AcSB
Accounting Standards Board

COVID-19
Resource

Impairment of Non-Financial Assets

What you need to know (April 2020)

What's the issue?

1. COVID-19 is having a significant economic effect on companies, many of which are now facing declines in production, sales, and demand for their goods or services. These declines affect a company's profitability and may give rise to events that indicate that its non-financial assets, such as intangible assets, goodwill, property, plant, and equipment may not be recoverable.

2. As we move forward, Canadian public companies will need to file financial statements. When preparing interim and annual financial statements in accordance with IFRS® Standards, management will need to assess whether there is any indication that the company's non-financial assets may be impaired. At the reporting date, if facts and circumstance indicate that an asset's carrying value may not be recoverable, an estimate of the asset's or cash-generating unit's (CGU)[1] recoverable amount is required. (IAS 36.9)

Does COVID-19 give rise to the need to test assets for impairment?

3. It depends. You'll need to consider both internal and external sources of information when assessing whether the company's assets or CGUs have impairment indicators. Such indicators could include:

   (a) the recent stock market decline resulting in the carrying amount of an entity's net assets exceeding its market capitalization;

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[1] A CGU 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. (IAS 36.6)

(b) adverse economic conditions affecting the sector and/or capital markets in which the entity operates;

(c) legal developments restricting the entity's ability to operate in the current environment; and

(d) supply-chain disruptions preventing an entity from operating profitably.

(IAS 36.12)

4. Management's indicator assessment will be subject to several uncertainties, such as the estimated duration of business closures, supply-chain disruptions, and reduced demand for the company's goods. Therefore, management may need to apply significant judgment to determine whether facts and circumstances indicate the need for an impairment test.

5. Finally, an impairment indicator does not need to indicate a permanent loss for it to trigger an impairment test. Factors such as the probability or permanence of the impairment loss are considered when calculating the asset's or CGU's recoverable amount.

How do I deal with significant estimation uncertainty in an impairment test?

6. COVID-19 may result in significant estimation uncertainty when determining future cash flows and discount rates to use when measuring an asset's or CGU's recoverable amount.

7. Management should ensure that any applicable COVID-19 risks are reflected either as adjustments to the future cash flows or as adjustments to the discount rate used in the recoverable amount calculation. (IAS 36.32 and A15)

8. Furthermore, the cash flow projections should continue to be based on reasonable and supportable assumptions that represent management's best estimate of the economic conditions expected over the remaining useful life of the asset. Where possible management should use external sources of information, such as analyst forecasts of commodity prices and projections published by reputable non-government organizations. (IAS 36.33)

9. Management might also consider what impact financial support from governments and other institutions might have on their cash flow projections and the risks built into the discount rate to be used.

Do the recent interest rate changes affect my discount rate?

10. It depends. The discount rate used in an impairment test should be market based and should consider risks associated with the asset's or CGU's estimated cash flows. In addition to company-specific risks (e.g., industry risk, product risk, etc.), market risks including country risk, currency risk, and price risk should also be considered. (IAS 36.A18)

11. When deriving the discount rate to use in your test, management may consider the company's weighted average cost of capital,[2] the company's incremental borrowing rate, and other market borrowing rates that may have been significantly affected by COVID-19. (IAS 36.A17)

12. A move by central banks to cut their overnight rate may not always result in a decline in a company's discount rate due to increases in the company-specific risks.

13. If you have more questions about how COVID-19 affects discount rates, see the Accounting Standards Board's (AcSB) easy-to-understand overview of Resources titled "Discount Rates."

What if I identify an issue after the reporting date?

14. You may, after the reporting date but before the financial statements are issued, determine that there is an indication that assets may be impaired. In this case, you will need to consider the accounting or disclosure impact on your current financial statements. (IAS 10.9(b))

15. If you have more questions about what events need to be accounted for and disclosed after the reporting period, see the AcSB's easy-to-understand overview of Resources titled "Events after the Reporting Period (IAS 10)."

How will COVID-19 affect my financial statement disclosures?

16. COVID-19 is likely to give rise to significant judgment and estimation uncertainty, such as the duration of the supply-chain disruptions, reduction in expected demand, and delays in business expansions.

17. Management may need to disclose information about the assumptions it used to conclude why an impairment test was not triggered if the assessment is subject to significant estimation uncertainty. (IAS 1.125)

18. Companies will need to disclose information about the key assumptions used to measure a CGU's recoverable amount when goodwill or an intangible asset with an indefinite useful life is included in that unit's carrying amount. (IAS 36.134(d)(i))

19. Furthermore, management should also consider the need to disclose key assumptions about any major sources of estimation uncertainty in determining future cash flows or the discount rates that could result in material adjustment to an asset's or CGU's carrying amount. (IAS 1.125)

Has the IFRS Discussion Group talked about this topic?

20. The Group has had several conversations about impairment of non-financial assets. The discussions listed below may be helpful as you think about how COVID-19 affects your impairment assessments:

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[2] A firm's weighted average cost of capital represents its blended cost of capital across all sources, including common shares, preferred shares, and debt. (Source: Corporate Finance Institute, "Definition of WACC."

