

# ***Impairment of assets***

- 14.1 This section sets out the considerations for social landlords in assessing impairment of assets, which is dealt with in Section 27 of FRS 102, *Impairment of Assets*.
- 14.2 Social landlords hold a range of assets including properties held for their social benefit. The principles to be applied in assessing whether a property is held for their social benefit are set out in paragraphs 8.3 to 8.6 of this SORP. This SORP considers that properties held for their social benefit are not held solely for the cash inflows they generate and that they are held for their **service potential**. The following section focusses on the considerations for impairment of properties held for social benefit.
- 14.3 For guidance on impairment of other assets, Section 27 of FRS 102, *Impairment of Assets* should be referred to. This section of FRS 102 is applicable in assessing the impairment of all assets other than those highlighted in paragraph 27.1 of FRS 102 which includes the following that may be particularly relevant to social landlords:
- (a) Assets arising from construction contracts (see Section 23 of FRS 102, *Revenue*); and
  - (b) Investment properties (see Section 16 of FRS 102, *Investment Property*).

## **Introduction**

- 14.4 A social landlord must assess whether an indicator of impairment exists at each reporting date. If such an indicator exists, a social landlord must carry out an impairment assessment and estimate the recoverable amount of the asset or cash-generating unit. Where a social landlord has performed an appraisal of a development programme or scheme which was approved by the Board and completed, in all material respects, in accordance with these plans, there is no requirement to perform an impairment assessment on the initial recognition of the development programme or scheme. This includes the situation where a social landlord develops properties for their service potential within its own business or where it acquires properties for their service potential from a third party.

## **Indicators of impairment**

- 14.5 A social landlord must assess at each reporting date whether there is any indicator of impairment. Paragraph 27.9 of FRS 102 sets out the indicators of impairment that must, as a minimum, be considered by a social landlord. A social landlord should also consider whether there is any indicator of impairment where there is a material change to a development programme or scheme, for example when there is a change in the planned use of the properties or a change in the way the properties are to be managed. The indicators of impairment in paragraph 27.9 of FRS 102 are not repeated in this SORP, however this SORP considers that the most common indicators of impairment which could have a material impact on a development programme or scheme are as follows:
- (a) A contamination or other similar issue that was not identified as part of the planning of a development which results in a material increase in development costs. For example identification of asbestos which requires material additional expenditure for removal of the asbestos in order to complete the development.
  - (b) A change in government policy, regulation or legislation which has a material detrimental impact on the development programme or scheme. For example, a change in health and safety legislation resulting in a material increase in expenditure incurred to ensure compliance with the new regulations or a change to the rent regime which has a material impact on the rent that can be charged for a social housing property.

- (c) A change in demand for a property that is considered irreversible. For example, a material increase in the level of voids exceeding those originally forecast and which is not anticipated to reverse in future periods without material additional expenditure being incurred.
  - (d) A material reduction in the market value of properties in those circumstances where assets are intended or expected to be sold or where the occupant has the right to purchase under shared ownership arrangements.
  - (e) Obsolescence of a property, or part of a property, for example where there is a plan to regenerate existing properties by demolishing them or replace components of existing properties.
- 14.6 These indicators of impairment may impact all social housing properties within a social landlord's property portfolio, or they may only impact a specific development programme, scheme or individual property. For example, a change in regulation or government policy is likely to impact all social housing properties, whereas a contamination issue is likely to impact a specific development or property only.
- 14.7 Social landlords should review the remaining useful life, the depreciation (amortisation) method and the **residual value** of an asset where there is an indicator of impairment and adjust the respective item in accordance with the relevant section of FRS 102 (for example, Section 17 *Property, Plant and Equipment* or Section 18 *Intangible Assets other than Goodwill*), even if no impairment loss is recognised.
- 14.8 Where an indicator of impairment exists, a social landlord must perform an impairment assessment as follows:
- (a) Determine the level at which an impairment is to be assessed (i.e. the asset or **cash-generating unit**);
  - (b) Estimate the recoverable amount of the asset or cash-generating unit;
  - (c) Calculate the carrying amount of the asset or cash-generating unit; and
  - (d) Compare the carrying amount to the recoverable amount to determine if an impairment loss has occurred.
- 14.9 An impairment loss occurs when the carrying amount of the asset or cash generating unit exceeds its recoverable amount.

