ASSET ACCOUNTING POLICY

GUIDELINE 5: IMPAIRMENT

Version 1.0

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1.0 PURPOSE

This guideline is intended to support the Asset Accounting Policy. It provides additional explanations on accounting for asset impairment.

2.0 WHAT IS ASSET IMPAIRMENT?

A non-current asset is impaired whenever its carrying amount as recorded in the fixed asset register exceeds its recoverable amount. Recoverable amount is the higher of an asset's *fair value less cost to sell* or its *value in use*.

The concept of fair value is described in detail within both *Guideline 1* and *Guideline 4.* Essentially fair value equates to market value wherever a readily available market exists or depreciated current replacement cost where a market for the asset is not available.

Value in use is applicable to assets that generate some form of cash inflow. In the context of the Council where the future economic benefits of an asset are not primarily dependant on its ability to generate net cash inflows and given that the Council would generally replace the asset if deprived of it, NZ GAAP deems value in use to be depreciated current replacement cost.

For the Council's purposes, the concept of recoverable amount can therefore be summarised as being the higher of *market value* where a readily available market exists and *depreciated current replacement cost*.

Where no readily available market exists for an asset the recoverable amount simply equates to its depreciated current replacement cost. This is applicable to the majority of infrastructure assets as well as any buildings with no market evidence.

At the end of each financial year, Council is required to assess whether there is an indication that an asset may be impaired. If there is an indication that asset(s) may be impaired then the asset(s) recoverable amount must be calculated.

Intangible assets with an indefinite useful life and intangible assets not yet available for use (e.g. Software that is work in progress) must be tested annually for impairment and recoverable amounts determined whether or not there are any internal or external indications of impairment.

3.0 INDICATORS OF ASSET IMPAIRMENT

Regular depreciation and revaluation processes undertaken by the Council generally account for normal fluctuations in the value of assets. Consequently, an asset will only become impaired as a result of some type of irregular event or catastrophe.

Under the requirements NZ GAAP, the Council is required to assess each financial year whether there has been an event or catastrophe that could give rise to any assets being impaired. To satisfy NZ GAAP, each area of the Council is required to undertake a formal review each year to determine whether there have been any indicators of asset impairment.

Indicators of asset impairment relevant to Council would generally fit into one of the following categories:

- Sudden natural event such as a flood, earthquake, major bush fire, tsunami or severe storm.
- Prolonged natural event such a drought or rain.
- Major damage to an asset caused through an accident, arson or inappropriate use.
- Change to the extent or manner in which an asset can be used.
- Change to an asset's technological, market, economic or legal environment.

4.0 IMPAIRMENT TEST

Whenever it is determined as part of the annual review that there have been indicators of impairment (i.e., an irregular event or catastrophe has occurred), the recoverable amount of each asset impacted is to be determined. The recoverable amount is then compared to the asset's carrying value as recorded in the fixed asset register to ascertain whether an adjustment in the accounts is to be recognised for asset impairment. Such a process is commonly referred to as the *impairment test*, whereby:

Carrying Value > Recoverable Amount = **Impairment Loss**
Carrying Value ≤ Recoverable Amount = **No Impairment**

Where the recoverable amount is less than the asset's carrying value the NZ GAAP requires the impairment loss to be offset against the asset revaluation surplus for the applicable asset class. Any balance should then be recognised as an expense within the Statement of comprehensive revenue and expense.

Whenever an asset has been destroyed or subsequently removed from service following an irregular event or catastrophe there is no need to perform an impairment test. In such circumstances the asset should be accounted for as a disposal (refer to *Guideline 6*)

There is no need to perform an impairment test on any asset restored back to its pre-event level of service prior to financial year end.

5.0 EXAMPLES OF POTENTIAL ASSET IMPAIRMENT

a. A road has been badly damaged by a major flood and subsequent repairs have not fully restored the asset's pre-event level of service.

   Consequence: Test for asset impairment.

b. As a consequence of prolonged drought underground stormwater pipes have developed cracks that significantly impact on the service potential of the drainage network.

   Consequence: Test for asset impairment.

c. Structural deficiencies identified during a bridge inspection following an earthquake have resulted in a weight restriction being imposed and thereby a reduced level of service.

   Consequence: Test for asset impairment.

d. Following a bad fire caused by faulty wiring one of Council's offices has been demolished in preparation for the construction of a replacement building.

   Consequence: No need to test for asset impairment as the demolished building should be derecognised from the fixed asset register. Costs associated with the replacement building should be capitalised as a new asset in accordance with the methodology outlined within *Guideline 1*.

e. A prolonged period of rain resulted in large potholes along a stretch of road. The damage has since been fully repaired through operational related works.

   Consequence: No need to test for asset impairment as the road has been restored back to its pre-event level of service without Council incurring capital costs.

f. Another section of road suffered severe damage during the prolonged period of rain which necessitated its surface being replaced. Due to the nature and cost involved the reseal works were capitalised.

   Consequence: No need to test for asset impairment as the damage section of road should be derecognised from the fixed asset register as a partial disposal. Costs associated with the replacement section of road are to be capitalised in accordance with the methodology outlined within *Guideline 1*.

g. An external supplier recently announced that a particular software application will no longer be supported. As the Council does not have staff and relevant skills to maintain the software, operational use of the application has been reduced to limited functions. Such functionality can be performed by far less expensive software packages.

   Consequence: Test asset for impairment.

h. A particular range of Council plant can no longer be used for their intended purpose due to new emission standards being imposed by legislation. Their restricted level of service use can be provided by less expensive plant.

   Consequence*:* Test assets for impairment.

i. The market value of one of the Council's major land parcels may be impacted by an adjacent area being earmarked for toxic waste disposal.

   Consequence*:* Test asset for impairment.

j. A pathway passing through a Council reserve has been permanently closed following detection of high toxicity levels in surrounding wetlands. Although the pathway has not been removed it no longer provides any level of service.

   Consequence: No need to test for asset impairment as the pathway should be derecognised from the fixed asset register.

Refer to *Appendix A* for a copy of Audit New Zealand's impairment assessment template.

6.0 GUIDELINE REVIEW

The guideline is to be formally reviewed on a triennial basis in conjunction with Asset Accounting Policy review.

APPENDIX A: IMPAIRMENT ASSESSEMENT TEMPLATE

This template is provided by Audit New Zealand

Information required	Responsibility	Completed	ECM reference
An assessment of the continued applicability of the useful lives and residual values assigned.			
An assessment of the impairment/ impairment indicators (per section 8.2 of the fixed asset policy) applicable to all assets.			
Detailed calculations supporting value in use, and supporting valuations for fair value less costs to sell where impairment indicators have been identified.			
Highlight to the audit team any assets that have been impaired or any idle assets that are not in use, but are still being depreciated. For the idle assets, a documented assessment is required to justify why the asset does not need to be impaired.			