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<u>Item 4 of the Agenda</u>

Draft EPSAS Screening Report
IPSAS 26 – Impairment of cash-generating assets

Paper by PwC in cooperation with Eurostat

- for discussion -

This document was commissioned by Eurostat. It analyses the consistency of the named IPSAS standard with the draft EPSAS framework, with a view to informing future EPSAS standard setting. This version was prepared taking into account comments received from the participants of the Cell on Principles related to EPSAS Standards.

EPSAS screening report

IPSAS 26 - Impairment of cash-generating assets

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pwc

Table of contents

Background 3

Screening of IPSAS 26 ‘Impairment of non-cash-generating assets’ against criteria set in the draft EPSAS framework 7

Conformity with Qualitative Characteristics 8

Alignment with other frameworks 17

European Public Good 18

Conclusion 20

Background

Objectives

Reference is made to the general introduction to the EPSAS screening reports that covers the following elements:

- Key objectives of EPSAS.
- Standard setting process in the public sector.
- Purpose and scope of the screening reports.
- Approach of the screening reports.
- European public good.
- Common elements considered when preparing the reports.

General introduction to IPSAS 26

This International Public Sector Accounting Standard (IPSAS) deals with the impairment of cash-generating assets in the public sector. This standard is drawn primarily from IAS 36 'Impairment of assets', which was published by the International Accounting Standards Board (IASB).

In developing IPSAS 26 'Impairment of cash-generating assets', the International Public Sector Accounting Standards Board (IPSASB) applied its 'Process for Reviewing and Modifying IASB Documents' that identifies public sector modifications where appropriate. This approach enables the IPSASB to build on best practices in private sector financial reporting, while ensuring that the unique features of the public sector are addressed.

Due to the inherent character of their activities, public sector entities mainly hold non-cash generating assets, but may also hold cash-generating assets. While cash-generating assets are generating measurable future economic benefits based on return from commercial transactions, the value of non-cash-generating assets is based on their service potential. Impairment rules are therefore included in two separate standards, IPSAS 21 and IPSAS 26.

The extent to which the asset is held with the objective of providing a commercial return needs to be considered to determine whether the entity should apply the provisions of IPSAS 26 or IPSAS 21.

Many of the discussion points addressed in the screening paper on IPSAS 21 are relevant for IPSAS 26 assessment. Therefore, these standards should be considered by the future EPSAS standard setter at the same time.

The objective of the IPSAS 26 standard is to prescribe the procedures that an entity applies to determine whether a cash-generating asset is impaired and to ensure that

impairment losses are recognised. This standard also specifies when an entity would reverse an impairment loss and prescribes disclosures.

Cash-generating assets are assets held with the primary objective of generating a commercial return. An asset generates a commercial return when it is deployed in a manner consistent with that adopted by a profit-oriented entity.

Scope of the report

The present screening report analyses the measurement, presentation and disclosure requirements for cash-generating assets in the scope of IPSAS 26.

IPSAS 26 applies to fixed assets, such as property, plant and equipment, intangible assets as well as equity-accounted investments and investments in subsidiaries in the entity's stand-alone financial statements. Specific impairment rules included in other standards apply to other assets such as inventories, receivables and other financial assets.

Reference to EFRAG assessment

IPSAS 26 deals with the impairment of cash-generating assets of public sector entities while IAS 36 deals with the impairment of cash-generating assets of profit-oriented entities.

No specific individual technical assessment of IAS 36 (adopted by the IASB in 2001), the IFRS equivalent of IPSAS 26, was carried out by the EFRAG, and therefore no specific individual endorsement report was produced.

The EFRAG however provided on 19 June 2002 a positive assessment of all IAS standards existing at 1 March 2002, including IAS 36, as part of the overall introduction of IAS within the EU.