Meeting Date	Topic	Meeting Report
May 30, 2017	Goodwill Impairment Test	View Document
December 9, 2014	Measuring Recoverable Amount and Allocating Impairment Loss	View Document
September 5, 2013	Impairment and Reversal Indicators for Commodity-Based Companies	View Document
June 13, 2013	Interplay between Fair Value Measurement and Impairment	View Document
January 12, 2012	Impairment Test of Provisional Goodwill Acquired during the Current Period	View Document

What other resources are available?

21. Do you need more information? The following publication may provide more insight:

Eiichi Fujita, "Have non-financial assets become impaired – e.g. PPE, intangible assets and goodwill?" KPMG, March 20, 2020.

Extracts from Relevant IFRS® Standards

Standard	IFRS Guidance
IAS 1	125 An entity shall disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of those assets and liabilities, the notes shall include details of: (a) their nature, and (b) their carrying amount as at the end of the reporting period.
IAS 10	9 The following are examples of adjusting events after the reporting period that require an entity to adjust the amounts recognised in its financial statements, or to recognise items that were not previously recognised: … (b) the receipt of information after the reporting period indicating that an asset was impaired at the end of the reporting period, or that the amount of a previously recognised impairment loss for that asset needs to be adjusted. For example: (i) the bankruptcy of a customer that occurs after the reporting period usually confirms that the customer was credit-impaired at the end of the reporting period; and (ii) the sale of inventories after the reporting period may give evidence about their net realisable value at the end of the reporting period.
IAS 36	9 An entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset. 12 In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, the following indications: External sources of information (a) there are observable indications that the asset's value has declined during the period significantly more than would be expected as a result of the passage of time or normal use. (b) significant changes with an adverse effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which an asset is dedicated. (c) market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect the discount rate used in calculating an asset's value in use and decrease the asset's recoverable amount materially.

Standard	IFRS Guidance
	(d) the carrying amount of the net assets of the entity is more than its market capitalisation. Internal sources of information (e) evidence is available of obsolescence or physical damage of an asset. (f) significant changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, plans to dispose of an asset before the previously expected date, and reassessing the useful life of an asset as finite rather than indefinite. (g) evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected. Dividend from a subsidiary, joint venture or associate (h) for an investment in a subsidiary, joint venture or associate, the investor recognises a dividend from the investment and evidence is available that: (i) the carrying amount of the investment in the separate financial statements exceeds the carrying amounts in the consolidated financial statements of the investee's net assets, including associated goodwill; or (ii) the dividend exceeds the total comprehensive income of the subsidiary, joint venture or associate in the period the dividend is declared. 32 The elements identified in paragraph 30(b), (d) and (e) can be reflected either as adjustments to the future cash flows or as adjustments to the discount rate. Whichever approach an entity adopts to reflect expectations about possible variations in the amount or timing of future cash flows, the result shall be to reflect the expected present value of the future cash flows, ie the weighted average of all possible outcomes. Appendix A provides additional guidance on the use of present value techniques in measuring an asset's value in use. 33 In measuring value in use an entity shall: (a) base cash flow projections 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. Greater weight shall be given to external evidence. (b) base cash flow projections on the most recent financial budgets/forecasts approved by management but shall exclude any estimated future cash inflows or outflows expected to arise from future restructurings or from improving or enhancing the asset's performance.

Standard	IFRS Guidance
	Projections based on these budgets/forecasts shall cover a maximum period of five years, unless a longer period can be justified. (c) estimate cash flow projections beyond the period covered by the most recent budgets/forecasts by extrapolating the projections based on the budgets/forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified. This growth rate shall not exceed the long-term average growth rate for the products, industries, or country or countries in which the entity operates, or for the market in which the asset is used, unless a higher rate can be justified. 134 An entity shall disclose the information required by (a)-(f) for each cash-generating unit (group of units) for which the carrying amount of goodwill or intangible assets with indefinite useful lives allocated to that unit (group of units) is significant in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite useful lives: … (d) if the unit's (group of units') recoverable amount is based on value in use: (i) each key assumption on which management has based its cash flow projections for the period covered by the most recent budgets/forecasts. Key assumptions are those to which the unit's (group of units') recoverable amount is most sensitive. A15 Whichever approach an entity adopts for measuring the value in use of an asset, interest rates used to discount cash flows should not reflect risks for which the estimated cash flows have been adjusted. Otherwise, the effect of some assumptions will be double-counted. A17 As a starting point in making such an estimate, the entity might take into account the following rates: (a) the entity's weighted average cost of capital determined using techniques such as the Capital Asset Pricing Model; (b) the entity's incremental borrowing rate; and (c) other market borrowing rates. A18 However, these rates must be adjusted: (a) to reflect the way that the market would assess the specific risks associated with the asset's estimated cash flows; and (b) to exclude risks that are not relevant to the asset's estimated cash flows or for which the estimated cash flows have been adjusted. Consideration should be given to risks such as country risk, currency risk and price risk.