AcSB Accounting Standards Board

COVID-19 Resource

Impairment of Long-lived Assets (ASPE)

What you need to know (May 2020)

What's the issue?

1. COVID-19 has had a significant economic impact on Canadian businesses. It contributed to operating losses in the current period, to forecasted losses, or to an overall change in the business environment. As a result, enterprises should consider whether these changes indicate that long-lived assets are impaired in accordance with Section 3063, *Impairment of Long-lived Assets*, in Part II of the CPA Canada Handbook – Accounting Standards for Private Enterprise (ASPE).

2. This resource applies to assets within the scope of Section 3063, which applies to non-monetary long-lived assets including productive biological assets subject to amortization,[1] property, plant and equipment, intangible assets with finite useful lives, and long-term prepaid assets. (Paragraph 3063.02). For more information relating to goodwill and intangible assets with an indefinite life, refer to the resource, "Impairment of Goodwill and Intangible Assets with an Indefinite Life (ASPE)".

Do I need to test for recoverability of long-lived assets in the current period?

3. It depends. A long-lived asset shall be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable (Paragraph 3063.09). As such, enterprises will need to use judgment to assess whether the effects of COVID-19 indicate that long-lived assets are not recoverable. Indicators may include the following:

[1] Section 3041, *Agriculture*, issued in November 2019, added paragraph 3063.02(h) and amended paragraph 3063.02. An enterprise shall apply those paragraphs when it applies Section 3041.

(a) A significant decrease in the market price of an asset, such as piece of machinery, where demand has declined from manufacturers who have been adversely impacted by COVID-19;

(b) A significant increase in the cost to construct an asset due to delays arising from COVID-19;

(c) Current-period operating losses or a projection of continuing losses associated with its use due to machinery being left idle because of business closures or decreased demand; or

(d) An expectation (more likely than not) that the asset will be sold before the end of its useful life. If for example, a private enterprise needs to sell an asset earlier than expected to generate cash flows to run the business.

(Paragraph 3063.10)

When do I recognize an impairment loss and how is it measured?

4. When enterprises identify an impairment indicator, an impairment loss is recognized when the carrying amount is not recoverable *and* exceeds its fair value. (Paragraph 3063.04) This is a two-step process.

Step 1

5. Determine if the asset's carrying amount is recoverable. The asset is not recoverable if the carrying amount exceeds the sum of undiscounted cash flows associated with its use or disposition (Paragraph 3063.05).

6. Estimating the undiscounted cash flows associated with the assets use or disposition will require judgment. This requires considering how COVID-19 affects the business and how it may result in changes in cash flow or assets being used differently than initially expected. For example, a business may be experiencing interruptions, reduced workforce, or changes in consumer demand. There may also be changes in business plans and strategies, which could result in an asset being sold before the end of its useful life. These estimates should "include only the future cash flows (cash inflows less cash outflows) that are directly associated with, and that are expected to arise as a result of, its use and eventual disposition." (Paragraph 3063.18) Furthermore, the estimate of future cash flows should reflect the enterprise's own assumptions about its use, considering all evidence such as internal budgets and forecasts, as well as information communicated to those outside of the enterprise, such as lenders. (Paragraph 3063.19)

7. The estimate of future cash flows is not revised for changes after the balance sheet date. (Paragraph 3063.19) For enterprises with a December 31, 2019, year-end, the COVID-19 pandemic would have started after the reporting period. Therefore, the estimate of future cash flows would not change because of COVID-19 for purposes of determining the recoverable amount. For entities whose year-end is March 31, 2020, or later, the initial effects of COVID-19 would be reflected in the estimate of future cash flows for determining the recoverable amount. For more information relating to subsequent events, refer to the resource, "Subsequent Events (ASPE)."

Step 2

8. If the carrying amount is greater than the sum of undiscounted cash flows in Step 1, the second step is to compare the carrying amount to the fair value. An impairment loss is recognized for the amount by which the carrying value exceeds the fair value. (Paragraph 3063.06)

9. The fair value "can be characterized as the amount by which an item could be bought or sold in a current transaction between willing parties." (Paragraph 3063.A1) Quoted market prices in active markets are the best evidence, when available. An active market is one in which transactions take place with sufficient frequency and volume to provide pricing information on an ongoing basis. Due to COVID-19, there could be a significant decrease in the volume or level of activity in a market, which could impact the fair value. Enterprises will need to use judgment to determine whether, based on current market conditions, there has been a significant decrease in the level of activity. When an active market is not available, the estimate of fair value is based on the best information available, such as prices for similar items, or the results of valuation techniques. (Paragraphs 3063.A2 and A3)

What should I consider when estimating fair value using a valuation technique?