The IASB revised IAS 36 in March 2004 as part of the first phase of its business combinations project. In January 2008 the IASB amended IAS 36 again as part of the second phase of its business combinations project. The EFRAG issued positive endorsement advice on the first phase of the business combinations project, however it acknowledged the complexity of practical implementation of the impairment test in practice. In May 2013 IAS 36 was amended by 'Recoverable amount disclosures for non-financial assets' (amendments to IAS 36). The amendments required the disclosure of information about the recoverable amount of impaired assets, if that amount is based on fair value less costs of disposal and the disclosure of additional information about that fair value measurement.

IASB research project - Goodwill and impairment

In March 2020, the IASB published the discussion paper 'Business combinations - disclosures, goodwill and impairment'. The discussion paper sets out IASB's preliminary views on how companies can provide better information so that investors

can hold companies to account for acquisitions of other companies. The preliminary views focus on disclosure of information and on accounting for goodwill.

The IASB considered various ways to improve the goodwill impairment model, and how it could improve the disclosures for business combinations. After concluding that it would not be possible to make the impairment test significantly more effective, the IASB decided to refocus the objectives of the project as follows:

Objective A - Exploring whether to simplify the accounting for goodwill by permitting an indicator-only approach to determine when an impairment test is required; and/or reintroducing amortisation of goodwill.

Objective B - Exploring whether to improve the calculation of value in use by permitting cash flow projections to include future restructurings and future enhancements to an asset; and the use of post-tax inputs in the calculation of value in use.

Objective C - Identifying disclosures to enable investors to assess management's rationale for the business combination; and whether the subsequent performance of the acquired business, or combined business, meets expectations set at the acquisition date.

Completion of this project is expected in 2021.

Reference to EPSAS issue papers[1]

The PwC study of 2014[2] analysed the suitability of the IPSAS standards as a basis for developing EPSAS. This included the analysis of IPSAS 26. Following this analysis, IPSAS 26 was classified among the category ‘Standards that could be implemented with minor or no adaptations’. The study indeed revealed no major conceptual issues with IPSAS 26, the only comments received related to the judgmental areas: ‘Application of IPSAS 21 ‘Impairment of non-cash-generating assets’ and IPSAS 26 ‘Impairment of cash- generating assets’ may require some judgment but no major conceptual issue has been identified’.

While developing the technical proposal on EPSAS, Eurostat commissioned a series of twenty technical issues papers (IPs), which analyse key public sector specific accounting issues. The papers were discussed at the EPSAS Working Group meetings during 2016-2018. The papers are all publicly available on Eurostat’s website.

The EPSAS issue papers on the accounting treatment of infrastructure assets, military assets and intangible assets with a view to financial reporting requirements

[1] EPSAS Issues papers are available on https://ec.europa.eu/eurostat/web/epsas/key-documents/technical-developments

[2] Collection of information related to the potential impact, including costs, of implementing accrual accounting in the public sector and technical analysis of the suitability of individual IPSAS standards (Ref. 2013/S 107-182395)

under the future European Public Sector Accounting Standards (EPSAS) addressed the issue of impairment of such assets. These EPSAS issue papers were discussed by the EPSAS WG in 2017.

Given the fact that infrastructure assets and military assets are held for service delivery purposes rather than with the primary objective of generating commercial return, such assets are non-cash generating and, therefore, IPSAS 26 does not apply to them. The EPSAS issue paper acknowledged that judgment will be required to identify impairment and to measure the recoverable service amount under IPSAS 21.

Screening of IPSAS 26 ‘Impairment of cash-generating assets’ against criteria set in the draft EPSAS framework

Introduction

The EPSAS criteria listed in the draft EPSAS conceptual framework have been used to perform an assessment of IPSAS 26 ‘Impairment of cash-generating assets’, issued in 2008 by the IPSASB.

In order to develop recommendations, one should first considered whether IPSAS 26 would meet the qualitative characteristics of the draft EPSAS CF, i.e. whether it would provide relevant, reliable, complete, prudent, neutral, verifiable, economically substantive, understandable, timely and comparable information and would not be contrary to the true and fair view principle.

