12. Impairment of assets

Introduction

12.1. The reporting tiers applied for module 12 are as specified in the table below:

Table 12.1A: The tiered reporting requirements for module 12

All tiers	The requirements for impairment of assets in this module apply fully to all charities.

12.2. An impairment loss occurs when the carrying amount of an asset exceeds its recoverable amount. The impairment loss reflects a decline in the future economic resource or service potential of an asset, over and above the depreciation charged for the asset's use. Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life. Charities should refer to Section 27 of FRS 102 for more information on the recognition, measurement and disclosure of impairment of assets. This module must be applied by charities when accounting for the impairment of all assets except:

- contract assets and assets arising from costs to obtain or fulfil a contract (see paragraphs 23.121 to 23.123 of FRS 102)
- deferred tax assets
- assets arising from employee benefits
- investment properties measured at fair value
- biological assets social investments which must be referred to the SORP module 12 '*Accounting for social investments*'
- financial assets that fall within the scope of sections 11 and 12 of FRS 102 which deal with basic and other financial instruments

12.3. This module sets out for all charities:

- Impairment of inventories
- Impairment of assets other than inventories
- What to do if impairment is indicated
- Indicators of impairment
- Identification of the recoverable amount
- Accounting for impairment losses and reversals
- Disclosures to be made in the notes to the accounts

Impairment of inventories

12.4. At each reporting date, a charity must assess whether any inventories are impaired. In assessing whether inventories are impaired charities will need to compare the carrying amount of each item of inventory with its selling price less costs to complete and sell. If the inventory is impaired the carrying amount of the inventory should be reduced. See paragraph 27.2 to 27.4 of FRS 102 for the impairment of inventories described in this SORP as 'stock'.

Impairment of assets other than inventories

What to do if impairment is indicated

12.5. At each reporting date, a charity must assess whether there is any indication that an asset may be impaired. If there is no indication of impairment, then it is not necessary to estimate the recoverable amount. If there is an indication that an asset is impaired, then its recoverable amount must be estimated. An impairment loss must be recognised if, and only if, the recoverable amount of an asset is less than its carrying amount.

Indicators of impairment

12.6. Charities must refer to Section 10 of FRS 102 (paragraph 27.9) and the examples of indicators of impairment. Indicators of impairment may arise from both external and internal sources of information and include:

- a significant decline in an asset's market value
- significant changes in technology or markets, or in the economic or legal environment, which have an adverse effect on the charity's activities
- an asset becoming idle, or plans being made for its disposal earlier than expected
- evidence of an asset's obsolescence or physical damage
- evidence of worse than expected results, or cash flows, from the use of an asset

12.7. The demand or need for the services provided by a charity using an asset may fluctuate over time and a temporary reduction in demand is not necessarily an indication of its impairment. Similarly, an asset's service potential may not always be fully utilised and surplus capacity at certain periods will not always indicate impairment. For example, it may be necessary to have the spare capacity to respond to urgent need, or have the capacity to provide services at all times in the face of fluctuating need. In such circumstances, the surplus capacity is part of the required service potential of the asset, and the asset is not impaired.

12.8. However, where demand for services significantly decreases permanently or ceases altogether, the assets used to provide those services may be impaired. Similarly, major social, demographic or environmental changes may have an impact on the number, nature or needs of a charity's beneficiaries and may therefore also provide an indicator of impairment.

Identification of the recoverable amount

12.9. The recoverable amount of an asset is the higher of its fair value less costs to sell the asset, and its value in use. It is not always necessary to determine both an asset's fair value less costs to sell and its value in use as if either amount is equal to or exceeds the asset's carrying amount then the asset is not impaired.

12.10. Fair value less costs to sell is a measurement based on fair value. Section 2A of FRS 102 provides more guidance on fair value measurement. A fair value measurement must estimate the price at which an orderly transaction to sell an asset or to transfer a liability would take place between market participants at the measurement date.

12.11. A charity's assets may be subject to a restriction as to their use. A restriction may be imposed by the donor or created by the terms of an appeal used to fund the purchase of an asset. While a restriction will affect how the charity uses an asset, it is unlikely that a restriction imposed by charity law on the use of an asset would be passed on to a purchaser of that asset. Therefore, a restriction on use of an asset imposed by charity law would not normally be considered in determining the fair value of an asset.

