Financial Reporting on Cash-Generating Assets in the Public Sector

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Abstract: *Financial reporting on information of cash-generating assets belongs to the specific issues of public sector entities. The article deals with requirements for the procedures that a public sector entity applies to determine whether a cash-generating asset is impaired, and to measure, recognize and disclose the impairment losses. These issues are specified in International Public Sector Accounting Standard IPSAS 26, Impairment of Cash-Generating Assets. This IPSAS also specifies when a public sector entity would reverse an impairment loss and prescribes disclosures. The result of the examination of this issue is a comprehensive overview of knowledge about impairment of cash-generating assets with an emphasis on the importance of financial reporting on information of cash-generating assets in the public sector that has a significant impact on the financial position and financial performance of public sector entities.*

Keywords: *Public Sector, Financial Reporting, Cash-Generating Assets*

JEL codes: M40, M41, H83

1 Introduction

Impairment of cash-generating assets belongs to the current issues of financial reporting by public sector entities. Public sector entities hold assets with a specific characteristic – it is primarily generated a commercial return. Cash-generating assets are defined as assets held with the primary objective of generating a commercial return (IFAC, 2018). Assets generate a commercial return when they are deployed in a manner consistent with that adopted by a profit-oriented entity. This entity intends to generate positive cash inflows from the assets or from the cash-generating units of which the assets are a part and earn a commercial return that reflects the risk involved in holding the assets. Provisions of the International Public Sector Accounting Standard IPSAS 26, Impairment of Cash-Generating Assets, state the basic issues of specifying the procedures that a public sector entity applies to determine whether a cash-generating asset is impaired, and to ensure that impairment losses are recognized. An impairment is defined as a loss in the future economic benefits or service potential of an asset, over and above the systematic recognition of the loss of future economic benefits or service potential of asset through depreciation. Impairment loss is defined as an amount at which the carrying amount of the asset exceeds its recoverable amount. Public sector entity that prepares and presents general purpose financial statements under the accrual basis of accounting shall apply IPSAS 26 in financial reporting on the impairment of cash-generating assets. The researched object that is financial reporting on impairment of cash-generating assets by public sector was chosen because of its timeliness and dynamic development. We got information about the researched object from book and magazine sources, conference proceedings and from our own previous knowledge of the research activities. We have worked with the current literature published in 2018, which was mainly in English. This literature is listed in the references section. The above issue deals mainly with provisions of relevant International Public Sector Accounting Standards that are listed in the Handbook of International Public Sector Accounting Pronouncements, which was published in 2018 on the IFAC website (IFAC, 2018). We also used our knowledge of our research activities and articles in scientific journals and conference proceedings (Juhászová and Markovič and Mokošová, 2014), (Kordošová, 2016), (Kovalčíková, 2018), (Manea and Giju and Vatasoiu, 2010), (Ondrušová, 2016), (Pakšiová, 2016), (Šlosárová, 2016) and (Trifan, 2010). The knowledge gained forms the basis for the processing of results and conclusion.

2 Methodology and Data

The aim of this paper is to describe and analyse knowledge about the specific issues of financial reporting by public sector, results of the analysis of requirements for the procedures that a public sector entity applies to identify the cash-generating assets that may be impaired, to measure recoverable amount of an asset, to determine indications that an asset may be impaired, to recognize and measure an impairment loss of an asset, to determine indications that an impairment loss recognized in prior periods for an asset may no longer exist or may have decreased, to determine of reversal of an impairment loss of an asset and to disclose information on impairment of cash-generating assets. We applied epistemology as a basic method for researching this issue. Standard research methods, such as selection, analysis, and synthesis, presenting basic methodical approach to paper processing are applied. We combined the obtained knowledge to form new, higher level of knowledge of research issues. Ways of understanding and explaining requirements for the procedures that a public sector entity applies to determine whether a cash-generating asset is impaired and to measure, recognize and disclose the impairment losses, the inductive-deductive and analytic-synthetic logical scientific methods are used. In the conclusion, we stated opinions, in which we highlighted the importance of the financial reporting on impairment of cash-generating assets of public sector in a way that meets the objectives of financial reporting to provide information that is useful for accountability and decision-making purposes. The financial reporting on information about the impairment of cash-generating assets of public sector entities has a significant impact on the financial position and financial performance of public sector entities. Financial reporting on information of cash-generating assets is useful to enhance the transparency of general-purpose financial reports and provide transparent information that is useful for accountability and decision-making purposes.