This report considers recognition, classification and measurement as well as presentation and disclosure requirements applicable to impairment of non-cash-generating assets for each of the qualitative characteristics of the draft EPSAS CF.

Further, this paper includes a high-level comparison between the requirements of IPSAS 26 and other international accounting and financial reporting frameworks applied by the public sector entities in various jurisdictions, such as IFRS, ESA 2010 and EU Accounting Rules, bearing in mind the objective of alignment, reduction of cost of implementation and compliance cost.

Finally, the paper assesses whether IPSAS 26 would be conducive to the European public good.

The findings are presented below and the conclusion is included in the next section of this report.

Conformity with Qualitative Characteristics

Relevance

The entities should ensure that the carrying amounts of non-current assets in the statement of financial position are recoverable and not overstated.

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 amortisation - an entity may become aware that its assets shall not provide the expected future economic benefit or service potential.

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 to reflect the decline in the utility of the asset to the entity that controls it.

The principal accounting issues to consider under IPSAS 26 are as follows:

- How should entities identify the occurrence of an impairment loss?
- How should the recoverable amount of an asset be measured?
- How should an impairment loss be accounted for and reported on the financial statements?

IPSAS 26 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.

Under the draft EPSAS CF, selection of a measurement basis for assets needs to reflect the objectives of financial reporting under the EPSAS basis of accounting, as well as comply with qualitative characteristics, application principles and constraints of information in financial reports. Two measurement concepts are distinguished: historical costs and current value. The draft EPSAS CF clarifies that 'under the historical cost model at the reporting date the amount of an asset may be reduced by recognising depreciation and impairments'. The requirements of IPSAS 26 further develop this principle in the context of cash-generating assets.

IPSAS 26 requires public sector entities to assess whether there is any indication that an asset may be impaired at the end of each reporting period, based on the available external and internal sources of information.

If an indication of impairment exists, an entity is required to carry out an impairment test, i.e. estimate the recoverable amount of the asset and compare it to the asset's carrying amount. This methodology is consistent with the accrual basis of accounting and provides relevant and timely information about any changes with an adverse effect on the entity in the service potential of the assets.

The public sector entity must only perform an impairment test if - and only if - indicators of impairment exist. A wide range of indicators needs to be considered.

The standard provides a non-exhaustive list of primary external and internal indicators of impairment, for example:

- significant long-term changes that negatively impact the entity and the manner in which the asset is used, physical damage, indications from internal reporting that the service (for non-cash-generating assets) or economic (for cash-generating assets) performance is less than expected;
- during the period, an asset's market value has declined significantly more than would be expected as a result of the passage of time or normal use; or
- a decision to halt the construction of the asset before it is complete or in a usable condition.

Secondary (other) indicators are listed below:

- cash flows for acquiring the asset, or subsequent cash needs for operating or maintaining it, that are significantly higher than those originally budgeted;
- actual net cash flows or surplus or deficit flowing from the asset that are significantly worse than those budgeted;
- a significant decline in budgeted net cash flows or surplus, or a significant increase in budgeted loss, flowing from the asset; or
- deficits or net cash outflows for the asset, when current period amounts are aggregated with budgeted amounts for the future.

The impairment indicators should be used as a guidance rather than a compulsory checklist in the assessment of the need to perform a full impairment test at the reporting date.

An impairment loss should be recognised immediately in surplus or deficit, unless the asset is carried at revalued amount in accordance with another Standard (for example, in accordance with the revaluation model in IPSAS 17 and IPSAS 31). In this later case an impairment loss on a revalued asset is recognised in revaluation surplus to the extent that the impairment loss does not exceed the amount in the revaluation surplus for that class of assets. Such an impairment loss on a revalued asset reduces the revaluation surplus for that class of assets.

As acknowledged by the IPSASB, impairments are events that affect individual assets, or groups of assets, and do not result from periodic revaluations.

The impairment test required by IPSAS 26 is relevant in assessing the recoverable amount of the assets used to generate economic benefits. It has an important confirmatory and predictive value because it confirms the level of the future economic benefits generated by an asset, on the top of its historic cost and its systematic depreciation over the expected useful economic life.