12.12. Occasionally, the terms of a donation will require the on-going use of a specified asset by the charity that would prevent its sale. In such instances, there may be costs involved in removing the restriction before the asset can be sold. For example, there may be a restriction on the use of an asset that specifies that a building must only be used for educational purposes and there may be costs associated with the relaxation of that restriction. In such circumstances, the additional cost of removing a restriction should be reflected in the estimate of the asset's fair value less costs to sell. A restriction could also apply to any potential purchaser of an asset and the restriction may affect the fair value of an asset.

12.13. The method used to determine the 'value in use' of an asset held by a charity will depend on whether the asset is primarily held to generate cash as a commercial return, or for its service potential to the charity's beneficiaries.

12.14. An asset is held to generate an economic return when it is used to generate a positive cash flow and earn a return that reflects the risks involved in holding the asset. When an asset is held to generate cash flows, its value in use will be the present value of the future cash flows expected to be derived from the asset.

12.15. The calculation of an asset's value in use involves estimating the amount of the net cash flow that will be generated from the asset's use and then applying a discount rate to establish the present value of those future cash flows. The discount rate used is normally the current market rate the charity would pay to obtain comparable credit over the remaining life of the asset. The market rate should be adjusted for uncertainty in the asset's ability to generate cash in the future. Consequently, the greater the uncertainty, the greater the risk, and therefore the higher the market rate used in the calculation. This will in turn result in a lower present value amount for the value in use of the asset (see also paragraphs 27.15 to 27.20 of FRS 102).

12.16. However, charities often hold assets primarily to provide services to their beneficiaries rather than for generating cash flows. A charity may provide its services freely or at below commercial rates. Where an asset is primarily held for its service potential to beneficiaries, it would be inappropriate to measure value in use by reference to its cash flow. In such circumstances, it is more appropriate to regard value in use as the present value of the asset's remaining service potential rather than the present value of its cash flows.

12.17. The method used to value an asset's service potential should be reliable, relevant to the asset and capable of measurement (see paragraph 27.20A of FRS 102). Depreciated replacement cost is one method that may be used to provide a measure of an asset's service potential. The replacement cost of an asset is the lowest economical cost that would be incurred in replacing the asset's service potential. This value for replacement cost is then reduced to reflect the remaining useful life of the asset in its used condition.

12.18. Value in use measured on the basis of an asset's service potential will have particular relevance for specialist assets used by a charity. The market value of a specialist asset may not reflect the cost that a charity avoids by using that asset in providing services. For example, the market value of a specialist building may be less than its recent construction cost. However, provided the building continues to meet its intended service potential, then its value in use would be better reflected by its depreciated replacement cost (its construction cost) rather than the amount for which it could be sold in the market.

Accounting for impairment losses and reversals

12.19. If, and only if, the recoverable amount of an asset is less than its carrying amount, a charity must reduce the carrying amount of the asset to its recoverable amount. This reduction is an impairment loss which must be immediately recognised as expenditure in the statement of financial activities (SoFA). The impairment losses must be charged to the line items under which the asset is deployed.

12.20. If an asset is impaired, a review of its remaining useful life should also be undertaken; if its useful life has been significantly curtailed, the charge for depreciation should be adjusted accordingly. A similar review is undertaken if a previous charge for impairment is reversed, to identify whether the useful life of the asset has been extended.

12.21. On occasions, the recoverable amount of an asset may subsequently increase as a result of external conditions or an increase in the expected use of the asset. In these circumstances, for all assets other than goodwill, the carrying amount of the asset must be increased to the recoverable amount by reversing the impairment loss previously recognised. This reversal must be immediately recognised under the appropriate expense line(s) in the SoFA as a reduction in expenditure unless the asset is carried at the revalued amount in accordance with Module 10 of this SORP (for example, the revaluation model in module 10 for property, plant and equipment). Any reversal of an impairment loss of a revalued asset must be treated as a revaluation increase in accordance with the relevant section of this SORP or FRS 102. The reversal of an impairment loss must not increase the carrying amount of an asset above the amount that would have been its carrying amount if no impairment had been recognised. An impairment loss recognised for goodwill must not be reversed in a subsequent reporting period.

Disclosures to be made in the notes to the accounts

12.22. For each relevant class of asset held by a charity, the following information relating to impairment must be provided in the notes to the accounts:

- the amount of impairment losses recognised in the SoFA during the period (shown in relation to the line items(s) under which the impairment losses are included)
- the amount of reversals of any impairment losses recognised in the SoFA during the period (again, shown in relation to the line items(s) under which the impairment losses were reversed)

The disclosures required above must be produced for each relevant class of asset (see paragraph 27.33 of FRS 102).

12.23. A charity must also disclose a description of the events and circumstances that led to the recognition or reversal of an impairment loss.