10. When using a fair value technique, such as present value, enterprises will need to consider how COVID-19 affects the assumptions used in the model such as the timing and amount of cash flows, expectations about the possible variations in the amount of cash flows, the risk-free rate, and the price for bearing risk which is discussed in further detail in paragraph 11. The estimate of cash flows is based on reasonable and supportable assumptions and should consider all evidence available. (Paragraph 3063.A9) Therefore, the estimate of cash flows may need to be updated based on changes in how the asset is being used or expected to generate inflows and outflows in the future.

11. COVID-19 may also impact the discount rate used for the impairment test. The derivation of the discount rate includes a risk-free borrowing rate and an adjustment for risk. A reduction in overnight borrowing rates by central banks could result in a decrease in the discount rate due to a reduction in the risk-free rate. However, enterprises will need to consider whether the adjustment for risk has increased. An enterprise might consider risks related to the uncertainty of the pandemic's duration and its impact on expected cash flows, as well as other market risks such as market demand for the asset. Any risks adjusted in the cash flows should not be adjusted in the discount rate to avoid double counting.

12. For enterprises with a year-end prior to the start of the COVID-19 pandemic, such as December 31, 2019, the assumptions should reflect conditions existing at the balance sheet date and prior to the start of the pandemic. If management expects significant changes in estimates after December 31, 2019, disclosure may be required. Disclosure would include an estimate of the financial effect, when practicable, or a statement that such an estimate cannot be made. (Paragraph 3820.11(b)) For enterprises with later year-ends, such as March 31, 2020, the initial events of the COVID-19 pandemic would be included in the fiscal year, and the assumptions used in the impairment model would reflect those existing at the balance sheet date. However, as the pandemic evolves, there may be subsequent-event disclosure requirements for those entities to consider as well. For more information, refer to the resource Subsequent Events (ASPE).

Extracts from relevant Accounting Standards for Private Enterprises

<table>
<tr><th>Standard</th><th>Guidance</th></tr>
<tr><td>Section 3063</td><td>
.02 This Section applies to non-monetary long-lived assets, including productive biological assets subject to amortization, property, plant and equipment, intangible assets with finite useful lives, and long-term prepaid assets. It does not apply to:
(a) goodwill and intangible assets with indefinite useful lives (see GOODWILL AND INTANGIBLE ASSETS, Section 3064;
(b) investments, including equity method accounted investments (see INVESTMENTS, Section 3051;
(c) defined benefit assets (see EMPLOYEE FUTURE BENEFITS, Section 3462);
(d) future income tax assets (see INCOME TAXES, Section 3465);
(e) financial assets, financial liabilities and contracts to buy or sell non-financial items accounted for in accordance with FINANCIAL INSTRUMENTS, Section 3856;
(f) oil and gas assets accounted for using the full cost method (see ACCOUNTING GUIDELINE AcG-16, Oil and Gas Accounting — Full Cost);
(g) unproved oil and gas properties accounted for using the successful efforts method; or
(h) productive biological assets not subject to amortization (See AGRICULTURE, Section 3041).
.04 An impairment loss shall be recognized when the carrying amount of a long-lived asset is not recoverable and exceeds its fair value.
.05 The carrying amount of a long-lived asset is not recoverable if the carrying amount exceeds the sum of the undiscounted cash flows expected to result from its use and eventual disposition. This assessment is based on the carrying amount of the asset at the date it is tested for recoverability, whether it is in use or under development.
.06 An impairment loss shall be measured as the amount by which the carrying amount of a long-lived asset exceeds its fair value. If an impairment loss is recognized, the adjusted carrying amount becomes the new cost basis. For a depreciable long-lived asset, the new cost basis shall be amortized in accordance with PROPERTY, PLANT AND EQUIPMENT, Section 3061. An impairment loss shall not be reversed if the fair value subsequently increases.
.09 A long-lived asset shall be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.
</td></tr>
</table>