Faithful representation / Reliability

The notion of faithful representation and reliability in the draft EPSAS CF is linked to the qualitative characteristics of completeness, prudence, neutrality, verifiability and substance over form. These are separately discussed below.

The robustness of the assumptions used in the measurement of the recoverable amount can affect the reliability of the information. Under IPSAS 26, an entity is encouraged but not required to disclose key assumptions used to determine the recoverable amount of assets during the period. Disclosure of the key assumptions improve the QC of reliability and verifiability allowing users to assess the impact of changes in the assumptions on the financial performance of an entity.

An asset is impaired when its carrying amount exceeds its recoverable amount. The recoverable amount of an asset is defined as the higher of (1) its fair value less costs to sell and (2) its value in use. It is presumed that the entity will behave in a rational way: if the fair value less costs to sell is higher, the entity will sell the asset while, if it is the value in use which is higher, the entity will continue to use the asset.

Fair value

Fair value less costs to sell is the amount that can be obtained from the sale of the asset in an arm's length transaction between knowledgeable and willing parties, after deduction of the costs of disposal.

To determine this amount, the entity should consider in descending order:

- the price included in a binding sale agreement;
- the market price of the asset when it is traded on an active market, and
- the best information available, including reference to similar recent transactions. Using observable data (such as a market price if an asset is traded on an active market) provides reliable and verifiable information to the users of the GPFSs.

Value in use

To determine an asset's value in use, a public sector entity needs to estimate the future cash flows expected to be derived from the continuing use of the asset, or cash-generating unit, and from its disposal at the end of its useful life. It also needs to determine an appropriate discount rate to be applied to these cash flows.

The cash flow estimates should be based on the most recent budgets/forecasts approved by management as well as on reasonable and supportable assumptions, using an expected cash flows approach (i.e. weighting possible outcomes by their associated probabilities). Projections beyond the period covered by the most recent budgets/forecasts (five years maximum) should be extrapolated to calculate a terminal value. The growth rate used in making these extrapolations should not

exceed the average growth rate for the industry, product or location in which the entity operates or for the market in which the asset is used.

As future cash flows should be estimated for the asset in its current conditions, the future cash inflows and outflows that will arise in relation to a future restructuring to which the entity is not yet committed, or as a consequence of future capital expenditure, should be ignored. Factors such as illiquidity should be considered in assessing the cash flows expected to be derived from the asset.

Determination of the discount rate to be used to calculate the present value of the estimated future cash flows could be challenging. The discount rate should be a pre-tax rate that reflects the time value of money and the risks specific to the asset for which the future cash flows estimates have not been adjusted.

In order to provide reliable information, estimated cash flows and discount rates should be free from both bias and factors unrelated to the asset in question. For example, deliberately overstating estimated net cash flows or understating the discount rate to enhance the apparent future profitability of an asset introduces a bias into the measurement and is not allowed under IPSAS 26.

The concept of cash-generating unit

In practice, it is seldom possible to determine the cash flows generated by a single asset. Cash flows are therefore estimated for the lowest level of the entity for which cash flows can be determined independently of the cash flows generated by the other assets of the entity. That smallest identifiable group of assets held with the primary objective of generating a commercial return and capable of generating independent cash flows is called a cash-generating unit (CGU).

In such case, the cash flows are estimated for the CGU as a whole, based on the internal management reporting and budget process. In identifying CGUs, an entity considers how management monitors operations and makes decisions about continuing or disposing of the entity’s assets. This approach aims at fairly depicting the economic value of the group of assets constituting the CGU, taking into account cost-benefit considerations. Management information is indeed presumed to be readily available without significant costs and efforts and provides a solid basis for the cash flow projections required under IPSAS 26. Moreover, the design of the impairment test reflects the internal management and decision-making structure of an entity, providing additional insights into the cash-generating potential of the independent cash-generating units of a public organisation.