### **Determining the level at which properties held for their social benefit are assessed for impairment**

- 14.10 A social landlord must first determine the level at which properties held for their social benefit are to be assessed for impairment in order to measure the recoverable amount; this can be an individual asset or cash-generating unit. A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. On this basis this SORP considers it remote that a cash-generating unit would be all of a social landlord's social housing properties.
- 14.11 Cash inflows are inflows of cash and cash equivalents received from parties external to the social landlord. In identifying whether cash inflows from an asset (or group of assets) are largely independent of the cash inflows from other assets (or groups of assets), a social landlord should consider factors such as how management monitor business activities, (for example by regional areas, location of properties, type of activity, development programme, individual development scheme) or how management makes decisions about continuing or disposing of the assets and operations of the business.

- 14.12 The identification of a cash-generating unit involves judgement and the level at which a cash-generating unit is determined may change (see example 1 for further guidance).

### **Estimating the recoverable amount**

- 14.13 Paragraph 27.11 of FRS 102 states that the recoverable amount of an asset or cash-generating unit is the higher of its:

- a) **value in use**; and
- b) **fair value less costs to sell**.

- 14.14 Where an indicator of impairment exists and an impairment assessment is being performed, it is usually not necessary to estimate both the value in use and the fair value less costs to sell. If either of these amounts exceeds the carrying amount, then there is no impairment and it is not necessary to estimate the other amount.

- 14.15 The models set out below for estimating the recoverable amount of the asset or cash-generating unit are for the purposes of assessing impairment only. They are not to be used as measurement models to determine the fair value of a housing property asset where an accounting policy of revaluation is applied and the housing property is included in the Statement of Financial Position at valuation. In these circumstances, the guidance for revaluation of housing property assets set out in Section 17 of FRS 102, Property, Plant and Equipment and paragraph 8.23 of this SORP must be applied.

#### ***(a) Estimating value in use***

- 14.16 Value in use is the present value of the future cash flows expected to be derived from the asset or cash-generating unit. However, paragraph 27.20A of FRS 102 states that “for assets held for their service potential, a cash flow driven valuation (such as value in use) may not be appropriate. In these circumstances value in use (in respect of assets held for their service potential) is determined by the present value of the asset’s remaining service potential plus the net amount the entity will receive from its disposal. In some cases this may be taken to be costs avoided by possession of the asset. Therefore, depreciated replacement cost, may be a suitable measurement model but other approaches may be used where more appropriate”.

- 14.17 As noted in paragraph 14.2, this SORP considers that properties held for their social benefit are not held solely for the cash inflows they generate and that they are held for their service potential. Therefore a social landlord should use **value in use (in respect of assets held for their service potential) (VIU-SP)** to estimate value in use for these assets, which is explained more fully in paragraph 14.22.

- 14.18 However, as a practical expedient, when an indicator of impairment exists, a social landlord may estimate the value in use of properties held for their social benefit based on the expected future cash flows of the asset or cash-generating unit as set out in paragraphs 14.19 to 14.21. If this calculation estimates a recoverable amount that is higher than the carrying amount of the asset or cash-generating unit there is no impairment loss and the social landlord does not need to estimate the VIU-SP or fair value less costs to sell of the asset or cash-generating unit. The calculation of value in use is a practical measurement technique that, in most cases, can be calculated from information that a social landlord already holds via a development appraisal or business plan and therefore is considered to be a more straight forward estimation technique than VIU-SP.

#### **Value in use**

- 14.19 If a social landlord chooses to calculate the value in use of properties held for their social benefit based on the expected future cash flows of the asset or cash-generating unit, this value must be calculated in accordance with paragraphs 27.15 to 27.20 of FRS 102 which set out the

detailed considerations and requirements for a present value calculation in this context and require the following steps:

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

b) applying the appropriate discount rate to those cash flows.