Standard	Guidance
	.10 Examples of such events or changes in circumstances related to a long-lived asset include, but are not restricted to: (a) a significant decrease in its market price; (b) a significant adverse change in the extent or manner in which it is being used or in its physical condition; (c) a significant adverse change in legal factors or in the business climate that could affect its value, including an adverse action or assessment by a regulator; (d) an accumulation of costs significantly in excess of the amount originally expected for its acquisition or construction; (e) a current-period operating or cash flow loss combined with a history of operating or cash flow losses, or a projection or forecast that demonstrates continuing losses associated with its use; or (f) a current expectation that, more likely than not, it will be sold or otherwise disposed of significantly before the end of its previously estimated useful life ("more likely than not" means a level of likelihood that is more than 50 percent). There may also be other indications that the carrying amount of an asset is not recoverable. .12 *For purposes of recognition and measurement of an impairment loss, a long-lived asset shall be grouped with other assets and liabilities to form an asset group at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities.* .15 Goodwill is included in the carrying amount of an asset group to be tested for impairment only if the asset group is or includes a reporting unit (see GOODWILL AND INTANGIBLE ASSETS, Section 3064). Goodwill is not included in the carrying amount of a lower-level asset group that includes only part of a reporting unit. Estimates of future cash flows used to test that lower-level asset group for recoverability are not reduced to reflect the fact that goodwill is not included in the carrying amount of the asset group. .18 *Estimates of future cash flows used to test the recoverability of a long-lived asset shall include only the future cash flows (cash inflows less associated cash outflows) that are directly associated with, and that are expected to arise as a direct result of, its use and eventual disposition. These cash flows include the principal amount of any liabilities included in the asset group, but not interest that will be recognized as an expense when incurred.* .19 Estimates of future cash flows used to test the recoverability of a long-lived asset incorporate the enterprise's own assumptions about its use, considering all available evidence. The assumptions used in developing those estimates are reasonable in relation to the assumptions used in developing other information used by the enterprise for comparable periods, such as internal budgets and projections, accruals related to incentive compensation plans, or information communicated to others. However, if alternative courses of action to recover the carrying amount are under consideration (such as the future sale of the asset), or if a range is estimated for the amount of possible future cash flows associated with the likely course of action, the likelihood of those

Standard	Guidance
	possible outcomes is considered. That assessment is not revised for changes after the balance sheet date (such as a subsequent decision to sell the asset). A probability-weighted approach may be useful in considering the likelihood of these possible outcomes. A1 Fair value can be characterized as the amount at which an item could be bought or sold in a current transaction between willing parties (i.e., other than in a forced or liquidation sale). The fair value of a disposal group is the amount at which the group as a whole could be bought or sold in a current single transaction between willing parties, and would not necessarily equate to the sum of the fair values of the individual assets and liabilities of the group. A2 Quoted market prices in active markets are the best evidence of fair value and are used as the basis for fair value measurement, when available. A3 When quoted market prices are not available, estimates of fair value are based on the best information available, including prices for similar items and the results of other valuation techniques. Valuation techniques used would be consistent with the objective of measuring fair value. A4 A present value technique is often the best available technique with which to estimate the fair value of a long-lived asset and generally includes the following elements: (a) an estimate of the series of future cash flows at different times; (b) expectations about possible variations in the amount or timing of those cash flows; (c) the time value of money, represented by the risk-free rate of interest; and (d) the price for bearing the uncertainty inherent in the asset or liability. Other factors, if identifiable, include illiquidity and market imperfections. A9 Cash flow estimates are based on reasonable and supportable assumptions and consider all available evidence. The weight given to the evidence is commensurate with the extent to which the evidence can be verified objectively. A19 An estimate of fair value shall include the price that market participants are able to receive for bearing the uncertainties in cash flows — the adjustment for risk — if the amount is identifiable, measurable, and significant. An arbitrary adjustment for risk, or one that cannot be evaluated by comparison to market information, introduces an unjustified bias into the measurement. On the other hand, excluding a risk adjustment (if it is apparent that market participants include one) would not produce a measurement that faithfully represents fair value. There are many techniques for estimating a risk adjustment, including matrix pricing, option-adjusted spread models, and fundamental analysis. However, in many cases a reliable estimate of the market risk premium may not be obtainable or the amount may be small relative to potential measurement error in the estimated cash flows. In such situations, the present value of expected cash flows, discounted at a risk-free rate of interest, may be the best available estimate of fair value in the circumstances.

Standard	Guidance
Section 3820	.10 *Disclosure shall be made of those events occurring between the date of the financial statements and the date of their completion that do not relate to conditions that existed at the date of the financial statements but:* *(a)* cause significant changes to assets or liabilities in the subsequent period; or (b) will, or may, have a significant effect on the future operations of the *enterprise.* .11 *At a minimum, the disclosure shall include:* (a) *a description of the nature of the event; and* (b) an estimate of the financial effect, when practicable, or a statement that *such an estimate cannot be made.*