The concern that management may be too optimistic in making the assumptions needed to carry out the impairment test is mitigated by disclosing key assumptions used in the measurement and by adding, if applicable, a quantitative disclosure of the headroom for each of the CGUs.

When cash flows are determined at the level of a CGU, the resulting recoverable amount must be compared to the carrying amount of the long-term assets that are part of that CGU. Therefore, the allocation of the assets should be consistent with the definition of the cash-generating unit and its cash flows.

In general, application of the impairment requirements for cash-generating assets results in a faithful representation of the carrying values of the non-current assets in the statement of financial position, consistent with the measurement principles defined in the draft EPSAS CF. The concept of cash-generating units has been tested in the public sector since the publication of IAS 36. It is deemed to achieve the right balance between cost and benefit of the impairment review, generally resulting in timely and consistent reporting of significant impairment losses by profit-oriented entities.

Completeness

IPSAS 26 deals with the impairment of individual cash-generating fixed assets, such as property, plant and equipment, intangible assets as well as equity-accounted investments and investments in subsidiaries in the entity's stand-alone financial statements. IPSAS 26 therefore complements the rules included in the standards relating to these types of assets.

This approach achieves the QC of completeness and avoids duplication of the measurement requirements in other IPSAS.

Each material impairment loss requires a separate disclosure. An entity has to apply judgment to determine the level of materiality applied for the purpose of impairment loss disclosures.

An entity should 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 para 121:

(a) The main classes of assets affected by impairment losses (and the main classes of assets affected by reversals of impairment losses).

(b) The main events and circumstances that led to the recognition of these impairment losses and reversals of impairment losses.

A class of assets is a grouping of assets of similar nature and use in an entity's operations.

Under IPSAS 26, an entity is encouraged but not required to disclose assumptions used to determine the recoverable amount of assets during the period. However, disclosure of information about the estimates used to measure the recoverable amount of a cash-generating unit is required when goodwill or an intangible asset with an indefinite useful life is included in the carrying amount of that unit. In addition, if the recoverable amount is value in use, entities should disclose the discount rate(s)

used in the current estimate and previous estimate (if any) of value in use. Disclosure of the key assumptions on a voluntary basis contribute to the QC of completeness because the users could assess the impact of changes in the assumptions on the financial performance of an entity.

Prudence

The basic objective of the standard is consistent with the QC ‘prudence’: it consists in making sure that the carrying amount of cash-generating assets is not overstated and does not reflect more than the future economic benefits to be generated by the asset.

According to IPSAS 26, the increased carrying amount of an asset attributable to a reversal of an impairment loss should not exceed the carrying amount that would have been determined (net of depreciation or amortisation) had no impairment loss been recognised for the asset in prior periods. This achieved a prudent outcome in case of reversal of the impairment loss, consistent with the cost measurement model. Further comments about the reversal of impairment losses are provided under the QC ‘Neutrality’.

Neutrality

Information is neutral if it is free from bias. GPFSs are not neutral if the information they contain has been selected or presented in a manner designed to influence the making of a decision or judgment in order to achieve a predetermined result or outcome.

Estimating the value in use of an asset involves the following steps:

(a) Estimating the future cash inflows and outflows to be derived from continuing use of the asset and from its ultimate disposal; and

(b) Applying the appropriate discount rate to those future cash flows.

Estimating the value in use is based on the forward-looking information determined by management and is therefore subjective. Cash flow projections should be based on reasonable and supportable assumptions that represent management’s best estimate of the range of economic conditions that will exist over the remaining useful life of the asset. The standard encourages entities to give greater weight to external evidence of the possible future economic conditions.

IPSAS 26 requires an entity to make a formal estimate of recoverable amount if an indication of a reversal of an impairment loss is present. The indicators of the impairment reversal mirror the indicators of impairment of the standard, except for the repair of an asset previously damaged.

Both impairment loss and subsequent reversal of an impairment loss for an asset is recognised immediately in surplus or deficit.