14.20 Social landlords must apply an appropriate discount rate. Paragraph 27.20 of FRS 102 specifically requires that the discount rate(s) used in the present value calculation reflects the current market assessment of the time value of money and risks specific to the asset for which the future cash flow estimates have not been adjusted. This means that the discount rate must reflect the rate at which an individual social landlord would be able to secure finance for the development over a term commensurate with the length of the cash flows of the development rather than a social landlord's current average cost of borrowing.

14.21 Where a social landlord has received government grant for a housing property or scheme, any obligation to recycle or repay government grant on disposal of the property(ies) should be reflected in the present value calculation as it is a cash outflow linked directly to the ultimate disposal of the housing property.

#### **Value in use (in respect of assets held for their service potential)**

14.22 VIU-SP is an estimate of the value in use of an asset or cash-generating unit which takes into consideration the service potential of the asset or cash-generating unit and is not based purely on the cash flows generated. Whilst it is recognised that properties held for their social benefit do generate a cash flow, an estimation technique based purely on those cash flows does not reflect the value of the service potential of the asset or cash-generating unit to the social landlord.

14.23 This SORP considers that depreciated replacement cost will provide an estimate of the VIU-SP for properties held for their social benefit in circumstances where the asset or cash-generating unit still provides some level of service potential.

14.24 Where there is an issue which results in properties held for their service potential being unable to be let in their current condition, for example demand uncertainty or a serious structural defect, this SORP considers it is likely that the properties are no longer providing the social landlord with any service potential. In these circumstances the recoverable amount of such properties should be estimated by reference to its fair value less costs to sell or value in use, and not VIU-SP.

14.25 Depreciated replacement cost is defined in FRS 102 as 'the most economic cost required for the entity to replace the service potential of an asset (including the amount that the entity will receive from its disposal at the end of its useful life) at the reporting date.'

14.26 Depreciated replacement cost is the lowest cost of constructing or acquiring a replacement asset(s) to provide the same level of service potential to the social landlord that the existing asset or cash-generating unit was providing immediately before it was impaired. This cost will comprise the cost of replacing the land as well as the building and its components. If the lowest cost to replace the service potential of an asset is determined to be the cost of re-building the asset, this must be the lowest cost to do so and must reflect optimal conditions. The cost should therefore not include any additional costs incurred when the asset was originally built relating to problems or issues with the development.

14.27 Once this replacement cost is established it is then necessary to adjust (or depreciate) this cost. In the context of depreciated replacement cost this is not the same as the depreciation charged to expenditure to represent the systematic allocation of the depreciable amount of the asset over its useful life. The adjustment made is to reflect the physical deterioration of the

asset and any obsolescence (for example, where the design or specification of the asset no longer fulfils the function for which it was originally designed) that needs to be reflected in the depreciated replacement cost.

- 14.28 Alternative measurement models may be used to estimate VIU-SP provided they are relevant and can be reliably measured.

***(b) Estimating fair value less costs to sell***

- 14.29 Paragraph 27.14 of FRS 102 sets out how to estimate fair value less costs to sell. Fair value less costs to sell represents the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal. The best evidence of the fair value less costs to sell of an asset is a price in a binding sale agreement in an arm's length transaction or a market price in an active market. Where a social landlord has the freedom to sell a housing property on the open market, then the fair value less costs to sell will be equivalent to the market value of the property less the costs to sell (including any associated grant which is repayable).
- 14.30 Where a social landlord does not have the freedom to sell a housing property on the open market then fair value less costs to sell must be based on the best information available to reflect the amount that a social landlord could obtain, at the reporting date, from the disposal of the asset in an arm's length transaction between knowledgeable and willing parties, after deducting the costs of disposal. Relevant evidence to support this value could include the outcome of recent transactions of similar assets within the social housing sector, for example, the sales value achieved for social housing stock which has been transacted between social landlords within a similar area or region; or the highest of a number of competitive bids submitted for a specific scheme by different social landlords. The definition of EUV-SH in the RICS Valuation Standards indicates that this method of valuation would provide a fair value as defined in FRS 102 and therefore this could be the basis used to determine fair value of social housing properties.

**Calculate the carrying amount**

- 14.31 The carrying amount of the asset or cash-generating unit is calculated as the net book value of the asset or cash-generating unit (cost or valuation less depreciation) less any unamortised grant in the Statement of Financial Position relating to the asset or cash-generating unit.

