<sup>3</sup> made to the original draft guidelines

**Section B** [paras 4, 7, 11 *Examples* 11.1-11.3]

**Section C** [paras 1.1.1, 3]

**Section E** [para 3 *Example*]

**Section F** [para 5.1 *Example*]

**Section I** [*Summary of requirements*]

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<sup>3</sup> Only the most significant amendments have been included