The standard does not include repair of a damaged asset as an indication of reversal of impairment because IPSAS 17 requires entities to add subsequent expenditure to the carrying amount of an item of property, plant and equipment when it is probable that future economic benefits over the total life of the asset, in excess of the most recently assessed standard of performance of the existing asset, will flow to the entity. This requirement also applies to investment property that is measured using the cost model under IPSAS 16. These requirements negate the need for an indication of reversal of impairment that mirrors the physical damage indication of impairment.

The guidance relating to the reversal of an impairment loss is consistent with the QC of neutrality.

Verifiability

Verifiability is the quality of information that helps assure users that GPFSs is based on supporting evidence in a way that it faithfully represents the substance of economic and other phenomena that it purports to represent.

As indicated under the QC of 'Completeness', appropriate disclosures about the assumptions used in the impairment test should enable users to verify the information provided.

The assumptions used to determine the recoverable amount of an asset are often judgmental and are determined by management based on the experience and the external and internal information available. This inevitably involves a certain degree of subjectivity. It should be noted that IPSAS 26 encourages an entity to disclose key assumptions used to determine the recoverable amount of assets during the period. A transparent disclosure of key assumptions could improve the verifiability of the information provided under IPSAS 26, especially if the carrying value of the assets in the scope of IPSAS 26 is significant for the public sector entity.

Substance over form

The 'Substance over form' QC is achieved when the underlying transactions, other events, activities or circumstances are accounted for and presented in accordance with their substance and economic reality, and not merely their legal form.

Determining the fair value or the value in use of a cash-generating asset is not an easy exercise. However, the conceptual approach is sound. The screening exercise has not revealed any potential issues that could have a negative impact on the "Substance over form" QC.

Understandability

The 'Understandability' QC is achieved when information is presented in a manner that facilitates expert and non-expert users to comprehend its meaning.

Under IPSAS 26, where it is not possible to determine the recoverable amount for an individual asset, then the recoverable amount for the asset's cash generating unit (CGU) is determined. The CGU is the smallest identifiable group of assets that generates cash inflows from continuing use, and that is largely independent of the cash inflows from other assets or groups of assets.

IPSAS 26 contains extensive requirements and guidance on (a) goodwill impairment, (b) the allocation of goodwill to cash-generating units, and (c) how to test cash-generating units with goodwill for impairment.

As goodwill does not generate economic benefits independently of other assets, it should be assessed for impairment together with the other assets that are part of the CGU. The current approach in IPSAS 26 is built on the assumption that the benefits of goodwill are maintained for an indefinite period, so goodwill is not a wasting asset and therefore it is not amortised but tested for impairment annually.

An impairment loss recognised for goodwill cannot be reversed in a subsequent period. IPSAS 31 prohibits the recognition of internally generated goodwill. Any increase in the recoverable amount of goodwill in the periods following the recognition of an impairment loss for that goodwill is likely to be an increase in internally generated goodwill, rather than a reversal of the impairment loss recognised for the acquired goodwill.

It should be noted that, if applied well, the impairment test works as intended by the IPSASB, ensuring that individual assets or a group of assets (potentially including goodwill) that are part of a CGU, are not overstated. Although application of IPSAS 26 may be complex, the rationale for the principles included in the standard are understandable.

Providing the disclosures required by the standard, including in relation to the assumptions used in estimating the recoverable amount of the asset or group of assets, also makes financial statements more understandable. The main disclosures are listed in para 114-125 of the standard.

Comparability

A key objective of EPSAS is to achieve the necessary level of financial transparency and comparability of financial reporting, between and within EU Member States.

There are no significant explicit options or policy choices to be made under IPSAS 26.

However, IPSAS 26 is a standard whose application requires the exercise of judgment. This inevitably may lead to inconsistencies in the way the requirements of the standard are applied.

One key area of judgment is the determination of whether a long-term asset is a cash-generating asset or a non-cash generating asset.