**Recognising and measuring an impairment loss for a cash generating unit**

- 14.32 An impairment loss must be recognised for the asset or cash-generating unit if, and only if, the recoverable amount of the asset or unit is less than the carrying amount of the asset or cash-generating unit. Paragraphs 27.21 to 27.23 of FRS 102 set out how the impairment loss must be allocated to the assets of a cash-generating unit.
- 14.33 The impairment loss should be charged to the Statement of Comprehensive Income as expenditure and disclosed as a separate line within operating expenditure.

**Examples**

- 14.34 The following examples are based on the principles and considerations set out above:

***Example 1 – determining cash-generating units***

Social landlord A has a development programme of ten schemes which have been appraised together and approved by the Board as one programme. Five of the schemes are forecast to make a loss as they are solely for the provision of social housing, however the cash flows from

the other five schemes are to be used to fund the loss-making schemes. The ten schemes have been submitted to the regulator as one development programme which sets out how the funding of the schemes will work overall and funding is awarded for the overall development programme and not at an individual scheme level.

The social landlord would not go ahead with the five loss-making schemes if the other five schemes were not also part of the programme; the programme overall would not have been approved by the Board as financially viable and the contractual arrangement entered into with the regulator is for delivery of the overall development programme.

In these circumstances the social landlord does not have the option of unilaterally changing the development programme and removing the five loss-making schemes. Therefore the lowest level of identifiable cash inflows that are largely independent of the cash inflows from other assets or groups of assets is the cash inflows generated from the development programme of ten schemes.

The development programme is delivered as planned and the units move into management. At this point the social landlord is no longer bound by the original development programme contract and has flexibility in how it manages each scheme. The cash-generating unit is now determined to be at a scheme level as this is how the social landlord manages the programme. The social landlord considers whether there is an indicator of impairment at this point and concludes that there is no indicator as the development programme has been delivered to plan, and therefore no further assessment of impairment is required.

***Example 2 – indicators of impairment and measuring recoverable amount***

Social landlord C has owned and managed an estate of 10 units for many years. All of the units are general needs. The social landlord is considering demolishing the existing units and replacing them with more modern and better designed units, making better use of the site. The plan is to demolish the existing units, building 20 new units in their place. Five of these will be sold outright, five will be sold on shared ownership and 10 will be rented. The expectation is that grant will be forthcoming and that this, together with the expected proceeds, makes the new scheme viable.

Once the likelihood of the demolition taking place becomes probable, the social landlord reassesses the useful life of the existing units to end at the point at which the existing units are expected to be withdrawn from management. This is an indicator of impairment as set out in paragraph 14.5 of this SORP. Since the land is being retained in the new units and there is no indicator of impairment in relation to the planned new scheme at this stage, the impairment assessment is confined to the cost of the existing units net of attributable unamortised grant.

The social landlord decides it is unable to measure reliably the VIU-SP for an asset intended to be used for only a small number of years. In assessing the fair value less costs to sell of the units the restriction on the use of the units as general needs means that the market is restricted to a transaction with another social landlord. Transactions of similar units between social landlords are limited and this factor coupled with the age and design of the units leads the social landlord to conclude that the fair value less costs to sell would be very low. It therefore considers recoverable amount is best represented by calculating value in use.

The carrying amount of the units (i.e. cost of the existing units net of attributable unamortised grant) is higher than the value in use calculated and therefore an impairment loss is recognised to reduce the carrying amount to the value in use.

***Example 3 – indicators of impairment and measuring recoverable amount***

Social landlord D has a single unit in a village, which has become void. Another social landlord has recently built 25 units of a modern design in a different part of the village and is experiencing some difficulties in letting all of these units. Social landlord D considers that

there is a material impact arising from the demand issue and therefore that there is an indicator of impairment.

The social landlord recognises it cannot use VIU-SP to estimate the recoverable amount of the unit as demand is uncertain and the unit is not providing the same level of service to the business when it is void. The social landlord therefore considers that it can only estimate the recoverable amount of the unit as the higher of its fair value less costs to sell and value in use.