3 Results and Discussion

The basic issue that needs to be addressed is the identification of cash-generating asset that may be impaired. Impairment means a loss in the future economic benefits or service potential of an asset, over and above the systematic recognition of the loss of the future economic benefits or service potential of asset through depreciation. Impairment of a cash-generating assets reflects a decline in the future economic benefits or service potential embodied in an asset to the public sector entity that controls it. Cash-generating asset is impaired when the carrying amount of the asset exceeds its recoverable amount (IFAC, 2018). For example, the public sector entity may have a municipal parking garage that is currently being used at 25 percent of capacity. It is held for commercial purposes, and management has estimated that it generates a commercial rate of return when usage is at 75 percent of capacity and above. The decline in usage has not been accompanied by a significant increase in parking charges. The asset is impaired because carrying amount exceeds its recoverable amount. Carrying amount of an asset is the amount at which an asset is recognized in the statement of financial position, after deducting any accumulated depreciation and accumulated impairment losses. Recoverable amount of an asset is the higher of an asset's or a cash-generating unit's fair value less costs to sell and its value in use. Under the provisions of IPSAS 26, the public sector entity should assess each reporting date whether there is any indication that the cash-generating asset may be impaired. If any of those indications exists, the public sector entity should estimate the recoverable amount of the asset. If there is no indication of a potential impairment, IPSAS 26 does not require the public sector entity to make a formal estimate of the recoverable amount of the asset. When assessing whether there is any indication that the asset may be impaired, the public sector entity should consider both external and internal sources of information that are determined by IPSAS 26.

Under the provisions of IPSAS 26, recoverable amount is defined as the higher of an asset's fair value less costs to sell and its value in use. IPSAS 26 set out the requirements for measuring recoverable amount. These requirements use the term "an asset" but apply equally to an individual asset or a cash-generating unit. The cash-generating unit is defined as 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. Fair value less costs to sell of a cash-generating asset is defined as the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal. Value in use of a cash-generating asset is defined as 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. It is not always necessary to determine both an asset's fair value less costs to sell and its value in use. If either of these amounts exceeds the asset's carrying amount, the asset is not impaired, and it is not necessary to estimate the other amount. It may be possible to determine fair value less costs to sell, even if an asset is not traded in an active market. The active market is defined as the market in which the items traded within the market are homogeneous, willing buyers and sellers can normally be found at any time, and prices are available to the public. However, sometimes it will not be possible to determine fair value less costs to sell because there is no basis for making a reliable estimate of the amount obtainable from the sale of the asset in an arm's length transaction between knowledgeable and willing parties. In this case, the public sector entity may use the asset's value in use as its recoverable amount. If there is no reason to believe that an asset's value in use materially exceeds its fair value less costs to sell, the asset's fair value less costs to sell may be used as its recoverable amount. Measurement of assets are treated in a similar way by authors (Juhászová and Markovič and Mokošová, 2014), (Kordošová, 2016), (Kovalčíková, 2018), (Ondrušová, 2016), (Pakšiová, 2016), and (Šlosárová, 2016).

Recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. If this is the case, recoverable amount is determined for the cash-generating unit to which the asset belongs, unless either the asset's fair value less costs to sell is higher than its carrying amount or the asset is a part of a cash-generating unit but is capable of generating cash flows individually, in which case the asset's value in use can be estimated to be close to its fair value less costs to sell and the asset's fair value less costs to sell can be determined (IFAC, 2018).

IPSAS 26 set out methods of determining fair value less costs to sell. The best evidence of this value is the price stated in the binding sale agreement in an arm's length transaction adjusted for additional costs that would be directly attributable to the disposal of the asset. In the absence of a binding sale agreement, but an asset is traded in an active market, fair value less costs to sell is the asset's market price less the costs of disposal. The appropriate market price is usually the current bid price. When current bid prices are unavailable, the price of the most recent transaction may provide a basis from which to estimate fair value less costs to sell, if there has not been a significant change in economic circumstances between the transaction date and the date on which the estimate is made (IFAC, 2018). In the absence of a binding sale agreement or active market for an asset, fair value less costs to sell is based on the best information available to reflect the amount that the public sector entity could obtain, at reporting date, from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the costs of disposal. In determining this amount, the public sector entity could consider the outcome of recent transactions for similar assets within the same industry.

IPSAS 26 set out factors that are considered in measuring an asset's value in use. An estimate of the future cash flows the public sector entity expects to derive from the asset. Expectations about possible variations in the amount or timing of those future cash flows. The time value of money represented by the current market risk-free rate of interest. The price for bearing the uncertainty inherent in the asset. Other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows the public sector entity expects to derive from the asset. Estimating the value in use of an asset involves estimating the future cash inflows and outflows to be derived from continuing use of the asset and from its ultimate disposal and applying the appropriate discount rate to those future cash flows (IFAC, 2018).