In some cases, it may not be clear whether the primary objective of holding an asset is to generate a commercial return. In such cases it is necessary to evaluate the significance of the cash flows. It may be difficult to determine whether the extent to which the asset generates cash flows is so significant that IPSAS 26 is applicable, rather than IPSAS 21. An entity develops criteria so that it can exercise that judgment consistently in accordance with the definition of cash-generating assets and non-cash-generating assets and with the related guidance in IPSAS 26.

In case of doubt, it is presumed that the asset serves a public service objective and IPSAS 21 applies. The requirement to disclose the criteria developed by the entity to distinguish cash-generating from non-cash-generating assets provides useful information to be able to compare financial statements prepared under IPSAS.

The EPSAS standard setter could consider the potential benefits of additional guidance, in particular where the issues are public sector specific, such as the identification of cash-generating assets and reclassification of the assets between cash-generating and non-cash generating following the change in the primary objective of holding the assets. The possible reclassifications between cash and non-cash generating assets are not expected to occur frequently, and therefore have limited impact on the extent to which the QC of comparability is achieved.

The standard provides a non-exhaustive list of impairment indicators; this should assist preparers in identifying whether an asset might be impaired. Judgment is required in making this identification which might lead to impairment tests not being carried out in similar situations.

Central in the application of the requirements of the standard is also the determination of the recoverable amount of an asset. Assumptions need to be taken and in doing so judgment needs to be exercised. The lack of comparability that could result from an inconsistent use of judgment by preparers is mitigated by the provision of appropriate disclosures in the notes regarding the criteria and assumptions used in exercising such judgment. In addition, transparent disclosure of the key assumptions used to determine the recoverable amount improves the comparability of the information provided under IPSAS 26.

Finally, for the purpose of impairment testing, goodwill acquired in an acquisition should, from the acquisition date, be allocated to each of the acquirer's cash-generating units, or groups of cash-generating units, that is expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquired operation are assigned to those units or groups of units. The process of goodwill allocation also requires judgment. Different levels of goodwill allocations may impact the probability of that an impairment loss be recognised.

Alignment with other frameworks

ESA 2010

In terms of subsequent measurement, assets are measured at current prices as if they were acquired at the balance sheet date under ESA 2010. The measurement approach under ESA 2010 closely agrees with the fair value model under IPSAS.

A major difference between ESA 2010 and IPSAS however stems from the calculation of their respective surplus/deficit calculations. Under ESA rules, acquisitions of items of fixed assets are recorded as capital expenditures within surplus/deficit in the period of acquisition. The full impact is taken in the year of acquisition. In contrast, under IPSAS, the impact on the statement of financial performance is taken over time through yearly depreciation expenses and/or impairments.

Under ESA 2010 rules, the concept of impairment is not applied.

IFRS[3]

IPSAS 26, is drawn primarily from IAS 36 'Impairment of assets'. The main differences between IPSAS 26 and IAS 36 are as follows:

- IPSAS 26 defines cash-generating assets and includes additional commentary to distinguish cash-generating assets and non-cash-generating assets.
- Unlike IAS 36, IPSAS 26 does not include a definition of corporate assets or requirements relating to such assets.
- IPSAS 26 does not treat the fact that the carrying amount of the net assets of an entity is more than the entity's market capitalisation as indicating impairment. The fact that the carrying amount of the net assets is more than the entity's market capitalisation is treated by IAS 36 as part of the minimum set of indications of impairment.
- IPSAS 26 includes requirements and guidance on the treatment of non-cash-generating assets that contribute to cash-generating units as well as to non-cash-generating activities. IAS 36 does not deal with non-cash-generating assets.
- IPSAS 26 includes requirements and guidance dealing with the redesignation of assets from cash-generating to non-cash-generating and

[3] Refer to the IPSAS-IFRS Alignment Dashboard regularly updated by the IPSASB available on https://www.ifac.org/system/files/uploads/IPSASB/Agenda%20Item%201.5%20IPSAS%20IFRS%20Alignment%20Dashboard_June%202019.pdf

non-cash-generating to cash-generating. IPSAS 26 also requires entities to disclose the criteria developed to distinguish cash-generating assets from non-cash-generating assets. There are no equivalent requirements in IAS 36.