With respect to the fair value less costs to sell of the unit, if social landlord D has obtained consent from the regulator to dispose of the unit, it may estimate fair value less costs to sell as being the market value of the property less selling costs and the gross amounts of grant (reduced by abatement where applicable). However, if social landlord D has not obtained consent, then it will need to estimate fair value less costs to sell in the light of recent comparable transactions between social landlords or via an appropriate estimate of the amount that might be paid by another social landlord.

In calculating the value in use of the unit this is based on the future cash inflows and outflows of the unit and therefore will reflect a loss of income due to the unit being void.

The social landlord recognises an impairment loss where the carrying amount of the unit is higher than its recoverable amount – that is the higher of the fair value less costs to sell and the value in use calculated.

### **Additional requirements for impairment of goodwill**

- 14.35 Paragraphs 27.24 to 27.27 of FRS 102 set out the additional requirements to be considered when assessing the impairment of goodwill.

### **Reversal of an impairment loss**

- 14.36 An impairment loss recognised for all assets, including goodwill, must be reversed in a subsequent period if, and only if, the reasons for the impairment loss have ceased to apply. Indicators that an impairment loss may have decreased will generally be the opposite of those set out in paragraph 14.5 of this SORP. The procedure for determining whether all or part of the prior impairment loss must be reversed depends on whether the prior impairment loss was based on the recoverable amount of that individual asset (see paragraph 27.30 of FRS 102) or the recoverable amount of the cash-generating unit to which the asset belongs (see paragraph 27.31 of FRS 102). The reversal of an impairment loss should be included in the Statement of Comprehensive Income as a separate line within operating expenditure and not netted off operating expenditure.

### ***Impairment of properties developed for outright sale***

- 14.37 As set out in paragraph 27.2 of FRS 102, a social landlord must assess at each reporting date whether any inventories are impaired by comparing the carrying amount of each item of inventory (stock) (or group of similar items as defined in paragraph 27.3 of FRS 102) with its selling price less costs to complete and sell.
- 14.38 If an item of inventory (stock) is impaired, a social landlord must reduce the carrying amount of the inventory (stock) to its selling price less costs to complete and sell and that reduction is an impairment loss which is recognised immediately in the income and expenditure.
- 14.39 This is particularly relevant to social landlords holding properties developed for outright sale which are classified as inventory (stock) in the Statement of Financial Position at the reporting date. Social landlords must follow the guidance set out in this SORP when assessing mixed tenure development schemes.

14.40 At subsequent reporting dates:

- where circumstances that previously resulted in an impairment of inventory (stock) no longer exist; or
- when there is clear evidence of an increase in selling price less costs to complete and sell because of changed economic circumstances,

a social landlord must reverse the amount of the impairment (limited to the amount of the original impairment loss recognised in income and expenditure) so that the new carrying amount is the lower of cost and the revised selling price less costs to complete and sell.

### ***Disclosures***

14.41 Paragraphs 27.32 to 27.33A of FRS 102 set out the disclosure requirements for impairment that must be followed.

14.42 This SORP requires that the notes to the accounts include:

- the estimation technique used in measuring the recoverable amount for the purposes of the impairment assessment;
- the key judgements made in estimating the recoverable amount; and
- where VIU-SP is used to estimate the recoverable amount, the method used to calculate VIU-SP and the key assumptions made in calculating this value.

## **Glossary of terms**

Cash-generating unit	The smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or group of assets.
Depreciated replacement cost	The most economic cost required for the entity to replace the service potential of an asset (including the amount that the entity will receive from its disposal at the end of its useful life) at the reporting date.
Fair value less costs to sell	The amount obtainable from the sale of an asset or cash-generating unit in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal.
Residual value	The estimated amount that an entity would currently obtain 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	The economic utility of an asset, based on the total benefit expected to be derived by the entity from use (and/or through sale) of the asset.
Value in use	The present value of the future cash flows expected to be derived from an asset or cash-generating unit.
Value in use (in respect of assets held for their service potential)	When the future economic benefits of an asset are not primarily dependent on the asset's ability to generate net cash inflows, value in use (in respect of assets held for their service potential) is the present value to the entity of the asset's remaining service potential if it continues to be used, plus the net amount that the entity will receive from its disposal at the end of its useful life.