The carrying amount of the asset shall be reduced to its recoverable amount only if the recoverable amount of an asset is less than its carrying amount. That reduction is an impairment loss. Impairment loss of a cash-generating assets is defined as the amount by which the carrying amount of an asset exceeds its recoverable amount. The impairment loss should be recognized directly in surplus or deficit. After the recognition of an impairment loss, the depreciation charge for the asset shall be adjusted in future periods to allocate the revised carrying amount of asset, less its residual value on a systematic basis over its remaining useful life. Useful life of a cash-generating assets is defined as the period over which an asset is expected to be used by the public sector entity or the number of production or similar units expected to be obtained from the asset by the public sector entity.

The public sector entity shall assess at each reporting date whether there is any indication that an impairment loss recognized in prior periods for an asset may no longer exist or may have decreased. If any such indication exists, the public sector entity shall estimate the recoverable amount of the asset. When assessing whether there is any indication that the impairment loss recognized for the asset in prior periods may no longer exist or could have decreased, the public sector entity should consider the indications of external and internal sources of information that are determined by IPSAS 26. The impairment loss recognized in prior periods for an asset should be reversed only if there has been a change in the estimates used to determine the recoverable amount of asset since the last impairment loss was recognized. If this is the case, the carrying amount of the asset shall be increased to its recoverable amount. That increase is a reversal of an impairment loss. Recognition, measurement and reversal of impairment losses are treated in a similar way by authors (Manea and Giju and Vatasoiu, 2010), and (Trifan, 2010). A reversal of an impairment loss reflects an increase in the estimated service potential of an asset, either from use or from sale, since the date when the public sector entity last recognized an impairment loss for that asset. Under the provisions of IPSAS 26, the public sector entity is required to identify the change in estimates that causes the increase in estimated service potential. The increased carrying amount of an asset resulting from the reversal of an impairment loss shall not exceed the carrying amount that would have been determined (net of amortization or depreciation) if no impairment loss had been recognized for the asset in prior periods and reversal of an impairment loss for an asset shall be recognized immediately in surplus or deficit. After recognition of reversal of an impairment loss, the depreciation (amortization) charge for the asset shall be adjusted in future periods to allocate the revised carrying amount of the asset, less its residual value on a systematic basis over its remaining useful life.

The important issue is disclosing information on impairment of cash-generating assets. The public sector entity should disclose the criteria developed by the public sector entity to distinguish cash-generating assets from non-cash-generating assets. The public sector entity shall disclose for each class of assets the following information: the amount of impairment losses recognized 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 the amount of reversals of impairment losses recognized in surplus or deficit during the period, and the line item(s) of the statement of financial performance in which those impairment losses are reversed (IFAC, 2018). The public sector entity shall disclose for each material impairment loss recognized or reversed during the period the following information: the events and circumstances that led to the recognition or reversal of the impairment loss; the amount of the impairment loss recognized or reversed; the nature of the asset; a description of the cash-generating unit; whether the recoverable amount of the asset is its fair value less costs to sell or its value in use; the basis used to determine fair value less costs to sell, if the recoverable amount is fair value less costs to sell; and the discount rate(s) used in the current estimate; and previous estimate of value in use, if the recoverable amount is value in use.

Conclusions

The aim of this paper was to describe and analyse knowledge about the specific issues of financial reporting by public sector, results of the analysis of requirements for the procedures that a public sector entity applies to identify the cash-generating assets that may be impaired, to measure recoverable amount of an asset, to determine indications that an asset may be impaired, to recognize and measure an impairment loss of an asset, to determine indications that an impairment loss recognized in prior periods for an asset may no longer exist or may have decreased, to determine of reversal of an impairment loss of an asset and to disclose information on impairment of cash-generating assets. The result of examination of this issue is a comprehensive overview of knowledge about the impairment of cash-generating assets by public sector entities with an emphasis on the importance of financial reporting on information of cash-generating assets in the public sector that has a significant impact on the financial position and financial performance of public sector entities. Relevant International Public Sector Accounting Standards covered these issues. The application of the requirements of IPSAS standards to impairment of cash-generating assets meets the objectives of financial reporting. The financial reporting on information about the impairment of cash-generating assets of public sector entities is useful to enhance the transparency of general-purpose financial statements and provide transparent information that is useful for accountability and decision-making purposes.

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