EU accounting rules

EAR 18 'Impairment of assets' is based on IPSAS 21 and IPSAS 26 as regards the recognition and measurement of impairment losses for both cash-generating and non-cash generating assets. There are no significant differences between EAR 18 and IPSAS 21 and IPSAS 26.

European Public Good

Assessing whether IPSAS 26 is conducive to the European public good

The assessment of whether IPSAS 26 would be conducive to the European public good addresses the following items:

a) Whether the standard will improve financial reporting;
b) The costs and benefits associated with the standard; and
c) Whether the standard could have an adverse effect to the European economy, including financial stability and economic growth.

These assessments will allow the EU authorities to draw a conclusion as to whether the standard is likely to be conducive to the European public good.

The analysis revealed no reasons why IPSAS 26 would not be conducive to the European public good:

- Recognition, classification, measurement, presentation and disclosure requirements of IPSAS 26 will provide useful information to the users of the GPFSs and will improve the overall quality of financial reporting in the public sector. The main criterion in assessing the proposals is whether the accounting information provided about the recoverable amount of an entity's cash-generating assets will be improved when compared to the information provided currently under the local accounting frameworks of the EU member states. Based on the assessment, the requirements of IPSAS 26 satisfy this criterion.

- Implementation of the standard should result in a moderate one-off cost and should be relatively cost-neutral on an ongoing basis for preparers. The necessary procedures will need to be implemented to apply the requirements of IPSAS 26, but these practical challenges do not overweight the conceptual merits of the standard.

- Considering its conceptual merits, the standard will bring improved financial reporting when compared to heterogeneous reporting requirements currently applied in the EU. As such, its endorsement is conducive to the European public

good in that improved financial reporting improves transparency and assists in the assessment of management stewardship. The analysis has not identified any adverse effect of the standard to the European economy, including financial stability and economic growth, or any other factors that would mean the standard is not conducive to the European public good.

Conclusion

Assessing IPSAS 26 against the criteria formulated in the draft EPSAS framework

The analysis has not revealed major conceptual issues with IPSAS 26 'Impairment of cash-generating assets' and has not identified any major inconsistency between IPSAS 26 and the draft EPSAS framework.

Following the screening analysis summarised in the present report, the future standard setter could consider following conclusions. The information resulting from the application of IPSAS 26:

- would provide relevant, reliable, complete, prudent, neutral, verifiable, economically substantive, understandable, timely and comparable information needed for making economic decisions and achieving the necessary level of financial transparency and comparability of financial reporting in the European Union;
- would not be contrary to the true and fair view principle; and
- would be conducive to European public good.

However, in order to achieve consistent application of the new standard within the EU context and therefore better address the comparability objective of EPSAS financial statements, additional guidance and improvements in certain areas might be desirable.

- *Judgment and comparability.* The use of judgment and estimates is inherent in the preparation of financial statements and may to some extent affect the comparability of financial statements. This is particularly true in relation to the application of IPSAS 26 in various areas, including for distinguishing cash-generating from non-cash-generating assets, for identifying whether an asset is impaired, for allocating goodwill to CGUs, and for determining the recoverable amount of an asset. The future EPSAS standard setter might wish to develop more specific guidance in these areas. It should also be noted that the lack of comparability that could result from an inconsistent use of judgment by preparers is mitigated by the provision of appropriate disclosures in the notes regarding the criteria and assumptions used in exercising such judgment.

The analysis has not identified any adverse effect of the standard to the European economy, including financial stability and economic growth, or any other factors that would mean the standard is not conducive to the European public good.

The future standard setter could consider the conclusions of this assessment and likely net benefit of using the requirements of IPSAS 26 as a starting point in

implementing the equivalent EPSAS, considering the need for additional guidance in certain areas identified in the present EPSAS screening report.